4. Law of Agency

4.1. Creation and termination of Agency

It is a general principle of contract law that only the parties to the contract acquire rights and liabilities under it. A well recognized exception to this general rule is the concept of agency.

Here, a representative called an "agent" contracts with third parties on behalf of another person called the "principal". The "principal" acquires rights and liabilities under such a contract. That legal relationship between the principal and agent is called "agency".

A significant feature of an agency relationship is that the agent by his act and agency affects the principal's legal position towards third parties.

The law recognizes the agency device and the rules relationg to the conduct of activity through an agency is called the law of agency. There are two important general rules governing agency, namely,

I. Whatever a person may do himself, he may do through an agent except acts that involve personal skill and qualifications. Also, where the contract to be performed is of a personal nature, no agent can be employed.

Example : Marriage is a contract between two parties but is a contract of a personal nature. Accordingly, a person cannot marry through an agent.

II. Subject to the above rule, the second rule is that "He who does through another, does by himself". In other words, the acts of an agent are, for all legal purposes, the acts of the principal.

English law of agency applicable in Sri Lanka

The law governing agency in Sri Lanka is the law applicable in England. This is made clear by section 3 of the Civil Law Ordinance No. 5 of 1852 which states that, "in all questions or issues which have to be decided in Sri Lanka with respect to the law of principal and agent, the law to be administered shall be the same as would be administered in England in the like case." Accordingly, English cases on agency disputes will apply in Sri Lanka. There is no main statute law applicable to agency. The law of agency is therefore found mainly in common law principles decided by the courts.

Legal concept of Agency

The legal concept of agency is much more limited than the usage os the term in business or commerce. In legal terms, agency involves three persons,

- i. The principal
- ii. The agent
- iii. The third party

An agent is a person authorized, expressly or impliedly, to act for his principal so as to create or affect legal relations between the principal and the third party. The principal makes use of the agent to enter into a legal relationship with a third party.

The most important feature of legal agency is that the agent by his act of agency affects the principal's legal position towards third parties. Legal agency arises by operation of law rather than by agreement between the parties.

Example : Piyal is the principal. Sunil is the agent and Prasad is the third party. Piyal wishes to buy a large number of coconuts from Prasad. He sends his agent Sunil to purchase the coconuts on credit from Prasad. If Prasad gives the coconuts on credit to Sunil, then Sunil has contracts with Prasad on behalf of his principal, Piyal. It is Piyal (the principal) who is liable to pay for the coconuts to Prasad (the third party). By his act of taking delivery of the coconuts on credit, Sunil (the agent) has imposed legal liability on his principal (Piyal) to pay the third party (Prasad).

Creation of Agency

There are three main ways by which a agency relationship can be created;

- i. By express agreement
- ii. By implied agreement
- iii. By operation of law

Creation of Agency by express agreement

Here the appointment of the agent is made in writing or verbally. In formal cases when written appointments are made, it is done by a power of attorney which is normally stamped and registered.

Example : If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent.

Creation of Agency by implied agreement

There is no evidence that the agent has been appointed by any writing or verbally. But, there are facts and circumstances that can show that an agency has been created. In other words, agency is implied from the special circumstances of the case.

Example : For several months, Piyal (the principal) has paid Prasad (the third party) for goods sold on credit by Prasad to Sunil (the agent) for Perera's use and benefit. Piyal had never disputed Sunil's authority to receive the goods given to him by Prasad. Therefore, by conduct there is an implied agreement that Sunil was acting as Piyal's agent when buying goods on credit from Prasad.

Creation of Agency by operation of law

I. Agent of necessity

An agent of necessity can be described as a person who, in circumstances of an emergency (for example, a person's property being in danger of destruction) acquires by operation of law, a presumed authority to act as an agent. Here, some unforeseen events can create an agency and the agency relationship can arise even against the intentions and wishes of the parties concerned.

The object of the law in these circumstances is to recognize the inability of the agent to communicate with the principal. In the context, commercial necessity imposes on the agent the duty to act in good faith in the interest of all the parties. The legal rules relating to agents of necessity seek to achieve common sense in day to day human life.

Example : Piyal has a large coconut property on which Sunil is the caretaker. When Piiyal is abroad, there is a huge fire on the coconut property. Sunil becomes an agent of necessity for Piyal so as to save the property from being destroyed by fire. Piyal (the principal) will be liable for any expenses, Sunil (his agent of necessity) incurred to put out the fire and save the coconut property from destruction during Piyal's absence from the country.

In the case of *Lapraik v Burrows* (1859) 15 English Reports 50, when the ship arrived in the harbor, the captain found that the ship was unseaworthy and could not be put out to sea. So he decided to save further loss and sold the ship. The owners of the ship were held liable for the act of the captain who was regarded as their agent of necessity.

II. Creation of agency by marriage and cohabitation

A wife or de facto spouse is presumed to have authority to pledge the husband's credit for necessaries in keeping with their social status. Necessaries are items such as food, clothing and medical attention for the spouse and the children in keeping with the family's social standing.

Necessaries for which a wife can pledge the husband's credit as his agent do not include luxury items or items such as jewellery.

In the case of *Pianta v Macrow and Sons Pty Ltd* (1925) 27 WALR 99 a trader who sold a wife a diamond ring on credit cannot claim its cost from the husband if the wife does not pay for it.

If the husband has expressly informed traders not to supply any goods on credit to his wife, then it is unlikely that the husband will be liable for the debts incurred by the wife as his agent. *Harris v Morris* (1801) 170 ER 635.

III. Creation of agency by ratification

Ratification means that the principal adopts or confirms an earlier act done by the agent which was not binding on the principal. Ratification is treated as equivalent to original authority and by ratification the relationship of principal and agent is constituted retrospectively or retroactively.

Example : Sunil who is Piyal's agent has on 10 January 2009 purchases goods from Prasad on credit without Piyal's permission. After the purchase, on 20 January 2009, Piyal tells Prasad that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit. Piyal's subsequent statement on 20 January 2009 amounts to a ratification of the agent's (Sunil's) purchase of goods on 10 January 2009.

For agency by ratification to arise, some essential conditions must be satisfied.

- i. The agent's act that is ratified must have been done expressly on the principal's behalf. The third party with whom the agent contracted must have been aware that the agent was acting not for himself but on behalf of the principal. If the agent had not earlier disclosed to the third aprty that he was acting for another, then that act cannot be later ratified by the principal. *Keighley Maxsted & Co. v Durant* [1901] AC 240
- ii. The ratification must be based on full knowledge of the material facts.
- iii. The ratification must take place within a reasonable time.
- iv. A forgery cannot be ratified. A ratification will not have the effect of making a forged signature a good and valid signature. This is because if you permit a forged signature to be made valid by ratification, you will in effect be condoning or accepting a criminal offence.
- IV. Agency by Estoppel

The term 'estoppel' is a legal term and means that a person who has let another person believe that a certain state of affairs exists, is not later permitted to deny that state of affairs if the other person has acted to his detriment in reliance of that state of affairs. He is estopped or prevented from taking a different position. Therefore, in the law of agency if a person by words or by conduct represents to the world that someone is his agent, he cannot later deny that agency if third parties had dealt with that person as if he was the agent.

Example : If Piyal (the principal) has for several moths permitted Sunil to buy goods on credit from Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is stopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief.

In the case of *Rama Corporation v Proved Tin and General Investments Ltd* [1952] 2 QB 147, the English Court of Appeal emphasized three main requirements for agency by estoppel;

- i. A representation by a principal
- ii. A reliance by a third party on that representation
- iii. An alteration of the third party's position resulting from such representation.

In *Lloyds Bank Ltd v Chartered Bank of India, Australia and China* (1929) 1 KB 40, one Lawson, a senior employee of Lloyds Bank fraudulently drew cheques on the bank's account and paid them into a personal account he maintained at the Chartered Bank. When Lloyds Bank discovered the fraud, they claimed the value of the cheques so drawn from the Chartered Bank. The Chartered Bank argued that Lawson was an accredited agent of Lloyd's Bank and therefore Lloyd's Bank was liable as the principal for the agent's acts – even if they were unauthorized.

The Court refused to accept this argument by saying that the Chartered Bank should have questioned how a bank official was paying cheques of his employer into a private account. No estopel applied because the Chartered Bank could not prove that their loss was caused by any representation of Lloyd's Bank. Further it was the Chartered Bank's own negligence that caused the loss. Therefore, Lloyd's Bank was held not liable for the fraudulent act of Lawson.

Termination of Agency

Agency may be terminated by;

- i. Operation of law
- ii. Agreement between the principal and agent

Termination by operation of law

- a) The death, mental incapacity or bankruptcy of the principal or the agent terminates the agency.
- b) If the subject matter of the contract for which the agent is appointed becomes illegal or is frustrated, the agency is terminated.

Termination of agency by agreement between the principal and agent

Normally the way in which to terminate the agency is contained in the document establishing it. In the absence of any express provisions in the agency agreement, the agency may be terminated in the following ways;

- a) By mutual agreement between the principal and agent to bring the agency to an end.
- b) By the agent completely performing the contract of agency.
- c) By revocation of the agent's authority by the principal
- d) By dismissal of the agent by the principal on discovering that the agent had breached his duties.

4.2.Different types of Agents.

Considering the nature of the work performed by them, agents have been classified under the following names;

I. Mercantile Agent

A Mercantile agent is one who has authority either to sell goods or buy goods or to raise money on the security of goods.

II. Factors

A factor is a mercantile agent to whom goods are entrusted for sale. He enjoys wide discretionary powers in relation to the sale of goods. He can sell the goods in his own name upon such terms as he thinks fit. He may pledge the goods as well.

III. Commission agent

A commission agent is a mercantile agent who buys or sells goods for his principal on the best possible terms in his own name and who receives a commission for his labour.

IV. Del Credere Agent

This is an agent who in consideration of an extra commission, guarantees his principal that the third persons with whom he enters into contracts on behalf of the principal shall perform their financial obligations.

Example : he assures the principal that if the buyer does not pay, that he, the agent, will pay. Therefore, he is a special type of agent who acts as a guarantor (surety) as well as an agent.

V. Broker

This is an agent who is employed to make contracts for the purchase and sale of goods or property. A broker is not entrusted with the possession of the goods. He only acts as a connecting link and brings the buyer and seller together to the bargain and if the transaction is successful, the broker becomes entitled to his commission which is called brokerage. In many cases, brokers charge commission from both the buyer and seller because they act as agent for both.

4.3. Rights & duties of principal & agent

The status of agency results in a number of duties and obligations between the principal and agent. Such duties and obligations are normally spelt out in the agency agreement but they can also be implied into the agency agreement.

These duties and obligations may also vary (i) according to the nature of the agency (for example, whether the agency is for a remuneration of free (gratuitous) or (ii) according to the terms of agreement. A disregard or breach of the agent's obligations can lead to the agent's liability to the principal for damages for breach of contract and for negligence.

Duties of an agent to his principal

I. The Agent must follow the Principal's instructions

It is well established that an agent must perform the contract or transaction he has undertaken.

In *Turpin v Billton* (1843) 5 Man & G 455, the agent failed to insure the principal's goods which he had undertaken to safeguard. The agent was held liable for the loss.

In *Bertram Armstrong & Co v Godfrey* (1830) 12 English Rep 364 a broker was instructed to his principal to sell some shares when the market price reached a certain figure. The broker failed to do so. The market price then fell and he was forced to sell for less. The court held that the broker, as agent, was liable to the principal for the loss he suffered, that is the difference in price.

II. Agent's duty to exercise reasonable diligence, care and skill

The standard of care that an agent must exercise in acting for his principal is that which is normally expected of a person engaged in such work. As long as the agent has acted with normal care and skill having regard to the nature of the transaction and has acted in a reasonable manner as would be expected from an agent employed in such undertaking, he will not be liable for negligence, even if his efforts were unsuccessful.

In *Keppel v Wheeler* (1927) 1 KB 577, an agent was employed by a principal to find buyers for a property. The agent found a buyer and the buyer's offer was accepted by the principal (the seller of the property) subject to a sales contract to be drawn up. Subsequently, the agent received a higher offer for the property but neglected to inform the seller of the higher offer because the agent thought he had completed his job in getting the earlier offer. The court however, held that the agent should have informed his principal of the higher offer and because he had failed to do, he was liable to the principal (the seller) for the difference in the price of the higher offer. The agent had failed to exercise due diligence and care to get the maximum price possible for his principal.

In deciding whether an agent has exercised due care and skill in performing his duties, the courts draw a distinction between (i) agents for reward (i.e. agents who act for remuneration) and (ii) gratuitous agents (i.e. agents who are not paid for their services). It would appear that the absence of remuneration is a factor which tends to reduce the degree of care and skill that is expected of an agent.

III. The agent must act in person and not delegate his duties

The principal in appointing an agent expects him to act personally and not through others. Accordingly, unless when appointing the agent, the principal had permitted a delegation of duties, it is a well established rule of agency that an agent cannot delegate his duties to others. The Latin maxim is *delegatus non potest delegare* which means that a person to whom authority has been delegated may not delegate it to another.

In other words, the principal is entitled to rely on and receive the benefit of the skill and knowledge of the agent he has appointed.

In *John McCann & Co v Pow* (1975) 1 All ER 129, a principal appointed a firm of real estate agents to sell his flat. Without the principal's approval, the real estate agents gave details of the flat to a sub agent who found a buyer. Then the agents asked for their commission for the sale of the flat. The court held that since they had delegated the sale to a sub-agent without the principal's permission, the principal was not liable to pay the commission to the agent although the flat had been sold for the price requested.

There are three main exceptions to this rule that an agent must not delegate his duties to another. These are;

- i. The agent may delegate his duties where there is an express or implied authority to delegate such as by professional or trade usage.
- ii. The Agent may delegate purely ministerial acts such as the signing of a letter or the giving of a notice where such act requires no personal skill or confidence. See *Allam & Co Ltd v Europa Poster Services* [1968] All ER 826
- iii. If the delegation is ratified or approved by the principal, then obviously it will be valid.
 In De Bussche v Alt (1878) 8 Ch. D, 286, the agent took the precaution of obtaining the approval of the principal for the appointment of a sub-agent. It was held that the delegation was valid and binding on the principal.
- IV. Agents duty to act in the Principal's interest

The relationship of principal and agent is a confidential one. The agent must always act in the interests of and for the benefit of the principal. The agent's interests must not conflict with the principal's. If there is any problem for the agent to so conduct himself, he must relinquish his duties and terminate the agency.

The courts have jealously upheld this duty very strictly and taken the view that the principal's interest must always have priority over the agent's. The agent must also disclose anything he knows or learns which may affect the principal's interest and judgment.

As the principal places trust and confidence in the agent, the agent must act honestly and must not do anything improper.

In *McPherson v Watt* (1877) 3 App Cas 254 the principals wanted to sell a property and were about to advertise its sale. Their solicitor told them that he would find a purchaser. The solicitor then got his brother to bid for the property and after the property was sold to him he got his brother to convey the property to the solicitor. When the principals discovered that the true purchaser was the solicitor – their agent – they applied to court and got the sale set aside. The agent had acted improperly. He had put his interests above those of his principal.

The fiduciary or confidential obligation that is imposed on an agent requires that hi should not make a secret profit or commission in the performance of his duties.

In *Reiger v Campbell Stuart* (1939) 3 All ER 235 a principal wanted to buy a property and asked her agent to find a suitable property. The agent found a suitable property for £2000. Instead of informing the principal about this property for £2000, the agent got his brother to buy the property for £2000 and then pretended to buy the same property from the brother for £4500. He then offered the property to his principal for £5000 when its real value was £2000. Not knowing the truth, the principal bought the property for £5000 but subsequently when the principal learnt the improper actions of the agent, she claimed a refund of the profit the agent had made and the court held in her favour and ordered the agent to pay the difference to the principal.

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Any financial advantage an agent receives in the performance of his duties, including a bribe, is considered to be a secret profit.

In *De Bussche v Alt* (1878) 8 Ch D 286, an agent who was asked to sell a ship bought is himself when he was unable to find a purchaser at the fixed price. But later he sold it to a third party at a higher price. The court held that the agent had to account to the principal for this profit.

Because an agent is under a duty to account to his principal for all monies received by him as agent, he must keep his personal accounts and finances separate from the agency accounts and finances. He must not mix his principal's money with his personal money. For example, he must maintain separate bank accounts.

V. Agent's duty not to divulge confidential information

To act in the principal's interest, necessarily implies that the agent is also under a duty of confidentiality. Not only must the agent not tell others about the principal's business and affairs but he must not make use of such information for his personal benefit or interests. This duty of confidentiality (also called a duty of secrecy) is a well-known rule between the banker and his customer. A bank is the agent for its customer's account to others.

VI. Agent's duty to maintain accounts

A fundamental rule of the law of agency is that the agent must maintain proper accounts relating to his work as an agent. He must also not improperly mix his principal's funds with his personal fund and if he does doo the law will presume that the entire sum belongs to the principal.

Duties of the Principal towards the Agent

There are three main duties that the principal owes to his agent and the agent can in turn exercise these rights against the principal.

- i. The right to remuneration
- ii. The right to an indemnity
- iii. The right to exercise a lien

Even if the above three rights of an agent are not expressly specified in the document appointing the agent, they will be implied by the operation of law. In other words, unless any of these rights are expressly excluded by notice to the agent, a principal is bound by them.

I. Agent's right to remuneration

The amount of remuneration that an agent can claim will depend on the agreement appointing the agent. In may established commercial situations like solicitors, stockbrokers and real estate agents, the remuneration will depend on the fees and commissions charged in that particular profession or business. However, it is advisable that the agent should clarify the amount and terms of remuneration when accepting the agency.

II. Agent's right to indemnity

While acting for the principal, the agent may incur certain liabilities or make payments on behalf of the principal. In such circumstances the agent will be entitled by common law principles to be indemnified against such liabilities or to recover any amounts so paid.

III. Agent's right to a Lien

A lien is a legal right that a creditor has to retain the goods of a debtor as security for the performance of an obligation. A good example is a landlord of a rented property who has not been fully paid the rent by the tenant. The law recognizes the landlord's (creditor's) right to hold on to any furniture or other goods of the tenant (debtor) until the unpaid rent is paid. An agent can exercise a lien over the principal's goods which are in the agent's possession until the amount due to the agent is settled.

Legal liabilities in Agency law

Whenever a contract has been formed by employing an agent, issues arise as to the liability of the three parties. Since the agent is only a conduit or means to bring about the contract, the agent does not normally fact legal liability to the third party. The legal liability is between the third party and principal. Accordingly, when the agent discloses to the third party that hi is contracting as agent for a named principal, only the principal and not the agent, may sue and be sued on the contract.

In *Wakefield v Duckworth* [1915] 1 KB 218, a lawyer who had been retained to defend a man charged with murder employed a photographer to obtain some photographs to be used at the trial in the case. The photographer sued the lawyer for the cost of the photographs. But the court held that the solicitor was only acting as the agent of the accused person and the photographer knew of this situation. Thus, the solicitor was personally not liable to pay the photographer.

The agent can be personally liable on a contract in the following special circumstances

I. Where the agent has contract personally

When entering into the contract, the agent has failed to make it clear that he is contracting as an agent. The status of the agency has not been mentioned to the third party who has been led to believe that the agent was contracting with him on his own behalf and not as an agent

II. Personal liability of agent when he contracts on behalf of a non-existent principal

A good example of such a situation is where persons who are in the process of incorporating a company enter into contract in connection with the company's establishment. Such persons are called 'promoters' of the company and they can incur personal liability because the company (the principal) is not in existence at the time of the contract. See *Kelner v Baxter* [1861-73] All ER 2009

III. Agent signing bill of exchange or cheque

Where an agent's name appears on any bill of exchange, promissory note or cheque, the agent will be personally liable unless he makes it clear that he is acting in a representative capacity. Several sections of the Sri Lanka Bills of Exchange Ordinance contain statutory provisions to this effect.

Doctrine of the Undisclosed Principal

Where the agent contracts with a third party on behalf of a principal but does not inform the third party that he is an agent, it may be possible for the principal to subsequently reveal his existence as the principal and enforce the contract. This rule is known as the doctrine of the undisclosed principal. Such a person is obviously not a party to the contract but he can yet sue and be sued in his own name (as principal) on a contract entered into on his behalf by his agent so long as the agent had acted within authority.

Agent liable for breach of warranty of authority

If the agent claims that he is acting as an agent but in fact has no authority to enter into the contract in question, the agent can be sued by the third party for the untrue representation of authority he made. See *Collen v Wright* (1857) 8 E & B 647