

Fall 2007

The Double Doctrine Agent: Streamlining the Restatement (Third) of Agency by Eliminating the Apparent Agency Doctrine

Chad P. Wade

Follow this and additional works at: <https://scholar.valpo.edu/vulr>



Part of the [Law Commons](#)

Recommended Citation

Chad P. Wade, *The Double Doctrine Agent: Streamlining the Restatement (Third) of Agency by Eliminating the Apparent Agency Doctrine*, 42 Val. U. L. Rev. 341 (2007).

Available at: <https://scholar.valpo.edu/vulr/vol42/iss1/10>

This Notes is brought to you for free and open access by the Valparaiso University Law School at ValpoScholar. It has been accepted for inclusion in Valparaiso University Law Review by an authorized administrator of ValpoScholar. For more information, please contact a ValpoScholar staff member at scholar@valpo.edu.



THE DOUBLE DOCTRINE AGENT: STREAMLINING THE RESTATEMENT THIRD OF AGENCY BY ELIMINATING THE APPARENT AGENCY DOCTRINE

I. INTRODUCTION

*[W]hatever a man sui juris may do of himself, he may do by another; and as a correlative of the maxim, that what is done by another is to be deemed done by the party himself. "Qui facit per alium, per seipsum facere videtur."*¹

Although the law of agency is relatively new compared to other areas of law, agency law is the foundation upon which many forms of business organizations are built.² Agency provides the starting point for many of the laws governing partnerships and corporations.³ Furthermore, agency law continues to grow in prominence as laws governing relatively new entities, such as limited liability companies, expand and existing business entities seek to maximize efficiency through cooperation.⁴ An understanding of agency law "is of great assistance, if not prerequisite, to an understanding of the laws of partnership and corporations" because in "no other field of law is the close interrelation of business practice and the rules of law more apparent."⁵

In a world of growing conglomerates and entities in search of "synergies," it will become increasingly difficult to determine who has the ability to affect an organization's legal relationships and how those relationships can be affected. Agency law answers these questions. Some relationships are straight forward—the product of clear and direct communication by a principal to an agent regarding what and how a

¹ JOSEPH STORY, COMMENTARIES ON THE LAW OF AGENCY § 2, at 2 (Little, Brown, and Company 1882).

² FRANCIS B. TIFFANY, HANDBOOK OF THE LAW OF PRINCIPAL AND AGENT § 3, at 5 (West Publishing Co. 1924).

³ *Id.*; see also Glenn G. Morris, *Personal Liability for Corporate Participants Without Corporate Veil-Piercing: Louisiana Law*, 54 LA. L. REV. 207, 261 (1993) (discussing how corporate law derived the concept of non-liability from principals of agency law); cf. Mary Szto, *Limited Liability Company Morality: Fiduciary Duties in Historical Context*, 23 QUINNIPIAC L. REV. 61, 98 (2004) ("agency, partnership, and corporate law, [are] the immediate forbears of the LLC").

⁴ TIFFANY, *supra* note 2, at 5-6.

⁵ *Id.*

task should be done.⁶ Of greater concern, however, are the individuals who have the ability to affect an organization's legal relationships despite the fact that neither agency nor agreed authority exists.⁷ It is in these situations that business entities run the greatest risk of being caught unprepared for the consequences of actions taken by individuals unauthorized by the entities themselves. Further adding to the problem, courts' application of the doctrines of apparent authority, apparent agency, and agency by estoppel are inconsistent and confusing, at best.⁸ Such powerful doctrines must be carefully drafted and tailored to ensure that they accomplish their respective goals without unduly interfering with business' unending drive for economic efficiency. With that end in mind, this Note streamlines the law of agency by combining the doctrines of agency by estoppel and apparent agency in order to promote both economic and judicial efficiency.⁹

Part II of this Note focuses on state courts' treatment of agency law, in addition to treatments by the *Restatement Second of Agency* ("Restatement Second") and the *Restatement Third of Agency* ("Restatement Third").¹⁰ Specifically, Part II examines how each of the Restatements and courts establish an agency relationship between parties and create authority for the agent to act.¹¹ Part III of this Note analyzes courts' applications of the doctrines of apparent agency and agency by estoppel under the *Restatement Second* and *Restatement Third*, differentiating each.¹² Further, Part III discusses the differences between apparent agency and agency by estoppel, weighing the benefits of both doctrines within agency law.¹³ Finally, Part IV proposes to eliminate the doctrine of apparent agency from the *Restatement Third* and redraft section 2.05 outlining the use of agency by estoppel.¹⁴

⁶ See *infra* Parts II.A.1, II.B.1 (discussing the creation of actual agency and actual authority).

⁷ See *infra* Parts II.A.2., II.B.2., II.C.1 (discussing the requirements for apparent agency, apparent authority, and estoppel).

⁸ See *infra* notes 37, 106, 129 and accompanying text (discussing courts' incorrect characterization of the doctrines of perceived agency, agency by estoppel, and apparent authority as interchangeable and essentially the same doctrines).

⁹ See *infra* Part IV (proposing revision of the *Restatement Third* to eliminate perceived agency and expand agency by estoppel).

¹⁰ See *infra* Part II (explaining the requirements for actual agency, apparent agency, actual authority, apparent authority, incidental authority, inherent authority, and estoppel).

¹¹ See *infra* Part II.

¹² See *infra* Part III.

¹³ See *infra* Part III.

¹⁴ See *infra* Part IV.

II. LEGAL BACKGROUND OF AGENCY THEORY

In order to understand how to apply the doctrines contained in the *Restatement Third*,¹⁵ one must fully understand how the doctrines were stated in the *Restatement Second* and interpreted through case law. It is also important to examine how the *Restatement Third* has changed the language of the *Restatement Second*, thereby altering the doctrines. To this end, the following section surveys the major doctrines of agency law in light of contributions from the *Restatements* and federal and state case law.¹⁶ First, Part II.A examines how two entities can form an agency relationship and when a principal may be liable even when there is only a perception of agency.¹⁷ Part II.B discusses the concept of authority, demonstrating how different types of authority are created by the acts of a principal and the implications of each for the parties.¹⁸ Finally, Part II.C examines the doctrine of estoppel, which a third party may use to bind someone in the absence of either agency or authority.¹⁹

A. *Establishing an Agency Relationship*

The first step in determining if a principal is liable for the acts of another under agency law is to establish whether an agency relationship exists between the two parties. Part II.A.1 examines the requirements for creating actual agency.²⁰ Part II.A.2 studies how courts have used the doctrine of apparent agency, embodied in section 267 of the *Restatement Second*, to disperse liability in the absence of actual agency.²¹

1. Actual Agency

Agency is a legal concept which requires the existence of specific elements; therefore, mere intention to create an agency relationship is

¹⁵ RESTATEMENT (THIRD) OF AGENCY § 1.02 cmt. a (2006). The *Restatement (Third) of Agency* was published in July 2006 by the American Law Institute.

¹⁶ See *infra* Part II.

¹⁷ See *infra* Part II.A (examining the creation of both an actual agency relationship or, in the absence of actual agency, the creation of perceived agency under both the Second and Third Restatements of Agency).

¹⁸ See *infra* Part II.B (examining how the four types of authority: actual, apparent, incidental, and inherent, are created and applied by the *Restatement Second* and *Restatement Third*).

¹⁹ See *infra* Part II.C (examining how estoppel is used under the *Restatement Second* and predicting how it may be applied under the *Restatement Third*).

²⁰ See *infra* Part II.A.1 (describing how actual agency is created).

²¹ See *infra* Part II.A.2 (discussing the requirements for holding a principal liable under section 267 of the *Restatement Second* and noting changes in the language in the *Restatement Third*).

irrelevant if the elements of agency are absent.²² While a court may consider what titles parties give to their relationships, principals cannot escape liability for the acts of a person that fulfills the requirements of agency by simply classifying them by a different title.²³

Actual agency requires a “manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.”²⁴ In other words, there are three requirements for an agency relationship.²⁵ The first requirement is a manifestation of consent by the “principal” to allow the “agent” to act on the principal’s behalf.²⁶ While the *Restatement Second* does not provide a definition for “manifestation,” the *Restatement Third* specifically

²² RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b (1958) (“The relation which the law calls agency does not depend upon the intent of the parties to create it, nor their belief that they have done so.”); *see also* RESTATEMENT (THIRD) OF AGENCY § 1.02 cmt. a (2006). Section 1.02, comment a, states, “[w]hether a relationship is one of agency is a legal conclusion made after an assessment of the facts of the relationship and the application of the law of agency to those facts.” *Id.*; *see also* WARREN A. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 3D at 4 (West Publishing Co. 1964).

²³ RESTATEMENT (THIRD) OF AGENCY § 1.02 cmt. b (2006). Comment b, titled “Judicial acceptance or rejection of parties’ characterization,” states: “It is appropriate for the court to consider whether the parties’ characterization serves a function other than circumventing an otherwise-applicable statute, regulation, or rule of law, or invoking a statute, regulation, or rule of law to limit or prevent liability.” *Id.*

²⁴ RESTATEMENT (SECOND) OF AGENCY § 1; *see also* RESTATEMENT (THIRD) OF AGENCY § 1.01; *EEOC v. Ill. Dep’t of Emp. Sec.*, 6 F. Supp. 2d 784, 788 (N.D. Ill. 1998) (relying on the *Restatement Second* § 1 and holding that the determination of an agency relationship is a legal one that requires manifestation of consent by the principal to allow an agent to act on his behalf and subject to his control and consent to so act by the agent); Robert W. Hillman, *Power Shared and Power Denied: A Look at Participatory Rights in the Management of General Partnerships*, 1984 U. ILL. L. REV. 865, 879 (1984) (discussing how an agency relationship is hierarchical with the agent being submissive to the principal).

²⁵ *EEOC*, 6 F. Supp. 2d at 788. *Compare* RESTATEMENT (THIRD) OF AGENCY § 1.01 (stating “[a]gency is the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.”), *with* RESTATEMENT (SECOND) OF AGENCY § 1 (stating “(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. (2) The one for whom action is to be taken is the principal. (3) The one who is to act is the agent.”).

²⁶ *Kirkpatrick v. Boston Mut. Life Ins. Co.*, 473 N.E.2d 173, 176-77 (Mass. 1985) (quoting the RESTATEMENT (SECOND) OF AGENCY § 1 that “[a]n agency ‘results from the manifestations of consent by one person to another that the other shall act on his behalf and subject to his control’” and holding that it is a decision for the jury whether an employer acts as an insurance company’s agent when the employer takes care of administration of a group health plan).

illustrates that a “person manifests assent or intention through written or spoken words or other conduct.”²⁷

Second, in order for an agency relationship to exist, the “agent” must consent to act on behalf of the “principal.”²⁸ Although both parties must consent to the relationship, consent is not required to be stated in a contract or other legal writing.²⁹ In some cases, an agency relationship is established by examining the relationship of the parties and implying an agency relationship although no written agreement classifies the relationship as an agency.³⁰

²⁷ RESTATEMENT (THIRD) OF AGENCY § 1.03; *see also* RESTATEMENT (THIRD) OF AGENCY § 1.03 cmt. b. Comment b describes the concept of manifestation generally as:

A manifestation is conduct by a person, observable by others, that expresses meaning. It is a broader concept than communication. The relevant state of mind is that of the person who observes or otherwise learns of the manifestation. . . . Conduct often incorporates more than one manifestation, made to different people and carrying different legal consequences. The relevant audience for a manifestation depends on the consequence that the manifestation is alleged to carry. . . . Expressive conduct is not limited to spoken or written words, although it often takes those forms. Silence may constitute a manifestation when, in light of all the circumstances, a reasonable person would express dissent to the inference that other persons will draw from silence. Failure then to express dissent will be taken as a manifestation of affirmance.

Id.

²⁸ RESTATEMENT (SECOND) OF AGENCY § 1 (1); RESTATEMENT (THIRD) OF AGENCY § 1.01 (stating in pertinent part that “the agent manifests assent or otherwise consents so to act”).

²⁹ RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b (asserting that in order to have the relationship there must be an agreement but it is not required to be in the form of a contract); SEAVEY, *supra* note 22, § 3A at 3-4. Section 3A of the treatise articulates the point, stating “[a]lthough agency is intrinsically consensual, it is not necessarily contractual. Consideration is not essential; one acting for another at the other’s direction is an agent although he receives nothing for so acting.” SEAVEY, *supra* note 22, § 3A at 4.

³⁰ *See generally* A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285 (Minn. 1981). In *Cargill*, several local farmers sued Cargill for debts owed to them by the Warren Grain and Seed Company (Warren). *Id.* at 288. The farmers asserted that Cargill was Warren’s principal and, therefore, was liable for Warren’s debt. *Id.* Cargill agreed to extend Warren, a grain elevator company a \$175,000 line of credit. *Id.* In exchange for the line of credit, Warren named Cargill its grain agent and agreed to give Cargill a right of first refusal to buy all grain sold by Warren. *Id.* After several years the line of credit was increased to \$300,000 dollars, incorporating the first contract and its requirements. Cargill became more and more involved in Warren’s day to day operations. *Id.* at 289. The second contract required Warren to get permission from Cargill before it made any capital improvements worth more than \$5,000, declared a dividend, or purchased and sold stock. *Id.* Further, shortly after the contract was executed, Cargill sent several officials to Warren’s offices to examine the annual statements, accounts receivable, expenses, inventory, seed, machinery, and other financial matters. *Id.* The officials also told Warren that they would be reminded to make improvements recommended by Cargill. *Id.* Eventually Cargill sent a regional

The third requirement to establish an agency relationship is that the “principal” must possess a right of control over the “agent.”³¹ Although the “principal” does not need to actually exercise control over the “agent,” the principal simply needs to have the right to exercise control.³²

manager to oversee the Warren operation. *Id.* Despite Cargill’s efforts, Warren was forced to shutdown. *Id.* After Warren closed operations it was found to be in debt to Cargill in the amount of \$3.6 million and in debt to local farmers in the amount of \$2 million. *Id.* at 290. The court held that Cargill was Warren’s principal and was therefore liable for the debt owed to the farmers, reasoning that Cargill manifested consent by directing Warren to execute its directives. *Id.* at 291.

³¹ *Cleveland v. Caplaw Enter.*, 448 F.3d 518 (2d Cir. 2006). In *Caplaw*, two African-American males (the tenants) filed suit against the owner of an apartment building for discrimination in violation of the Fair Housing Act. *Id.* at 520. The tenants decided to rent an apartment shown to them by Heather Stauber an employee of LC Properties of Rochester LLC (LC). *Id.* LC managed the building which was owned by Mr. Caplaw. *Id.* After providing money towards the security deposit and signing a lease, the tenants prepared to move into the apartment. *Id.* However, when the tenants called to determine when they could pick up the keys to the new place another employee of LC, Lou Thyroff, said they would need to put down a bigger deposit and expressed uneasiness over whether the tenants would fit-into in the building, living above a “professional” that would not appreciate unruly college students. *Id.* Suspecting discrimination, the tenants contacted a housing agency which contacted LC on their behalf and discovered that the apartment had already been rented to another individual. *Id.* Later, when the tenants went to LC’s office to get their security deposit, Stauber told them that the “professional” tenant had complained about the apartment being shown to “black hoodlums.” *Id.* The tenants filed suit against LC and, later, against Caplaw as the owner of the building alleging that Caplaw was liable as LC’s principal under agency theory. *Id.* at 521. The court reversed the defendant’s summary judgment motion and held that Caplaw could be found to be LC’s principal and as such could be held liable for the acts of LC. *Id.* at 522. The court reasoned that the only issue disputed as to the agency relationship was right of control. Although Caplaw had not exercised his control, he still had the right to control. Agency law only requires a right of control, not the exercise of it. *Id.*

Similarly in *Miller v. McDonald’s Corp.*, the Oregon Court of appeals held that where a franchisor exercises control over a franchisee an agency relationship exists. *Miller v. McDonald’s Corp.*, 945 P.2d 1107 (Or. Ct. App. 1997).

In *Miller*, a company called 3K Restaurant (3K) owned a McDonald’s restaurant. *Id.* 3K was allowed to operate the restaurant under a licensing agreement with the McDonald’s Corp. *Id.* The licensing agreement was very detailed and mandated that 3K comply with several conditions to maintain its license. *Id.* at 1108-09. The agreement severely limited what 3K could do without approval of McDonald’s including dictating what color schemes could be used, the attire, appearance and amount of staff on hand, the layout of the restaurant’s dining and kitchen areas, and the hours of operation. *Id.* Despite the control exerted by McDonald’s Corp., the agreement also stated that the two entities were not in an agency relationship of any kind. *Id.* at 1109. The plaintiff sued McDonald’s Corp. on grounds that 3K was its agent and therefore McDonald’s could be held liable for the actions of 3K. *Id.* at 1110. The court held that there was evidence to support a jury finding that 3K was McDonald’s actual agent. *Id.* The court reasoned that where a franchisor goes beyond setting standards and retains the right to exercise control over day to day operations of the franchisee, an actual agency relationship exists. *Id.* at 1110. The court further reasoned that a jury could find that McDonald’s had exercised sufficient control to establish an actual agency relationship. *Id.* at 1111. *But see*, Byron E. Fox &

Furthermore, the “principal” neither needs to have complete control over every moment of the agency relationship nor for the control to be effective at all times.³³

The absence of any one of these three elements generally prevents courts from finding an actual agency relationship.³⁴ When an element of actual agency is omitted, however, some courts consult section 267 of the *Restatement Second* to impart liability upon a principal for the tortious acts of another.³⁵

2. Perceived Agency

In tort cases, a third party may hold a pseudo principal liable for the torts of a pseudo agent if the pseudo principal has intentionally or negligently held out the pseudo agent as his actual agent and the third party has relied on that manifestation.³⁶ The *Restatement Second* refers to this concept as “apparent agency.”³⁷ However, for purposes of this Note, “apparent agency” will be referred to as “perceived agency.” The difference in terminology is made because of the confusion between the

Jennifer L. Jonak, *Courts Differ Over Whether a Franchisor's Control Over a Franchisee Creates an Agency Relationship that Will Lead to Vicarious Liability for Tortious Conduct*, NAT'L L. J. Dec. 22, 1997, at B5 (arguing that the courts should have looked at whether McDonald's Corporation's control exceeded normal levels rather than just whether they had a right of control).

³² *McDonald's Corp.*, 945 P.2d at 1110 n.3 (citing to *Peeples v. Kawasaki Heavy Indust., Ltd.*, 603 P.2d 765 (1979)) (“Under the right to control test it does not matter whether the putative principal actually exercises control; what is important is that it has the right to do so.”).

³³ *Caplaw*, 448 F.3d at 523 (“Nevertheless, the control asserted need not ‘include control at every moment; its exercise may be very attenuated and, as where the principal is physically absent, may be ineffective’”) (quoting RESTATEMENT SECOND OF AGENCY § 14).

³⁴ SEAVEY, *supra* note 22, § 3D at 4.

³⁵ See generally *Petrovich v. Share Health Plan of Ill., Inc.*, 696 N.E.2d 356 (Ill. App. Ct. 1998); *B.P. Oil Corp. v. Mabe*, 370 A.2d 554 (Md. 1977); RESTATEMENT (SECOND) OF AGENCY § 276 (1958).

³⁶ RESTATEMENT (SECOND) OF AGENCY § 267. Section 267 states:

One who represents that another is his servant or other agent and thereby causes a third person justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.

Id.

³⁷ RESTATEMENT (SECOND) OF AGENCY § 267 (Section 267 is titled “Reliance upon Care or Skill of Apparent Servant or Other Agent”).

348 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42]

concepts of apparent agency and apparent authority, and the similarity of their respective spellings only exacerbates the problem.³⁸

Perceived agency is a form of estoppel, which focuses on the principal's interactions with the third party, rather than focusing on the principal's interactions with the agent.³⁹ The requirements of perceived agency, as laid out in section 267 of the *Restatement Second*, are two-fold.⁴⁰

The first requirement is an intentional "holding out" by the perceived principal that someone is his agent.⁴¹ *Crinkley v. Holiday Inns*,

³⁸ *Armato v. Baden*, 84 Cal. Rptr. 2d 294, 301 (Cal. App. Ct. 1999); *Baptist Mem'l Hosp. Sys. v. Sampson* 969 S.W.2d 945, 947 n.2 (Tex. 1998) ("Many courts use the terms ostensible agency, apparent agency, apparent authority, and agency by estoppel interchangeably. As a practical matter, there is no distinction among them"); *State Dep't of Transp. v. Heckman*, 644 So. 2d 527, 529 (Fla. Dist. Ct. App. 1994) ("The doctrine of agency by estoppel is similar to the doctrine of apparent authority such that there is no significant difference between them."); *see generally*, 6 AM. JUR. PROOF OF FACTS 3D Apparent Agency § 1 (discussing the confusion courts have created by using the names perceived agency, apparent agency, and apparent authority interchangeably).

³⁹ *FDL Foods, Inc. v. Kokesch Trucking, Inc.*, 599 N.E.2d 20, 28 (Ill. App. Ct. 1992) (stating that the doctrine of apparent agency is based on equitable estoppel).

⁴⁰ *See BP Oil*, 370 A.2d at 560-61 (Md. 1977) (citing the RESTATEMENT (SECOND) OF AGENCY section 267 and stating one is liable for the injuries to a third party if she has held out to that person that the injurer was her agent and the third party has justifiably relied upon it). *But See Little v. Howard Johnson Co.*, 455 N.W.2d 390, 394 (Mich. Ct. App. 1990). The court stated:

This Court has adopted the following three-part test to determine whether vicarious liability based on an [perceived] agency exists: [First] The person dealing with the agent must do so with belief in the agent's authority and this belief must be a reasonable one; [second] such belief must be generated by some act or neglect of the principal sought to be charged; [third] and the third person relying on the agent's apparent authority must not be guilty of negligence.

Id.

⁴¹ *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156, 166 (4th Cir. 1988); *see Gizzi v. Texaco, Inc.*, 437 F.2d 308, 309 (3d Cir. 1971). In *Gizzi*, the plaintiff purchased a used Volkswagen van from a Texaco service station. *Id.* The franchisee repaired the brakes before selling the car, but they failed shortly thereafter. *Id.* The station prominently displayed Texaco insignia, including the slogan "Trust your car to the man who wears the star." *Id.* Texaco engaged in considerable national advertising to convey the impression that its dealers were skilled in automotive servicing. *Id.* About 30 percent of Texaco dealers sold used cars. *Id.* There was a Texaco regional office across the street from the station, and those working in that office knew that the franchisee was selling cars from the station. *Id.* The court held that, under New Jersey law, the question of whether Texaco had held out the station operator out as its apparent agent was for the jury. *Id.* at 310. The court further held that based on the facts, a jury could find that the station operator was an apparent agent of Texaco. *Id.*; *see also Billops v. Magness Constr. Co.*, 391 A.2d 196, 198 (Del. 1978) (holding that requiring the franchisee to use the Hilton logo, sign, and color scheme to the exclusion of all others is sufficient to establish that the franchisor held out the franchisee as its agent); RESTATEMENT (SECOND) OF AGENCY § 267 cmt. a. Comment a states:

Inc., clearly illustrates the “holding out” requirement.⁴² In *Crinkley*, hotel guests were assaulted by a group dubbed the “Motel Bandits.”⁴³ The plaintiffs sued the franchisor, Holiday Inn, for inadequate security under the theory that the operator of the hotel was a perceived agent of Holiday Inn, Inc.⁴⁴ The court held that perceived agency was a question for the jury and that a reasonable jury could find that Holiday Inn had held out the franchisee as its agent to the third party.⁴⁵

The second requirement of perceived agency is actual, reasonable reliance by the injured third party on the manifestations of agency by the perceived principal.⁴⁶ *Miller v. McDonald’s Corp.*, illustrates the reliance required under the doctrine of perceived agency.⁴⁷ In *Miller*, the plaintiff suffered injuries while dining at a McDonald’s restaurant.⁴⁸ McDonald’s Corporation was the franchisor of the restaurant; however, the restaurant was owned and operated by a company called 3K Restaurants

The mere fact that acts are done by one whom the injured party believes to be the defendant’s servant is not sufficient to cause the apparent master to be liable. There must be such reliance upon the manifestation as exposes the plaintiff to the negligent conduct. The rule normally applies where the plaintiff has submitted himself to the care or protection of an apparent servant in response to an invitation from the defendant to enter into such relations with such servant. A manifestation of authority constitutes an invitation to deal with such servant and to enter into relations with him which are consistent with the apparent authority.

Id.; 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2, 473 (discussing several state courts’ treatments of the holding out requirement).

⁴² *Crinkley*, 844 F.2d at 156.

⁴³ *Id.* at 158-59.

⁴⁴ *Id.* at 159. The franchise agreement between Holiday Inn and the hotel operator required the franchisee to use the “Holiday Inn” trade name and trademarks. *Id.* at 166-67. Furthermore, Holiday Inn, Inc. was the original builder of the hotel and engaged in national advertising that promoted its system of hotels without distinguishing between those that it owned and those that it franchised. *Id.* The only indication that the defendant did not own the hotel was a sign in the restaurant that stated that the franchisee operated it. *Id.*

⁴⁵ *Id.* at 167.

⁴⁶ *Miller v. McDonald’s Corp.*, 945 P.2d 1107, 1112 (Or. Ct. App. 1997) (holding that the crucial issues are whether the defendant held out the franchisee as its agent and whether the plaintiff relied on that holding out). *Williams v. St. Claire Med. Center*, 657 S.W.2d 590, 596 (Ky. Ct. App. 1983) (holding a perceived agency existed because, “[i]n applying the above legal principles to the situation here presented, it logically follows that the appellant justifiably believed Johnson to be a hospital employee”); RESTATEMENT (SECOND) OF AGENCY cmt. a. See generally 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2, 474 (discussing the different levels of reliance courts’ use and how that affects their analysis).

⁴⁷ *McDonald’s Corp.*, 945 P.2d at 1113.

⁴⁸ *Id.* at 1108. The plaintiff was injured when she bit into a heart shaped sapphire that was inside her sandwich. *Id.*

350 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42

("3K").⁴⁹ The plaintiff sued McDonald's Corporation on the theory that, even absent an actual agency relationship, McDonald's Corporation should be held liable because 3K was its perceived agent.⁵⁰ The court agreed holding that summary judgment for McDonald's Corporation was improper because there was evidence to support a jury finding that the plaintiff relied upon McDonald's Corporation's holding out of 3K.⁵¹

While *Miller* demonstrates the level of reliance required for perceived agency, the *Restatement Second* enumerates several other key aspects of the doctrine.⁵² First, the manifestations or "holding out" of the perceived principal do not have to be intentional.⁵³ In some cases courts use perceived agency when the perceived principal appears to have taken insufficient steps to inform the public of the non-agency relationship.⁵⁴ Further, courts only require "ordinary knowledge" of business relationships (i.e. franchises) by third parties seeking to assert perceived agency.⁵⁵ The second key aspect of the doctrine of perceived agency is that it requires actual and reasonable reliance on the manifestations by the perceived principal.⁵⁶ The third and final key

⁴⁹ *Id.* 3K was allowed to operate the restaurant under a licensing with the McDonald's Corporation. *Id.*

⁵⁰ *Id.* at 1111.

⁵¹ *Id.* at 1114. Specifically, the court reasoned that the plaintiff's testimony that she relied on the general reputation of McDonald's restaurants in choosing to patronize the restaurant in question was sufficient evidence to establish a jury question on reliance, especially when considered in concert with McDonald's Corporation's attempt to create a "public perception of a common McDonald's system at all McDonald's." *Id.*

⁵² RESTATEMENT (SECOND) OF AGENCY § 267 (1958).

⁵³ RESTATEMENT (THIRD) OF AGENCY § 1.03 cmt. b (2006) ("Silence may constitute a manifestation when, in light of all the circumstances, a reasonable person would express dissent to the inference that other persons will draw from silence. Failure then to express dissent will be taken as a manifestation of affirmation.").

⁵⁴ See generally *McDonald's Corp.*, 945 P.2d at 1107; *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156 (4th Cir. 1988); *Gizzi v. Texaco, Inc.*, 437 F.2d 308 (3d Cir. 1971).

⁵⁵ *McDonald's Corp.*, 945 P.2d at 1113 (holding that to expect that the general public would know that individual restaurants are owned by a franchisee rather than the franchisor would demand a higher level of sophistication about general franchise relationship than the court is willing to assume. Especially in the face of efforts on the part of the Franchisor to make it appear all of the restaurants are part of a uniform national system); see also Robert W. Emerson, *Franchisors' Liability When Franchisees are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609, 645-71 (1992) (discussing the Common Knowledge doctrine and conducting a survey to question the appropriateness of the Common Knowledge doctrine in the Franchisor-Franchisee liability context).

⁵⁶ RESTATEMENT (SECOND) OF AGENCY § 267 (1958) (requiring "a third person justifiably to rely") (emphasis added); 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2, 476 (discussing whether section 267 requires reliance and which form of reliance it requires).

aspect of perceived agency as laid out in the *Restatement Second* is that there is no requirement of a change of position.⁵⁷

On the other hand, the *Restatement Third* contains several changes which may alter how courts apply the doctrine of perceived agency.⁵⁸ As stated previously, courts consult section 267 of the *Restatement Second* to confer perceived agency.⁵⁹ However, section 267 has been divided into two different parts under the *Restatement Third*.⁶⁰ Under section 7.07, a principal can be held liable for the torts of another if he holds out to a third party that the other is his employee.⁶¹ The language of section 7.07 is very different from the language of section 267 as the drafters tried to combine several sections into one.⁶² However, the Comment f definition of “employee” is very similar to the language of section 267, except for a change from “represents that another is his servant or other agent”⁶³ to “causes a third party to believe that an actor is the person’s employee.”⁶⁴

Ultimately finding that section 267 does require reliance but only simple or justifiable reliance.).

⁵⁷ See *supra* note 56 and accompanying text. The relevance of this aspect of perceived agency will become more prevalent when the level of reliance required by agency by estoppel is discussed later in this Note.

⁵⁸ RESTATEMENT (THIRD) OF AGENCY §§ 7.07, 2.05.

⁵⁹ RESTATEMENT (SECOND) OF AGENCY § 267.

⁶⁰ RESTATEMENT (THIRD) OF AGENCY tbls., at 489 (referring readers looking for *Restatement Third* sections that correspond to *Restatement Second* section 267 to sections 7.07 and 2.05).

⁶¹ RESTATEMENT (THIRD) OF AGENCY § 7.07 cmt. f.

⁶² RESTATEMENT (THIRD) OF AGENCY § 7.07. Section 7.07 defines an “Employee Acting Within Scope of Employment” as follows:

(1) An employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment.

(2) An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer’s control. An employee’s act is not within the scope of employment when it occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer.

(3) For purposes of this section,

(a) an employee is an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work, and
(b) the fact that work is performed gratuitously does not relieve a principal of liability.

Id.

⁶³ RESTATEMENT (THIRD) OF AGENCY § 7.07 cmt. f. The text of section 7.07 cmt. f states in pertinent part:

A person who causes a third party to believe that an actor is the person’s employee may be subject to liability to the third party for

The language shift is significant for two reasons. First, section 267 of the *Restatement Second* was used as a basis for finding liability in contexts other than just an employer-employee relationship.⁶⁵ Therefore, states that adopt the *Restatement Third* may have to look to a section other than 7.07 to impart liability.⁶⁶ The logical choice would be to use section 2.05 *Estoppel to Deny Existence of Agency Relationship*.⁶⁷ This choice leads to the second reason why the language change in section 7.07 is significant. Under section 267, a plaintiff only needed to show justifiable reliance to have a claim of perceived agency.⁶⁸ However, section 2.05 of the *Restatement Third* makes it explicitly clear that in order to claim estoppel the plaintiff will have to show detrimental reliance.⁶⁹ As a result of these changes, it will be harder for plaintiffs to hold perceived principals liable in relationships other than in the employee-employer context.⁷⁰

B. Authority to Bind a Principal

After establishing an agency relationship, the agent must possess the authority to act in order to bind the principal. *Restatement Second* sets forth four types of authority: actual;⁷¹ apparent;⁷² incidental;⁷³ and

harm caused by the actor when the third party justifiably relies on the actor's skill or care and the actor's conduct, if that of an employee, would be within the scope of employment.

Id.; see also RESTATEMENT (SECOND) OF AGENCY § 267; *supra* note 36 (providing the full text of section 267).

⁶⁴ RESTATEMENT (THIRD) OF AGENCY § 7.07 cmt. f.

⁶⁵ See generally *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1107 (Or. Ct. App. 1997) (holding a restaurant franchisor liable for the negligence of a franchisee restaurant owner); *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156, 166 (4th Cir. 1988) (holding a Hotel chain franchisor liable for inadequate security at a hotel owned and operated by a franchisee.); *BP Oil Corp. v. Mabe*, 370 A.2d 554 (Md. 1977) (attempting to hold a gas station franchisor liable for the negligence of a franchisee gas station owner).

⁶⁶ See *infra* Part III.B.2 (analyzing the various ways courts that adopt the *Restatement Third* may choose to examine agency problems between franchisors and franchisees).

⁶⁷ RESTATEMENT (THIRD) OF AGENCY § 2.05 and parallel tbls. at 489.

⁶⁸ See *supra* note 56 and accompanying text. See generally, 6 AM. JUR. PROOF OF FACTS 3D Apparent Agency § 2, 476-77.

⁶⁹ RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt. d ("The third party must prove a reasonable and detrimental change of position. . ."). See also *infra* Part II.C.5 (discussing the concept of detrimental reliance).

⁷⁰ See *infra* notes 182-91 and accompanying text (discussing the difficulties of proof in agency by estoppel cases where change of position is required); see *infra* notes 225-27 and accompanying text (discussing how applying *Restatement Third* § 7.07 to a franchisor-franchisee relationship will cause problems for plaintiff's attorneys as they would have to characterize the relationship as employer-employee).

⁷¹ RESTATEMENT (SECOND) OF AGENCY § 7 (1958).

⁷² RESTATEMENT (SECOND) OF AGENCY § 8.

⁷³ RESTATEMENT (SECOND) OF AGENCY § 35.

inherent.⁷⁴ Conversely, the *Restatement Third* only recognizes actual and apparent authority, while incorporating incidental and inherent authority into several other sections.⁷⁵ Equally important to the question of who can bind a principal is the question of how a person can bind the principal.⁷⁶

1. Actual Authority

Actual authority is authority for an agent to act based upon manifestations by the principal to the agent.⁷⁷ As previously stated, an agency relationship requires that the principal maintain the right to control the acts of the agent performed on the principal's behalf.⁷⁸ Actual authority is created when the principal exercises that right of control by manifesting consent for the agent to act in certain ways.⁷⁹ However, the manifestations do not have to be explicit.⁸⁰ If the manifestations to the agent specify how the agent should act, the actual authority is called "expressed actual authority."⁸¹ Alternatively, actual authority may be inferred by the agent from the context in which the

⁷⁴ RESTATEMENT (SECOND) OF AGENCY § 7; RESTATEMENT (THIRD) OF AGENCY §§ 2.01, 2.02.

⁷⁵ RESTATEMENT (THIRD) OF AGENCY §§ 2.01, 2.02; RESTATEMENT (THIRD) OF AGENCY §§ 2.03, 3.03; RESTATEMENT (THIRD) OF AGENCY § 2 int. nt. (referring to incidental authority as implied authority and stating that inherent authority has been absorbed by other sections).

⁷⁶ See *infra* Parts II.B.1-4.

⁷⁷ Compare RESTATEMENT (SECOND) OF AGENCY § 7 ("Authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him."), with RESTATEMENT (THIRD) OF AGENCY § 2.01 ("An agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act").

⁷⁸ *Cleveland v. Caplaw*, 448 F.3d 518, 522 (2d Cir. 2006); *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1111 (Or. Ct. App. 1997); RESTATEMENT (THIRD) OF AGENCY § 1.01; RESTATEMENT (SECOND) OF AGENCY § 1.

⁷⁹ RESTATEMENT (SECOND) OF AGENCY § 7.

⁸⁰ *FDL Foods, Inc. v. Kokesch Trucking, Inc.*, 599 N.E.2d 20, 27 (Ill. App. Ct. 1992) (declaring that actual authority may be either expressed or implied); RESTATEMENT (SECOND) OF AGENCY § 7 cmt. b (asserting that authorization of an agent's conduct can be gleaned from reasonable inferences of the principal's conduct that the principal intended the agent to act even if that was not the principal's intent).

⁸¹ RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b ("As commonly used, the term 'express authority' often means actual authority that a principal has stated in very specific or detailed language."); RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c ("It is possible for a principal to specify minutely what the agent is to do. To the extent that he does this, the agent may be said to have express authority.").

authority was granted.⁸² This type of actual authority is referred to as “implied actual authority.”⁸³ The distinguishing factor between actual authority and other types of authority is that it is based on the manifestations from the principal to the agent.⁸⁴ Further, because actual authority is based solely on the manifestations of the principal, it is not contingent upon the principal’s unexpressed wishes or mental state.⁸⁵ Under actual authority, the agent is not assumed to know everything that the principal knows.⁸⁶

The *Restatement Third* has largely kept the doctrine of actual authority intact from the *Restatement Second*.⁸⁷ Sections 2.01 and 2.02 of the *Restatement Third* simply change the wording of actual authority from section 7 of the *Restatement Second*, to make it explicit that the section pertains solely to actual authority.⁸⁸ However, despite the change in the

⁸² RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c (describing implied authority as powers which are implied or inferred from the words used, customs, and relationship of the parties); RESTATEMENT (SECOND) OF AGENCY § 26. Section 26 states:

Except for the execution of instruments under seal or for the performance of transactions required by statute to be authorized in a particular way, authority to do an act can be created by written or spoken words or other conduct of the principal which, reasonably interpreted, causes the agent to believe that the principal desires him so to act on the principal’s account.

Id. (emphasis added).

⁸³ RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b (explaining that implied authority is a form of actual authority to act in a way that the agent believes the principal wants him to act); RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c.

⁸⁴ Compare RESTATEMENT (SECOND) OF AGENCY § 7 (defining actual agency), with RESTATEMENT (SECOND) OF AGENCY § 8 (defining apparent authority). Compare RESTATEMENT (THIRD) OF AGENCY §§ 2.01, 3.01 (defining actual agency), with RESTATEMENT (THIRD) OF AGENCY §§ 2.03 3.03 (describing apparent authority); *Mared Indus., Inc. v. Mansfield*, 690 N.W.2d 835, 844 (Wis. 2005) (recognizing the doctrinal differences between actual and apparent authority).

⁸⁵ RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. c (explaining that it is misleading to say that actual authority reflects the principal’s intentions because the unexpressed intentions of a principal do not create actual authority unless they are reflected in some form of manifestation); RESTATEMENT (THIRD) OF AGENCY § 3.01 cmt. c (2006) (explaining that a principal’s unexpressed willingness for another to act is not grounds for actual authority. The principal must make a manifestation as defined in section 1.03 in order to create actual authority).

⁸⁶ RESTATEMENT (THIRD) OF AGENCY § 3.01 cmt. c (2006).

⁸⁷ RESTATEMENT (THIRD) OF AGENCY § 2.01 rpt. nt. a (stating there is no intended change between the *Restatement Second* and *Third* with respect to actual authority).

⁸⁸ RESTATEMENT (THIRD) OF AGENCY § 2.01.

An agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal’s manifestations to the agent, that the principal wishes the agent so to act.

Id. RESTATEMENT (THIRD) OF AGENCY § 2.02 states:

language of sections 2.01 and 2.02, the comments to those sections show that, in practice, these sections will operate the same way as section 7 of the *Restatement Second*.⁸⁹

2. Apparent Authority

The second type of authority, apparent authority, arises through manifestations by the principal to a third party.⁹⁰ There are several ways for an agent to attain apparent authority.⁹¹ Direct communication from the principal to the third party would qualify as creating apparent authority; however, that is not the only way in which apparent authority may be created.⁹² Manifestations may also come from the principal

(1) An agent has actual authority to take action designated or implied in the principal's manifestations to the agent and acts necessary or incidental to achieving the principal's objectives, as the agent reasonably understands the principal's manifestations and objectives when the agent determines how to act.

(2) An agent's interpretation of the principal's manifestations is reasonable if it reflects any meaning known by the agent to be ascribed by the principal and, in the absence of any meaning known to the agent, as a reasonable person in the agent's position would interpret the manifestations in light of the context, including circumstances of which the agent has notice and the agent's fiduciary duty to the principal.

(3) An agent's understanding of the principal's objectives is reasonable if it accords with the principal's manifestations and the inferences that a reasonable person in the agent's position would draw from the circumstances creating the agency.

Id.

⁸⁹ Compare RESTATEMENT (THIRD) OF AGENCY §§ 2.01 cmts. a-c, 2.02 cmts. a-h (2006), and *CSX Transp., Inc. v. Recovery Express, Inc.*, 415 F. Supp. 2d 6 (D. Mass. 2006) (citing the RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 2) (Mar. 2001) (stating that an agent acts with actual authority when, at the time of taking action the agent reasonably believes that the principal wishes the agent so to act), with *FDL Foods, Inc. v. Kokesch Trucking, Inc.*, 599 N.E.2d 20, 27 (Ill. App. Ct. 1992) (citing Section 7 of the *Restatement Second*) (stating that actual authority may be expressed or implied), and *Currey v. Lone Star Steel Co.*, 676 S.W.2d 205 (Tex. App. Ct. 1984) (stating that actual authority is authority that the principal confers on the agent, allows the agent to believe that he has, or by want of due care allows the agent to believe he has); *Mared Indus., Inc. v. Mansfield*, 690 N.W.2d 835 (Wis. 2005) (citing to the *Restatement Second* section 7, stating actual authority is the power of an agent to act on behalf of the principal because the principal has made a manifestation to allow the agent to so act).

⁹⁰ SEAVEY, *supra* note 22, § 8D at 13.

⁹¹ See *infra* notes 93-95 and accompanying text (explaining the ways an agent can receive apparent authority through a principal's manifestations to a third party); see *supra* notes 81-87 and accompanying text (discussing the ways an agent can be given actual authority through manifestations by the principal).

⁹² *Lind v. Schenley Indus.*, 278 F.2d 79, 86 (3d Cir. 1960) (finding that a company owed its employee money from a raise in which the employee was told by the Vice President to

telling the agent to misinform the third party of the agent's authority.⁹³ Further, the authority may be created by the principal placing the agent in a position which would lead third parties to believe that the agent has such authority.⁹⁴ Once the principal has made a manifestation, apparent authority requires that the third party reasonably believe that the agent has authority, and that the belief be traceable to the principal's manifestations.⁹⁵ A principal may not be bound by apparent authority if the third party's belief that the agent had authority was unreasonable.⁹⁶

talk with his supervisor and the supervisor, despite having no actual authority to make an offer, told the employee he would get a 1% commission on sales of the people below the employee). See also RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. c. "Manifestations as defined in § 1.03 may take many forms. These include explicit statements that a principal makes directly to a third party." *Id.*; RESTATEMENT (SECOND) OF AGENCY § 27.

Except for the execution of instruments under seal or for the conduct of transactions required by statute to be authorized in a particular way, apparent authority to do an act is created as to a third person by written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him.

RESTATEMENT (SECOND) OF AGENCY § 27; see also SEAVEY, *supra* note 22, § 8D at 13.

⁹³ RESTATEMENT (THIRD) OF AGENCY § 3.03 cmt. b. "A principal may also create apparent authority by actually or apparently authorizing an agent to make representations to third parties concerning the agent's own authority or position, even though the agent's representations by themselves would be insufficient." *Id.*; SEAVEY, *supra* note 22, § 8D at 13.

⁹⁴ *Three-Seventy Leasing Corp. v. Ampex Corp.*, 528 F.2d 993, 996-97 (5th Cir. 1976). In *Ampex*, Three-Seventy filed a suit against Ampex for breach of contract. *Id.* at 995. As a result of negotiations between the owner and sole employee of Three-Seventy and a salesman for Ampex, a writing was produced by Ampex to sell Three-Seventy six computer memory units. *Id.* The owner of Three-Seventy signed the writing; however, the court found that a contract did not exist because there was no meeting of the minds. *Id.* at 995-96. In the alternative, the court held that Ampex was bound to sell the memory units because their salesman had apparent authority to bind Ampex. *Id.* at 997. Absent manifestations to the contrary, an agent has apparent authority to do those things which are usual to the business which the agent is employed to conduct. *Id.* Additionally, it was reasonable for a third person to believe that a salesman had authority to bind his employer to sell items. *Id.*; see also *Hallock v. State*, 474 N.E.2d 1178, 1182 (N.Y. 1984) (holding that, absent manifestations that limit an attorney's actual authority, an attorney is clothed with apparent authority to enter into settlements by nature of her position). *But see Sarkes Tarzian, Inc. v. U.S. Trust Co. of Fl. Savings Bank*, 397 F.3d 577, 586 (7th Cir. 2005) (holding that there was no ground to submit a question of apparent agency to the jury since the defendant made no manifestations to the plaintiff that the defendant's attorney had authority to bind them to a contract).

⁹⁵ RESTATEMENT (THIRD) OF AGENCY § 2.03 (omitting any requirement that the third party detrimentally rely, i.e. change position, on the manifestation, and instead only requiring the reliance be reasonable); RESTATEMENT (THIRD) OF AGENCY § 3.03 cmt. b.

⁹⁶ RESTATEMENT (THIRD) OF AGENCY § 2.03; see also RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. c (Section 2.03 requires that the third party reasonably believe the agent has authority and that the reasonableness will reflect business custom, usage particular to the industry, and prior dealings).

Further, an agent cannot bind a principal by tricking the third party into believing that the agent has authority.⁹⁷

The *Restatement Third* retains the doctrine of apparent authority unchanged from the *Restatement Second*.⁹⁸ However, the *Restatement Third* provides a deeper analysis of the issue.⁹⁹ Namely, the *Restatement Third* points out some unique attributes to apparent authority which are not present in actual authority.¹⁰⁰ For example, apparent authority may exist even after the agency relationship has been terminated.¹⁰¹ Also, the exercise of apparent authority by an agent may create a cause of action for the principal against the agent.¹⁰²

Treatment of apparent authority by the courts has varied as the doctrine has developed.¹⁰³ Many courts assert that the doctrine of apparent authority is indistinguishable from the doctrines of perceived (apparent) agency and agency by estoppel.¹⁰⁴ However, both the *Restatement Third* and *Restatement Second* recognize that while apparent

⁹⁷ *Sarkes Tarzian*, 397 F.3d at 583 (“New York explicitly rejects the idea that an agent can confer apparent authority on him or herself.”); *Hallock*, 474 N.E.2d at 1181 (“The agent cannot by his own acts imbue himself with apparent authority.”); RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. c (“An agent’s success in misleading the third party as to the existence of actual authority does not in itself make the principal accountable”).

⁹⁸ RESTATEMENT (THIRD) OF AGENCY § 2.03 rpt. n. a.

⁹⁹ *See supra* notes 103-04 and accompanying text.

¹⁰⁰ *See supra* notes 103-04 and accompanying text.

¹⁰¹ RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. a; RESTATEMENT (THIRD) OF AGENCY § 3.11. Section 3.11, titled “Termination of Apparent Authority” states: “(1) The termination of actual authority does not by itself end any apparent authority held by an agent. (2) Apparent authority ends when it is no longer reasonable for the third party with whom an agent deals to believe that the agent continues to act with actual authority.” *Id.*

¹⁰² RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. a.

[T]he formulation in this section defines an agent’s “power,” which if exercised in a manner not coincident with actual authority, is not rightful as toward the principal. An agent who appears to a third party to be authorized, but who lacks actual authority, would breach the agent’s duty to the principal by acting in excess of actual authority. See § 8.09. The principal has a claim against the agent for any loss incurred.

Id.

¹⁰³ *See generally* *Sarkes Tarzian, Inc. v. US Trust Co. of Fl. Savings Bank*, 397 F.3d 577 (7th Cir. 2005); *Hallock v. New York*, 474 N.E.2d 1178 (N.Y. 1984); *Three-Seventy Leasing Corp. v. Ampex Corp.*, 528 F.2d 993 (5th Cir. 1976).

¹⁰⁴ *Baptist Mem’l Hosp. Sys. v. Sampson*, 969 S.W.2d 945, 947 n.2 (Tex. 1998) (“Many courts use the terms ostensible agency, apparent agency, apparent authority, and agency by estoppel interchangeably. As a practical matter, there is no distinction among them”); *see also*, *Armato v. Baden*, 84 Cal. Rptr. 2d 294, 301 (Cal. App. Ct. 1999). *See generally*, 6 AM. JUR. PROOF OF FACTS 3D § 1 (discussing the confusion courts have created by using the names perceived agency, apparent agency and apparent authority interchangeably).

authority contains elements of estoppel, it is a distinct concept from perceived agency and agency by estoppel.¹⁰⁵ Each Restatement points out that perceived agency and agency by estoppel are used to create an agency relationship where one does not exist, while apparent authority expands an agent's authority within an independently created agency relationship.¹⁰⁶ As a result, both Restatements maintain a distinction among apparent authority, perceived agency, and estoppel.¹⁰⁷

3. Incidental Authority

The third type of authority, incidental authority, is the authority for an agent to perform the tasks which are concomitant to accomplishing the authorized act.¹⁰⁸ The doctrine of incidental authority provides an agent with authority, even though the principal's manifestations are not sufficiently clear or all encompassing.¹⁰⁹ The illustrations for *Restatement Second* section 35 provide clear examples of what type of actions are considered to be within an agent's incidental authority.¹¹⁰ The *Restatement Third*, on the other hand, simply incorporated incidental authority into its definition of actual authority, thereby eliminating the need for a separate section on the issue.¹¹¹

4. Inherent Authority

The scope and reach of the fourth type of authority, inherent authority, have been relatively limited.¹¹² In fact, to date, only one court

¹⁰⁵ RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. e; RESTATEMENT (SECOND) OF AGENCY § 8 cmt. d (1958).

¹⁰⁶ RESTATEMENT (SECOND) OF AGENCY § 8 cmt. d (1958).

¹⁰⁷ *Id.*

¹⁰⁸ RESTATEMENT (SECOND) OF AGENCY § 35. "Unless otherwise agreed, authority to conduct a transaction includes authority to do acts which are incidental to it, usually accompany it, or are reasonably necessary to accomplish it." *Id.*

¹⁰⁹ RESTATEMENT (SECOND) OF AGENCY § 35 cmt. b.

¹¹⁰ RESTATEMENT (SECOND) OF AGENCY § 35 illus. 1-4.

¹¹¹ RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. d.

If a principal's manifestation to an agent expresses the principal's wish that something be done, it is natural to assume that the principal wishes, as an incidental matter, that the agent take the steps necessary and that the agent proceed in the usual and ordinary way, if such has been established, unless the principal directs otherwise. The underlying assumptions are that the principal does not wish to authorize what cannot be achieved if necessary steps are not taken by the agent, and that the principal's manifestation often will not specify all steps necessary to translate it into action.

Id.

¹¹² See *infra* notes 114-15 and accompanying text.

of last resort, the Indiana Supreme Court, has adopted the doctrine.¹¹³ However, a few intermediate courts have used the doctrine to bind a principal.¹¹⁴ Inherent authority binds a principal in cases where no actual or apparent authority exists and the elements of estoppel are not present.¹¹⁵ The doctrine was created for two reasons: “the need to ensure fairness for the parties dealing with the agent and the goal of promoting the general commercial convenience of all parties involved.”¹¹⁶ However, with growing concerns for the doctrine’s seemingly boundless possibilities, the drafters of the *Restatement Third* decided to eliminate the section and absorb some of its concepts into

¹¹³ See generally *Menard, Inc. v. Dage-MTI, Inc.*, 726 N.E.2d 1206 (Ind. 2000). In *Menard, Inc.*, *Menard Inc.* sued for specific performance of a contract for the purchase of a thirty acre piece of property. *Id.* at 1210. The defendant, *Dage-MTI, Inc.*, claimed that the contract was not enforceable because it was only signed by the President of *Dage-MTI* and was not approved by the board of directors, which was required by a board resolution. *Id.* at 1209-10. The court held that despite the board’s continual reminder to the President that any offer would have to be approved by the board, the *Dage-MTI* was bound to the contract by the President. *Id.* at 1216. The court reasoned that *Dage-MTI*’s President acted as *Dage-MTI*’s agent, possessed inherent authority and, therefore, bound the company. *Id.* at 1216. The court further reasoned that the President had inherent authority because he acted within the usual and ordinary scope of his authority, *Menard* reasonably believed the President to have the authority, and *Menard* had no notice that the President’s actions were not authorized. *Id.* at 1213-16.

¹¹⁴ E.g., *Kahn v. Royal Banks of Mo.*, 790 S.W.2d 503 (Mo. Ct. App. 1990). In *Kahn*, a dispute arose over whether a husband and wife were jointly liable for a loan the husband secured on both of their behalves. *Id.* at 506. The wife had signed a power of attorney giving the husband the right to act on her behalf. *Id.* However, when the bank foreclosed on the loan the wife filed suit claiming she was not liable for the debts. *Id.* The wife argued that because the husband had acted in self interest and not her interest he was acting without authority to bind her to the loans. *Id.* The court held that the husband had acted with inherent authority and therefore held the wife jointly liable for the debt. *Id.* at 509. Due to the fact that the bank was unaware that the husband was breaching his fiduciary duties to his wife, the husband was acting with inherent authority, and therefore bound the wife as principal to the husband’s dealings with the bank, a third party. *Id.*

¹¹⁵ RESTATEMENT (SECOND) OF AGENCY § 8A.

Inherent agency power is a term used in the restatement of this subject to indicate the power of an agent which is derived not from authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent.

Id.

¹¹⁶ Gregory Scott Crespi, *The Proposed Abolition of Inherent Agency Authority by the Restatement (Third) Of Agency: An Incomplete Solution*, 45 SANTA CLARA L. REV. 337, 344 (2005) (discussing section 8A comment a of the *Restatement Second of Agency*).

other areas.¹¹⁷ For that reason this note will not discuss the doctrine further.¹¹⁸

C. *An Alternate Theory for Binding a Principal: Estoppel*

Beyond the “traditional” concepts of agency and authority, both the *Restatement Second* and *Restatement Third* contain a section on estoppel.¹¹⁹ In agency law, estoppel is viewed as a net that allows courts the freedom to hold a principal liable in cases where the agent is lacking either an agency relationship or authority to bind the principal.¹²⁰ Estoppel can also be used to prevent a principal from denying an agency relationship or authority; however, estoppel is preempted by all other doctrines contained within the *Restatements*.¹²¹ In order for estoppel to apply, therefore, courts must be sure that no other doctrines within the *Restatements* apply. Part II.C scrutinizes the doctrine of estoppel by examining its requirements under the *Restatements*, how it has been used by the courts, and how it is distinguished from similar concepts like perceived agency and apparent authority.¹²²

The doctrine of estoppel is deeply rooted in American and English jurisprudence.¹²³ Several treatises on the subject provide a good background of the topic.¹²⁴ However, for purposes of agency law, estoppel is defined in section 8b of the *Restatement Second* and section 2.05 of the *Restatement Third*.¹²⁵

¹¹⁷ RESTATEMENT (THIRD) OF AGENCY § 2 intro. note; RESTATEMENT (THIRD) OF AGENCY parallel tbls (2006); see Crespi, *supra* note 116, at 344 (discussing section 8A comment a of *Restatement Second of Agency*).

¹¹⁸ See Crespi, *supra* note 116; Matthew P. Ward, *A Restatement or a Redefinition: Elimination Of Inherent Agency in the Tentative Draft of The Restatement (Third) Of Agency*, 59 WASH. & LEE L. REV. 1585 (2002) (discussing the American Law Institute’s decision to eliminate the doctrine of inherent authority from the *Restatement Third*).

¹¹⁹ RESTATEMENT (THIRD) OF AGENCY § 2.05; RESTATEMENT (SECOND) OF AGENCY § 8b.

¹²⁰ See RESTATEMENT (THIRD) OF AGENCY § 2 int. nt. 4 (2006).

¹²¹ *Id.*

¹²² See *infra* Part II.C.1 (discussing agency law’s treatment of estoppel generally and specifically the doctrine of agency by estoppel).

¹²³ As such, an attempt to give adequate depth to the history of the doctrine in this Note would be both an exercise in futility and well beyond the scope of this Note.

¹²⁴ See generally ELIZABETH COOKE, *THE MODERN LAW OF ESTOPPEL* (Oxford University Press 2000); ALEXANDER KINGCOME TURNER, *THE LAW RELATING TO ESTOPPEL BY REPRESENTATION* (Butterworths & Co. 1966).

¹²⁵ RESTATEMENT (THIRD) OF AGENCY § 2.05.

A person who has not made a manifestation that an actor has authority as an agent and who is not otherwise liable as a party to a transaction purportedly done by the actor on that person’s account is subject to

Under the *Restatement Second*, an individual is estopped from denying an agency relationship if he intentionally or carelessly caused a belief in a third person that one is acting on his behalf or, knowing of the belief, failed to correct the mistake and caused the third party to change position in reliance on that belief.¹²⁶ As at least one jurisdiction in Texas has noted, estoppel is closely related to several other agency doctrines.¹²⁷ However, to say that the doctrines are equivalent would be incorrect.¹²⁸ Apparent authority, for example, is analytically similar to estoppel; however, estoppel, as defined in both the *Restatement Second* and *Third*, does not necessarily require that the third party's belief be directly traceable to the principal in order to apply.¹²⁹ For instance, in order for there to be a claim of apparent authority, the third party's belief must be

liability to a third party who justifiably is induced to make a detrimental change in position because the transaction is believed to be on the person's account, if

- (1) the person intentionally or carelessly caused such belief, or
- (2) having notice of such belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts.

Id. Further:

- (1) A person who is not otherwise liable as a party to a transaction purported to be done on his account, is nevertheless subject to liability to persons who have changed their positions because of their belief that the transaction was entered into by or for him, if
 - (a) he intentionally or carelessly caused such belief, or
 - (b) knowing of such belief and that others might change their positions because of it, he did not take reasonable steps to notify them of the facts.
- (2) An owner of property who represents to third persons that another is the owner of the property or who permits the other so to represent, or who realizes that third persons believe that another is the owner of the property, and that he could easily inform the third persons of the facts, is subject to the loss of the property if the other disposes of it to third persons who, in ignorance of the facts, purchase the property or otherwise change their position with reference to it.
- (3) Change of position, as the phrase is used in the restatement of this subject, indicates payment of money, expenditure of labor, suffering a loss or subjection to legal liability.

RESTATEMENT (SECOND) OF AGENCY § 8b (1958).

¹²⁶ RESTATEMENT (SECOND) OF AGENCY § 8b.

¹²⁷ *Baptist Mem'l Hosp. Sys. v. Sampson*, 969 S.W.2d 945, 947 n.2 (Tex. 1998) ("Many courts use the terms ostensible agency, apparent agency, apparent authority, and agency by estoppel interchangeably. As a practical matter, there is no distinction among them.").

¹²⁸ RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt c (discussing how estoppel is different than the doctrines of actual and apparent authority).

¹²⁹ RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt. d (discussing that estoppel applies even in cases where a third party belief is not directly traceable to the principal).

362 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42]

traceable to a manifestation on the part of the principal.¹³⁰ Estoppel, on the other hand, does not require as close a fit between the third party's belief and the principal.¹³¹

Hoddeson v. Koos Bros.,¹³² which is the basis for Illustration Two from the *Restatement Third* section 2.05, was the first case to use agency by estoppel to confer liability.¹³³ In *Hoddeson*, Ms. Hoddeson entered a furniture store owned by Koos Brothers to make a purchase.¹³⁴ While in the store, Ms. Hoddeson was approached by a man who appeared to work for Koos Brothers.¹³⁵ The man then proceeded to take notes, presumably recording her order, as Ms. Hoddeson selected furniture to purchase.¹³⁶ At the end of the discussion, Ms. Hoddeson paid for the furniture and left the store.¹³⁷ After waiting for a period of time past the expected delivery date, Ms. Hoddeson went back to the store to inquire what was causing the delay.¹³⁸ When she returned, Koos Brothers' employees informed her that they had no record of the transaction.¹³⁹ It was assumed that the man who had helped her had not been a member

¹³⁰ RESTATEMENT (THIRD) OF AGENCY § 2.03.

¹³¹ RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt. d.

¹³² 135 A.2d 702 (N.J. 1957).

¹³³ *Id.*; see also RESTATEMENT (THIRD) OF AGENCY § 2.05 illus. 2 (2006). Illustration 2 states:

P owns a large retail furniture store, known as "P's Furniture Emporium." P, who is often absent from the premises, does not otherwise maintain surveillance over the store's sales force. T, a prospective customer, enters the store and is approached by A, whose demeanor and attire lend A the appearance of a salesperson. After examining floor samples, T purchases several items of furniture for cash, giving the cash to A. A gives T a receipt written on a standard-looking form, with "P's Furniture Emporium" printed at the top. A explains to T that the items purchased are not presently in inventory but will be delivered to T's home within two weeks. A is an imposter who is not an employee or other agent of P. A does not remit any of the cash paid by T to P. No furniture is delivered to T. T's change of position is justified by T's belief that A is what A purports to be, a salesperson with authority to sell from P's inventory. Whether P may deny A's authority is a question for the trier of fact.

¹³⁴ *Hoddeson*, 135 A.2d at 703.

¹³⁵ *Id.* The man was dressed in a suit, and as he approach he asked her if he could be of some help. *Id.*

¹³⁶ *Id.* at 704.

¹³⁷ *Id.* The man informed Ms. Hoddeson that the furniture she had picked out was not in stock and would have to be shipped to her. *Id.* Ms. Hoddeson then gave the man \$168.50 in payment for the items and left the store without receiving a receipt. *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

of the sales staff at all.¹⁴⁰ The court remanded the case based on a lack of evidence and findings by the lower court to hold that the “apparent” salesman was an agent with any kind of authority to bind the furniture store.¹⁴¹ However, the court held that under a theory of estoppel, regardless of whether the salesman had authority, the furniture store could not escape liability by disavowing an agency relationship where it had failed to adequately protect its customers from people falsely pretending to be salesmen.¹⁴²

Another distinction among estoppel, apparent authority, and perceived agency is the level of reliance required.¹⁴³ Most jurisdictions only require justifiable reliance in cases where an actual agency relationship is lacking.¹⁴⁴ However, at least one jurisdiction, Illinois, has adopted estoppel and its requisite detrimental reliance/change of position where an actual agency relationship does not exist.¹⁴⁵

In *Gasbarra v. St. James Hospital*,¹⁴⁶ the plaintiff sued a hospital for improper care by physicians in the hospital’s emergency room.¹⁴⁷ The hospital asserted, as a defense, that it could not be held liable because the physicians were independent contractors.¹⁴⁸ In response, the plaintiff claimed that, despite the lack of actual agency, the hospital was liable under the doctrine of equitable estoppel.¹⁴⁹ The court held that there were insufficient grounds to hold the hospital liable under the doctrine

¹⁴⁰ *Id.* Both Ms. Hoddeson and her aunt, who had accompanied her on the day of the purchase, were unable to positively identify the man who had helped them from the regular sales staff that worked at the store. *Id.* Both did acknowledge that one man bore a resemblance to the man that had helped them but a subsequent examination of Koos Brothers records showed the identified man was on vacation the day the women were in the store. *Id.*

¹⁴¹ *Id.* at 706.

¹⁴² *Id.* at 706-07.

¹⁴³ RESTATEMENT (THIRD) OF AGENCY § 2.05 (stating reliance as “. . . a third party who justifiably is induced to make a detrimental change in position because the transaction is believed to be on the person’s account. . .”); see also *supra* note 97 and accompanying text; *supra* notes 56-57 and accompanying text.

¹⁴⁴ See *supra* Part II.A.2.

¹⁴⁵ *Gasbarra v. St. James Hosp.*, 406 N.E.2d 544, 554-55 (Ill. App. Ct. 1980).

¹⁴⁶ *Id.*; see also Keith Phoenix & Anne L. Schlueter, *Hospital Liability for the Acts of Independent Contractors: The Ostensible Agency Doctrine*, 30 St. LOUIS U. L.J. 875, 885 (1986) (discussing the facts and holding in *Gasbarra*).

¹⁴⁷ *Gasbarra*, 406 N.E.2d at 548.

¹⁴⁸ *Id.* The emergency room physicians were employed by the Doctors Emergency Care Association and were independent contractors not employee agents of the hospital. *Id.*

¹⁴⁹ *Id.* at 554.

of estoppel because the plaintiff failed to show any detrimental change of position.¹⁵⁰

Estoppel is distinct from apparent authority and perceived agency because estoppel, as applied by most jurisdictions, requires a more stringent form of reliance.¹⁵¹ Furthermore, the *Restatement Third* Introductory Note Four demonstrates that apparent authority and estoppel are related but separate doctrines, stating:

Estoppel is relevant to agency when a representation is made that one person has authority to act on behalf of another. In this Restatement, when doctrines other than estoppel are applicable to a situation, those doctrines govern. Unlike many cases, but like Restatement Second, Agency, this Restatement treats apparent authority as a doctrine distinct from estoppel. It does so to clarify the law and to make clear when and why it is necessary for a plaintiff to show detrimental reliance.¹⁵²

By asserting that agency doctrines preempt the doctrine of estoppel, the *Restatement Third* recognizes that estoppel's applicability, as defined in that Restatement, overlaps the applicability of apparent authority and perceived agency to hold a person liable for the acts of another.¹⁵³

The law of agency embodies concepts from several areas of law including but not limited to torts and contracts.¹⁵⁴ As a result, there has been much confusion over which doctrines apply in different circumstances.¹⁵⁵ However, while the *Restatement Third* is a useful tool to help guide courts in evaluating agency problems, it is a secondary source and as such should not stand in the way of a court's ability to find a result that is equitable and just.

¹⁵⁰ *Id.* at 555. The court reasoned that the facts supported the conclusion that the plaintiff relied on the manifestations of the hospital; however, the plaintiff had failed to present any evidence that she changed her position (i.e. failed to take her child to another hospital) which is required to support an estoppel claim. *Id.*

¹⁵¹ See *supra* notes 144-51 and accompanying text (explaining the how estoppel requires a more stringent form of reliance than the doctrines of apparent authority and perceived agency).

¹⁵² RESTATEMENT (THIRD) OF AGENCY § 2 int. nt. 4 (2006) (detrimental reliance is required by estoppel unlike apparent authority which only requires justifiable reliance).

¹⁵³ *Id.*

¹⁵⁴ See generally RESTATEMENT (THIRD) OF AGENCY.

¹⁵⁵ See *supra* Part II.

III. ANALYSIS

The doctrine of perceived agency embodies characteristics similar to estoppel.¹⁵⁶ Thus, what is the significant difference between estoppel and perceived agency? As a corollary, should courts retain both doctrines? An examination of cases interpreting these doctrines shows that the major distinguishing characteristic embodied in *Restatement Second* sections 267 and 8b, respectively, is the reliance required by each doctrine.¹⁵⁷ Under perceived agency, a plaintiff is only required to show that he justifiably relied upon the manifestations of the principal when dealing with an agent.¹⁵⁸ By comparison, under the doctrine of agency by estoppel, a plaintiff is required to show that he was justified in relying upon the principal's manifestations and that he changed his position based upon that reliance.¹⁵⁹ It is clear that there is a need for an agency doctrine which protects third parties who rely on manifestations by a principal that another is their agent. However, the doctrines must be flexible enough to protect consumers, while not discouraging business from working together in new and creative ways. Requiring detrimental reliance in cases of third party reliance where no agency relationship exists will do just that.

One scholar, Joseph H. King, argues that the reliance required by perceived agency is, in fact, the detrimental reliance of estoppel.¹⁶⁰ However, the Michigan Court of Appeals is the only authority King cites concluding that courts require such detrimental reliance in perceived agency cases.¹⁶¹ Yet, a close examination of that case reveals another interpretation.¹⁶² The vast majority of cases relying on the *Restatement*

¹⁵⁶ See *supra* note 39 and accompanying text.

¹⁵⁷ See *infra* Part III. See generally, 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2, 474-75.

¹⁵⁸ See generally, 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2, 474-75.

¹⁵⁹ *Id.*

¹⁶⁰ Joseph H. King Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 WASH & LEE L. REV. 417, 446-56 (2005). Mr. King argues that perceived agency requires four prongs of reliance: Actual Reliance; Actually Attaching Importance to the Manifestation; Justified in Believing the Truth of the Manifestation; and Justified in Attaching Importance to the Manifestation. *Id.* at 448-59. He further argues that Actually Attaching Importance to the Manifestations is the detrimental reliance prong of perceived agency reliance. *Id.* at 449-56.

¹⁶¹ *Little v. Howard Johnson Co.*, 455 N.W.2d 390 (Mich. Ct. App. 1990).

¹⁶² See *infra* notes 202-06 and accompanying text (examining the holding in *Little v. Howard Johnson* and arguing that the court did not actually require detrimental reliance change of position).

366 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42]

Second section 267 only require justifiable reliance.¹⁶³ The different levels of reliance would not be troublesome except that nearly every instance in which a court relies on section 267 to impart liability could just as easily fall under section 8b estoppel.¹⁶⁴ Further, the *Restatement Third* failed to fix the problem when it maintained the distinction between perceived agency and agency by estoppel.¹⁶⁵ Because the language of *Restatement Second* section 267 was retained almost completely in *Restatement Third* section 7.07 Comment f, courts choosing to adopt the *Restatement Third* can maintain the distinction between justifiable and detrimental reliance.¹⁶⁶ Part III.A of this Note analyzes how courts have discussed and utilized the *Restatement Second* in determining liability for Employers and Franchisors. Part III.B examines how applying sections 7.07 and 2.05 of the *Restatement Third* may alter a court's analysis of employer and franchisor liability.

A. *Restatement Second: A Confusion of Doctrines by the Courts*

1. Employer – Employee Relationships

One of the two broad circumstances in which courts have applied agency by estoppel or perceived agency is when the third party believed the person was an employee of the principal and, therefore, believed the person to be an agent of the principal. Although only moderately common, this situation has the capability of arising in an enormous number of settings. Part III.A.1.a. examines the courts reasoning in the watershed case for using agency by estoppel to impart liability, *Hoddeson v. Koos Bros.*¹⁶⁷ Part III.A.1.b. analyzes courts' decisions on conferring liability to hospitals for the acts of independent contractor physicians.¹⁶⁸

¹⁶³ See *supra* notes 46-57 (discussing the reliance required for perceived agency); see also 6 AM. JUR. PROOF OF FACTS 3D *Apparent Agency* § 2 at 476-77.

¹⁶⁴ See *infra* Parts III.A, III.B.

¹⁶⁵ See *supra* notes 58-65 and accompanying text (examining how the *Restatement Third* altered the doctrine of perceived agency's language from the *Restatement Second*); *supra* Part II.C. (reviewing the *Restatement Second* and *Third's* treatment of estoppel).

¹⁶⁶ See *supra* notes 62-70 and accompanying text (considering a court's options for applying *Restatement Third* § 7.07).

¹⁶⁷ See *infra* Part III.A.1.a (breaking down the court's reasoning in *Hoddeson* and hypothesizing reasons for the courts lack of discussion on detrimental reliance).

¹⁶⁸ See *infra* Part III.A.1.b (comparing reasoning in applying agency by estoppel or perceived agency in cases of torts committed by independent contractor physicians).

a. Salesmen: Attempts to Define a Doctrine

The seminal case for using estoppel to hold a business responsible for the acts of an apparent salesman is *Hoddeson v. Koos Bros.*¹⁶⁹ The *Hoddeson* court remanded the case, making no finding as to whether the furniture store was actually estopped from denying the agency relationship.¹⁷⁰ However, the court reasoned that agency by estoppel may be appropriate in these types of cases.¹⁷¹ Although the court's reasoning followed that of the *Restatement Second*, sections 8b and 267, noticeably missing from the court's discussion was the degree of reliance required. The court only indirectly mentioned the degree of reliance by stating that the principal should be estopped if the acts of the perceived agent would lead a person of "ordinary prudence and circumspection to believe that the impostor was . . . the proprietor's agent."¹⁷² This description of reliance lacks the detrimental reliance change of position language, which is the touchstone of estoppel analysis.¹⁷³ The omission of the detrimental reliance language is likely the product of two factors. First, the facts of *Hoddeson* demonstrate so clearly that there was detrimental reliance that it was likely uncontested by the defendant and, as such, the court did not feel compelled to discuss it in the case.¹⁷⁴ Second, *Hoddeson* was decided a year before the *Restatement Second* was published, and the *Restatement (First) of Agency* did not include a section on estoppel.¹⁷⁵ The combination of Ms. Hoddeson's obvious change of position with no Restatement section expressly requiring detrimental

¹⁶⁹ See *supra* notes 135-43 and accompanying text (discussing the facts and holding of *Hoddeson v. Koos Brothers*).

¹⁷⁰ *Hoddeson v. Koos Bros.*, 135 A.2d 702 (N.J. 1957).

¹⁷¹ *Id.* at 707.

[W]here a proprietor of a place of business by his dereliction of duty enables one who is not his agent conspicuously to act as such and ostensibly to transact the proprietor's business with a patron in the establishment, the appearances being of such a character as to lead a person of ordinary prudence and circumspection to believe that the impostor was in truth the proprietor's agent, in such circumstances the law will not permit the proprietor defensively to avail himself of the impostor's lack of authority and thus escape liability for the consequential loss thereby sustained by the customer.

Id.

¹⁷² *Id.*

¹⁷³ See *supra* note 153 and accompanying text.

¹⁷⁴ See *supra* note 153 and accompanying text. It is uncontestable that had Ms. Hoddeson known the "salesman" that approached her in the store that day was not really an employee of Koos Brothers, she would not have placed her order and given him the money.

¹⁷⁵ See generally, RESTATEMENT (FIRST) OF AGENCY (1933).

reliance likely led the court to omit any meaningful discussion of the reliance required by agency by estoppel.

b. Independent Contractor Physicians: Uncertainty in Choosing a Doctrine

Courts' treatment of the relationship between hospitals and their independent contractor physicians varies by jurisdiction.¹⁷⁶ Most jurisdictions use perceived agency to confer liability on hospitals; however, a minority of jurisdictions, most notably Illinois, rejected perceived agency in favor of using agency by estoppel.¹⁷⁷ Because of the additional requirement of change of position, it is much harder for a plaintiff to prevail in jurisdictions that use agency by estoppel.¹⁷⁸ *Williams v. St. Claire Medical Center*¹⁷⁹ and *Gasbarra v. St. James Hospital* demonstrate the different ways courts have examined the relationship between a hospital and its independent contractor physicians.¹⁸⁰

When courts apply the *Restatement Second* section 267 in an employer-employee relationship, change of position is not required in order to have a valid claim.¹⁸¹ In applying the doctrine of perceived agency to the facts, the *St. Claire Medical Center* court recognized that, by failing to give the plaintiff notice that the anesthesiologist was not an employee of the hospital, it held him out as such.¹⁸² Further, in discussing the plaintiff's reliance, the court stated that the plaintiff's belief that the anesthesiologist was an employee of the hospital was

¹⁷⁶ See *infra* notes 178-80 and accompanying text.

¹⁷⁷ See *supra* Part II.A.2; see also Ferraro and Camarra, *Hospital Liability: Apparent Agency or Agency by Estoppel*, 76 ILL. B.J. 364 (1988) (discussing Illinois' refusal to follow other jurisdictions' lead of adopting perceived agency in hospital liability cases). But see *Gasbarra v. St. James Hosp.*, 406 N.E.2d 544 (Ill. App. Ct. 1980) (supp. opinion).

¹⁷⁸ See *infra* notes 235-38 (discussing the difficulties of bringing a claim that requires change of position); see also Phoenix & Schlueter, *supra* note 147, at 885. They state: the most difficult aspect of the [agency by estoppel] theory from the plaintiff's perspective is the inherent proof problem. To recover under this doctrine, a plaintiff must establish . . . that the representation caused the plaintiff's reliance on the care or skill of the apparent agent to the plaintiff's detriment.

Phoenix & Schlueter, *supra* note 147, at 885.

¹⁷⁹ *Williams v. St. Claire Medical Center*, 657 S.W.2d 590, 596 (Ky. Ct. App. 1983).

¹⁸⁰ See *infra* notes 182-90 and accompanying text (describing how courts treated hospital liability differently in the case of independent contractor physicians).

¹⁸¹ *St. Claire*, 657 S.W.2d at 592. The hospital denied liability on the basis that the surgeon and nurse who administered the anesthetics were independent contractors and the hospital was not vicariously liable for their acts. The court disagreed and stated that the hospital could be held liable under perceived agency as set forth in the *Restatement Second*. *Id.*

¹⁸² *Id.*

justifiable, omitting any discussion of change of position.¹⁸³ By contrast, Illinois has rejected the use of perceived agency in the context of hospital liability.¹⁸⁴

In *Gasbarra*, the plaintiff sought recovery for the malpractice of a physician that resulted in the death of her child.¹⁸⁵ In a supplemental opinion, the court discussed the plaintiff's agency claim.¹⁸⁶ The court found that no actual agency relationship existed, and without mention of perceived agency, rejected the plaintiff's claim for agency by estoppel.¹⁸⁷ In finding that there was no merit to the plaintiff's claim for agency by estoppel, the court stated that the plaintiff failed to provide any evidence in the record that suggested she changed her position based on a belief that the emergency room physicians were employees of the hospital.¹⁸⁸ In other words, the plaintiff failed to show evidence that if she had known the physicians were not employees of the hospital she would have chosen to take her child to another hospital.¹⁸⁹ Accordingly, requiring change of position in this context makes it much harder for plaintiffs to hold hospitals vicariously liable for the acts of their independent contractor physicians.¹⁹⁰

2. Franchisor – Franchisee Relationships

Despite the fact that Illinois courts have used agency by estoppel and rejected perceived agency in one context, no jurisdiction has been willing to apply agency by estoppel to franchisor-franchisee relationships.¹⁹¹ Franchisor–franchisee relationships are present in a wide variety of business enterprises, and imposition of liability on franchisors for the acts of franchisees, absent actual agency, has been commonly based upon section 267 of the *Restatement Second*.¹⁹² Furthermore, as the Oregon

¹⁸³ *Id.*

¹⁸⁴ *Gasbarra v. St. James Hosp.*, 406 N.E.2d 544, 548 (Ill. App. Ct. 1980) (holding that Illinois rejects the justifiable reliance required by other states and dismisses *Gasbarra's* claim of perceived agency on grounds that she has failed to show a detrimental reliance change of position).

¹⁸⁵ See *supra* notes 148-50 and accompanying text.

¹⁸⁶ *Gasbarra*, 406 N.E.2d at 553.

¹⁸⁷ *Id.* at 554-55.

¹⁸⁸ *Id.* at 555.

¹⁸⁹ *Id.*

¹⁹⁰ See *supra* note 178.

¹⁹¹ See *infra* Part III.A.2.

¹⁹² See Randall K. Hanson, *The Franchising Dilemma: Franchisor Liability for Action of a Local Franchisee*, 19 N.C. CENT. L.J. 190, 198 (1991) [hereinafter *Dilemma*]; Randall K. Hanson, *The Franchising Dilemma Continues: Update on Franchisor Liability for Wrongful Acts By Local Franchisees*, 20 CAMPBELL L. REV. 91, 99-100 (1997) [hereinafter *Continues*].

370 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42

Court of Appeals reasoned in *Miller v. McDonald's Corp.*, “[t]he crucial issues are whether the putative principal held the third party out as an agent and whether the plaintiff relied on that holding out.”¹⁹³

Courts consider a variety of factors to find that a franchisor has “held out” a franchisee as its agent.¹⁹⁴ Among those factors courts have most notably deliberated are the effects of a franchisor’s national advertising and a franchisee’s use of the franchisor’s name and insignia on signs and other displays in the store.¹⁹⁵ As to the question of reliance, courts have almost uniformly announced and applied the requirement of justifiable reliance rather than detrimental reliance/change of position.¹⁹⁶

The lone case which applies *Restatement Second* section 267 and expressly states that change of position is required is *Crinkley v. Holiday Inns, Inc.*¹⁹⁷ However, as the court applied the test for perceived agency, the requirement of change of position was absent.¹⁹⁸ The court reviewed the evidence and found plenty of support for the notion that the Crinkleys had actually relied on Holiday Inn, Inc.’s representations.¹⁹⁹ However, the court did not mention any testimony or evidence that the Crinkley’s would have chosen not to stay at the Holiday Inn had they been informed that the Hotel was owned and operated by anyone other than Holiday Inn, Inc. Thus, while the court claimed to be requiring detrimental reliance/change of position of the plaintiffs, in reality it applied the lower standard of justifiable reliance.

Little v. Howard Johnson Co. is another case often cited as an example of a court requiring detrimental reliance/change of position in perceived agency analysis.²⁰⁰ The belief that the court required detrimental reliance/change of position is based on the court’s statement, “[h]ere, plaintiff has failed to offer any documentary evidence that she was

¹⁹³ *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1112 (Or. Ct. App. 1997).

¹⁹⁴ King, *supra* note 161 at 441.

¹⁹⁵ *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156, 166 (4th Cir. 1988) (relying on national advertising to establish a holding out); *Billops v. Magness Constr. Co.*, 391 A.2d 196, 199 (Del. 1978) (relying on franchisor’s requirement that franchisee use the franchisor’s trade name and insignia); *Gizzi v. Texaco*, 437 F.2d 308, 310 (3d Cir. 1971) (relying on national advertising to establish a holding out).

¹⁹⁶ See *supra* Part II.A.2.

¹⁹⁷ 844 F.2d 156, 166 (4th Cir. 1988).

¹⁹⁸ *Id.* at 167.

¹⁹⁹ *Id.* (stating the Crinkleys chose to find another Holiday Inn when there was no room at a Holiday Inn close to there destination. Also noting Mr. Crinkley’s testimony that he was surprised to find out that Holiday Inn, Inc. was not involved in the operation of the hotel).

²⁰⁰ *Little v. Howard Johnson Co.*, 455 N.W.2d 390, 394 (Mich. Ct. App. 1990).

harmful as a result of relying on the perceived fact that the franchisee was an agent of defendant."²⁰¹ Taken by itself, the court's statement appears to suggest that detrimental reliance/change of position is required. However, when viewed in light of the facts of the case, another reading emerges.²⁰²

Little involved a restaurant customer slipping and falling on an icy sidewalk.²⁰³ Arguably, the conditions which caused the plaintiff's injury were completely unrelated to the aspects of the restaurant that the franchisor would have promoted, as uniform to the franchise, to encourage patronage to member franchisees.²⁰⁴ When considered in conjunction with the surrounding facts, the court's language requires that the instrument which injures a plaintiff must be part of the holding out by the franchisor upon which the plaintiff relied.²⁰⁵ In many cases, this requirement is inherently fulfilled, as in the case *Miller v. McDonald's Corp.*

In *Miller*, the plaintiff was injured from biting into a sapphire that was inside her sandwich.²⁰⁶ In finding a perceived agency relationship, the court recognized that McDonald's use of uniform menus, food production methods, and service standards, constituted a holding out of the franchisee as McDonald's agent.²⁰⁷ While not discussed in the case, it is self-evident that the instrumentality which caused plaintiff's injury, the food, was part and parcel of the representations made by the franchisor and relied upon by the plaintiff.²⁰⁸ It may be, as King suggests, that requiring a close fit between the instrumentality of injury and the manifestations by the principal would fulfill a detrimental reliance requirement in cases where the plaintiff is injured by an

²⁰¹ See King, *supra* note 161, at 445-46.

²⁰² See *infra* notes 204-06 and accompanying text.

²⁰³ *Id.* at 392.

²⁰⁴ Although the court makes no finding as to this point, it seems unlikely that Little would have chosen to eat at the Howard Johnson restaurant because she expected that restaurants in Howard Johnson hotels are more or less likely to have their sidewalks properly cleared.

²⁰⁵ See King, *supra* note 161, at 452 (stating "one relying on apparent agency should similarly have to prove justifiable reliance not merely on a manifestation of agency, but agency with respect to, again, the specific injurious instrument or conduct responsible for the harm in question").

²⁰⁶ *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1108 (Or. Ct. App. 1997).

²⁰⁷ *Id.* at 1113.

²⁰⁸ See generally King, *supra* note 161, at 452 (arguing that courts should require a plaintiff's reliance to be tied to a belief that the franchisor had control of the instrumentality that caused the injury but failing to distinguish how doing so would fulfill a detrimental reliance or change of position requirement).

372 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42]

instrumentality that is not part of the principal's manifestation. However, in cases like *Miller*, findings that the plaintiff was injured by an instrumentality which was part of the principal's manifestations fail to bring a court any closer to determining whether the plaintiff has detrimentally relied.²⁰⁹ Therefore, combining those two concepts runs the risk of further muddling an already cloudy area of agency law.²¹⁰

Beyond *Miller* and *Little*, courts from a wide range of jurisdictions have explicitly stated that the only reliance required to hold a franchisor liable for the acts of a franchisee is justifiable reliance.²¹¹ In doing so, courts have equated enticement with reliance and found franchisors liable based solely on the plaintiff's testimony that they chose to do business with the franchisee because they thought they were dealing with the franchisor.²¹² However, noticeably lacking in all of the

²⁰⁹ See *supra* notes 207-09 and accompanying text.

²¹⁰ But see *King*, *supra* note 161, at 445-46 (discussing *Little v. Howard Johnson Co.* and contending that the case requires detrimental reliance change of position).

²¹¹ See generally *McDonald's Corp.*, 945 P.2d at 1113; *Billops v. Magness Constr. Co.*, 391 A.2d 196, 198 (Del. 1978); *Gizzi v. Texaco, Inc.*, 437 F.2d 308, 309 (3d Cir. 1971).

²¹² *Billops*, 391 A.2d at 199.

Plaintiffs have presented evidence of their reliance on Hilton as a "quality enterprise". Depositions of several of the plaintiffs produced the following testimony: By Mr. Billops: "... we did go to the Hilton Hotel for the evening and the people paid \$10.00 for the event and not this shabby treatment ...". By Mr. Naylor: "We received letters from the Hilton, signed by Parker [the banquet director] that they were happy that we had picked their hotel to have our affair in. And we said now we have got a first class hotel with a first class affair. That is why we charged \$10.00 in advance... that night the treatment of Parker and the attitude of the personnel at that point, it so alarmed me that it broke my heart because I put a lot of faith and trust into the Hilton, because it was a major hotel ...". These are statements of express reliance on the Hilton name, and the quality it represents.

Id.; see also *Crinkley*, 844 F.2d at 167.

As to the reliance prong of the test, Sarah Crinkley testified that she and her husband had previously stayed at Holiday Inns and that she was familiar with its national advertising. She also testified that they originally attempted to make reservations at a Holiday Inn in Charlotte because they thought it would be a good place to stay. Rather than looking for another Charlotte area hotel when they could not get a room at the Holiday Inn near their destination, they used a Holiday Inn directory to find another convenient motel. James Crinkley testified that he did not know the difference between a franchise inn and a company owned inn at the time ... and noted that he would be greatly surprised to find out that Holiday Inns was not involved in the operation of the Holiday Inn-Concord beyond the franchise agreement. While the Crinkleys' evidence of actual reliance

franchisor-franchisee cases is any evidence that the plaintiffs have given up an alternative opportunity they would have taken had they known the business was not run by the franchisor. Further, without such evidence, it is unclear how a plaintiff can claim that he was injured by the franchisor's representations. Given this understanding of how courts have applied the doctrines of perceived agency and agency by estoppel under the *Restatement Second*, courts will be faced with the decision of which doctrine to use under the *Restatement Third*.²¹³

B. Restatement Third: *Attempting to Streamline the Law*

As previously discussed, the *Restatement Third* contains similar language to the *Restatement Second* in the areas of perceived agency and agency by estoppel.²¹⁴ As a result, courts in jurisdictions where the *Restatement Third* is adopted will have a choice of which doctrine to use when faced with agency cases involving employer-employee and franchisor-franchisee relationships.

1. Employer-Employee Relationship Under *Restatement Third* section 7.07

Because *Restatement Third*, section 7.07 Comment f retains much of the same language as *Restatement Second*, section 267, courts in jurisdictions where the *Restatement Third* has been adopted can use section 7.07 and apply the same analysis as courts did under the *Restatement Second*.²¹⁵ In fact, the *Restatement Third's* change of language, if anything, makes it more explicit that section 7.07 Comment f is meant to be used in the employer-employee context.²¹⁶ Therefore, in applying it to the facts in the various hospital contexts, the court would conduct the same analysis as under the *Restatement Second*.²¹⁷

Under this analysis, the first question would be, did the principal hold out the agent as its employee?²¹⁸ Secondly, did the plaintiff rely on

may be marginal, we think it sufficed under the applicable substantive principles to raise a jury issue.

Crinkley, 844 F.2d at 167.

²¹³ See *infra* Part III.B.

²¹⁴ See *supra* Parts II.A.2 (perceived agency), II.C.1 (agency by estoppel).

²¹⁵ See *supra* notes 58-65 and accompanying text (discussing the language change from *Restatement Second* § 267 to *Restatement Third* §7.07 Comment f).

²¹⁶ See *supra* notes 64-65 and accompanying text (explaining the change in language from master-servant to employer-employee in *Restatement Third* Section 7.07 Comment f).

²¹⁷ See *supra* notes 180-93 and accompanying text.

²¹⁸ See *supra* notes 41-45 and accompanying text (discussing the holding out requirement for perceived agency as applied in *Crinkley v. Holiday Inns, Inc.*).

the holding out of the principal?²¹⁹ Finally, was the plaintiff's reliance reasonable and justifiable?²²⁰ If the answer is "yes" to all three questions, then the principal is liable, but, if the answer is "no" to any of these factors, the principal is not liable.²²¹

Yet, while the change in language from section 267 to the language of section 7.07 is insignificant in dealing with employer-employee relationships, it is significant in the context of franchisor-franchisee relationships.²²²

2. Franchisor-Franchisee Relationships Under *Restatement Third* section 7.07 Comment f

Courts routinely relied on the *Restatement Second* section 267 to impose liability upon franchisors for the misdeeds of their franchisees.²²³ However, while the franchisor-franchisee relationship certainly fits within the language of section 267 as a master-servant relationship, section 7.07 Comment f's use of employer-employee language may become a pitfall for unsuspecting practitioners. In order to fall within the reach of section 7.07 Comment f, an attorney will have to give an employer-employee basis for asserting vicarious liability.²²⁴ Because franchisees are not generally considered employees of franchisors, practitioners will have to draw their complaints carefully, asserting that the tortious acts of the franchisee employee should be imputed to the franchisor, because the franchisor held out all employees of the franchisee as employees of the franchisor.²²⁵

Applying this idea to the facts of *Miller v. McDonald's*, the plaintiff would have to draw her complaint carefully, asserting that McDonald's Corporation held out all workers at McDonald's restaurants as being employed by McDonald's Corporation; and, as such, McDonald's Corporation should be vicariously liable for the acts of all McDonald's employees. Once that is established, the court could use the same

²¹⁹ See *supra* note 46 and accompanying text.

²²⁰ See *supra* notes 46-54 and accompanying text (discussing the reliance requirement for perceived agency as applied in *Miller v. McDonald's Corporation*).

²²¹ See *supra* Part II.A.2.

²²² See *supra* Part II.A.2; see also, *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1110 (Or. Ct. App. 1997). "The relationship between two business entities is not precisely an employment relationship." *Id.*

²²³ See *supra* Part II.A.2 (demonstrating how courts have used perceived agency to apply liability to restaurant and hotel franchisors).

²²⁴ RESTATEMENT (THIRD) OF AGENCY § 7.07 (2006).

²²⁵ See *supra* note 223.

analysis as it would under *Restatement Second* section 267 to impute liability upon the franchisor.²²⁶ Conversely, some courts may be unwilling to extend the language of section 7.07 Comment f to franchisor-franchisee relationships, in which case the court may look to section 2.05 to decide franchisor liability.

3. Franchisor-Franchisee Relationships Under *Restatement Third* Section 2.05

Section 8b of the *Restatement Second* is embodied in section 2.05 of the *Restatement Third*.²²⁷ Although the language of section 2.05 looks as if it contains an internal inconsistency, it appears to operate in the same manner as section 8b.²²⁸ Therefore, courts applying section 2.05 in either the employer-employee or the franchisor-franchisee relationship should require evidence that the principal caused the third party to believe the other was his agent and that the third party justifiably and detrimentally changed position as a result of the belief.²²⁹ Applying the doctrine of agency by estoppel in both the employer-employee and franchisor-franchisee relationship would be a departure from precedent for most jurisdictions.²³⁰ However, the shift from perceived agency to agency by estoppel would prevent some of the abuse caused by plaintiffs seeking “deep pockets” to sue.²³¹

²²⁶ See *supra* notes 40-54 and accompanying text (describing the courts analysis to find a holding out by the defendant and justifiable reliance by the plaintiff).

²²⁷ RESTATEMENT (THIRD) OF AGENCY parallel tbls. at 482.

²²⁸ RESTATEMENT (THIRD) OF AGENCY § 2.05 begins with the opening clause:

A person who has not made a manifestation that an actor has authority as an agent and who is not otherwise liable as a party to a transaction purportedly done by the actor on that person’s account is subject to liability to a third party who justifiably is induced to make a detrimental change in position because the transaction is believed to be on the person’s account, if

(1) the person intentionally or carelessly caused such belief. . .

Id. The phrase “[a] person who has not made a manifestation that an actor has authority as an agent” is new to the Restatement’s section on estoppel. See RESTATEMENT (SECOND) OF AGENCY § 8b (1958). However, Section 2.05 (1) says the principle will be liable if the principal causes a belief in the third party that another is his agent. RESTATEMENT (SECOND) OF AGENCY § 2.05. Therefore, in order for Section 2.05 to apply, the principal must not make a manifestation that a person is an agent, but has to intentionally cause the third party to believe the agent has authority. This inconsistency becomes irreconcilable when examined in light of the *Restatement Third’s* expansive view of manifestation. RESTATEMENT (THIRD) OF AGENCY § 1.03.

²²⁹ See *supra* Part II.C.1.

²³⁰ See *supra* Parts II.A.2, II.C.1.

²³¹ Dilemma, *supra* note 193, at 192-94 (discussing the reasons asserted for expanding and limiting franchisor liability); King, *supra* note 161, at 465-84 (stating and discussing

376 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42]

As previously discussed, the difference between perceived agency and agency by estoppel is the level of reliance required by each of the doctrines. Of all the cases examined in this Note, only *Gasbarra* stated that it required agency by estoppel's detrimental reliance/change of position and went on to apply that standard to the facts.²³² In all the other cases, the record is generally lacking of any evidence that the plaintiffs changed position based on the appearance of an agency relationship.²³³

In *Miller v. McDonald*, there was evidence that the plaintiff had patronized the McDonald's restaurant in reliance on a reasonable expectation about the quality of service at McDonald's generally.²³⁴ However, there is no evidence that she would have chosen not to patronize the restaurant were she aware that McDonald's Corp. was not the owner. This lack of evidence of a true change of position would preclude a plaintiff from recovering from the defendant franchisor under the doctrine of agency by estoppel. Similarly, while the plaintiff in *Gizzi v. Texaco, Inc.* justifiably relied on the manifestations by Texaco that they owned the station where he bought his car, there is no evidence that the plaintiff would have chosen not to buy the car had he known the station was owned by someone other than Texaco.²³⁵

Overall, courts' adoption of perceived agency in both the employer-employee and franchisor-franchisee relationships has allowed more plaintiffs to recover from the perceived principal than would have under the doctrine of agency by estoppel.²³⁶ Further, while there are justifiable concerns about leaving a plaintiff without a remedy, courts should be wary of being too lenient in allowing plaintiffs to recover without

"Consistency and Predictability," "Modern Irrelevance of the Historical Underpinnings of Vicarious Liability," "Dilemmas of Franchisors," "Loss Prevention, Risk Reduction, and Incentives," "Loss Spreading," "Loss Allocation," "Corrective Justice," "Deep Pocket [Hunting]," "Administrative Costs," "Fairness," and "Autonomy and Freedom of Enterprise and to Contract" as reasons for limiting franchisor liability) (alteration in the original).

²³² See *supra* notes 148-52 and accompanying text.

²³³ See *supra* notes 32, 41 and accompanying text (discussing the cases *Miller v. McDonald's Corporation*, *Crinkley v. Holiday Inns Inc.*, *Gizzi v. Texaco Inc.* and *Billops v. Magness Constr. Co.*).

²³⁴ *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1113 (Or. Ct. App. 1997).

²³⁵ *Gizzi v. Texaco, Inc.*, 437 F.2d 308, 310 (3d Cir. 1971) (recounting Gizzi's testimony "[a]ppellant Gizzi testified that he was aware of the advertising engaged in by Texaco and that it had instilled in him a certain sense of confidence in the corporation and its products.").

²³⁶ See *supra* Part III.

establishing that they were injured by conduct of the “principal.”²³⁷ By not requiring detrimental reliance/change of position, courts allow plaintiffs to recover for conduct that they would have undertaken regardless of the manifestations by the “principal.” Therefore, the best way to promote the advantages that result when entities are allowed to work together, while protecting the consuming public, is to require plaintiffs to show detrimental reliance or change of position when asserting a claim under perceived agency and agency by estoppel.

IV. CONTRIBUTION

As discussed in Part II, courts have been inconsistent and confusing in applying the doctrines of perceived agency, agency by estoppel, and apparent authority.²³⁸ Due to the fact that courts consistently fail to differentiate between the doctrines, the law could be clarified by eliminating one or more of them. The question becomes, which doctrine should be eliminated?

Apparent authority should remain in tact because it applies to a vastly different situation than the other two doctrines.²³⁹ Therefore the courts’ interpretation aside, apparent authority is an independently important doctrine that serves an indispensable role in agency law. On the other hand, perceived agency and agency by estoppel cover roughly the same situation in agency law, and operate in the same way except for one respect.²⁴⁰ Furthermore, as discussed in Part III, the doctrine of agency by estoppel protects franchisors and employers by requiring the plaintiff to show reliance and a change position, typically forgoing the choice of the defendant’s competitor if they had known an agency relationship did not exist.²⁴¹ Consequently, this Note suggests removing the perceived agency language from the *Restatement Third* section 7.07 Comment f and expanding section 2.05 in order for agency by estoppel

²³⁷ Dilemma, *supra* note 193, at 193.

²³⁸ See *supra* Parts II.A.2 (perceived agency), II.C.1 (agency by estoppel), II.B.2 (apparent authority).

²³⁹ See *supra* Part II.B.2 (discussing that apparent authority only applies after an agency relationship has been established whereas the other two doctrines impose an agency relationship where one did not exist).

²⁴⁰ Compare Parts II.A.2 (discussing how perceived agency is used to confer liability in the absence of an agency relationship where a third party has justifiably relied on the appearance of an agency relationship), with Part II.C. (discussing how agency by estoppel has been used to confer liability in the absence of an agency relationship where a third party has justifiably relied on the appearance of an agency relationship and detrimentally changed position based on that reliance).

²⁴¹ See *supra* Part III.

378 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 42

to cover the situations which were previously addressed in the *Restatement Second* section 267.²⁴² These changes will streamline the law and help guide courts in applying agency by estoppel.

A. *Proposed Amendment to Restatement (Third) of Agency § 7.07 Comment f*
243

f. Definition of employee. For purposes of respondeat superior, an agent is an employee only when the principal controls or has the right to control the manner and means through which the agent performs work. The definition has the consequence of distinguishing between employees and agents who are not employees because they retain the right to control how they perform their work. If a person has no right to control an actor and exercises no control over the actor, the actor is not an agent. See § 1.01, Comment *f*(1).

The fact that an agent performs work gratuitously does not relieve a principal of vicarious liability when the principal controls or has the right to control the manner and means of the agent's performance of work.

~~A person who causes a third party to believe that an actor is the person's employee may be subject to liability to the third party for harm caused by the actor when the third party justifiably relies on the actor's skill or care and the actor's conduct, if that of an employee, would be within the scope of employment. For the general principle of estoppel, see § 2.05.~~

B. *Commentary*

This revision completely eliminates the *Restatement Second's* section 267 language from the *Restatement Third*.²⁴⁴ The elimination of perceived agency from the *Restatement Third* will have three main effects.²⁴⁵

First, eliminating this language will force courts to apply *Restatement Third* section 2.05 in cases where the plaintiff claims a principal is liable

²⁴² See *infra* Part IV.

²⁴³ The proposals are the contribution of the author. Specifically, the proposed deletions are struck out.

²⁴⁴ See *supra* notes 58-71 and accompanying text (discussing the *Restatement Third's* change of the perceived agency language and its possible impacts).

²⁴⁵ See *infra* note 247.

even though no agency relationship exists.²⁴⁶ Currently, the only ways to bind a principal when the requirements for an actual agency do not exist, as a matter of law, are to use perceived agency or agency by estoppel.²⁴⁷ The elimination of perceived agency forces courts, which choose to adopt the *Restatement Third*, to use agency by estoppel.

Secondly, this change would result in the creation of a uniform standard for imparting liability upon a principal despite the absence of an agency relationship.²⁴⁸ As previously discussed, a court's choice to apply either the *Restatement Second* section 8b or 267 changes the required level of reliance.²⁴⁹ Unlike perceived agency, agency by estoppel, as embodied in *Restatement Third* section 2.05, has a clearly articulated reliance standard—change of position, along with explanation of what fulfills that standard.²⁵⁰ Therefore, by eliminating perceived agency from the *Restatement Third* and promoting the use of agency by estoppel, courts will have clearer guidance for what level of reliance is required.²⁵¹

²⁴⁶ Compare Part II.A.2, with Part II.C.1.

²⁴⁷ See *supra* Parts II.A, II.C.

²⁴⁸ See *infra* notes 250-51.

²⁴⁹ See *supra* Part III.A (examining how under the *Restatement Second* § 267 justifiable reliance is required; however, under the *Restatement Second* Section 8b Detrimental Reliance is required).

²⁵⁰ RESTATEMENT (THIRD) OF AGENCY § 2.05 (2006):

§ 2.05 Estoppel To Deny Existence Of Agency Relationship

A person who has not made a manifestation that an actor has authority as an agent and who is not otherwise liable as a party to a transaction purportedly done by the actor on that person's account is subject to liability to a third party who justifiably is induced to make a *detrimental change in position* because the transaction is believed to be on the person's account, if

- (1) the person intentionally or carelessly caused such belief, or
- (2) having notice of such belief and that it might induce others to *change their positions*, the person did not take reasonable steps to notify them of the facts. . . .

b. *Terminology.* The doctrine in this section encompasses definitions of "ostensible authority" that hold a principal accountable for an appearance of authority arising solely from the principal's failure to use ordinary care. Some statutes and cases so define "ostensible authority," while others use it as a synonym for "apparent authority" as defined in § 2.03. "*Detrimental change of position*" means an expenditure of money or labor, an incurrence of a loss, or subjection to legal liability, not the loss of the benefit of a bargain.

Id. (emphasis added).

²⁵¹ See *supra* notes 250-51 and accompanying text.

The third effect of eliminating the perceived agency language from section 7.07 is to move the issue of holding individuals liable for the acts of another who is not his agent to the forefront of the Restatement. It appears that the drafters of the *Restatement Third* were making a concerted effort to consolidate sections of the *Restatement Second*.²⁵² In fact, section 7.07 incorporates all or part of thirty different sections from the *Restatement Second*.²⁵³ Undoubtedly, when trying to combine so many sections, priorities have to be set and certain concepts take a back seat to others. In the *Restatement Third*, perceived agency suffers that fate by being buried in Comment f of a section concerned with determining whether or not a person is acting within his scope of employment.²⁵⁴ This is not to say that questions about scope of employment and perceived agency are not related. However, as previously discussed, perceived agency has been used in contexts beyond the traditional scope of employment inquiries.²⁵⁵ Furthermore, including the doctrine of perceived agency within the *Restatement Third's* section on scope of employment makes little sense considering the questions each methodology tries to answer.

The purpose of section 7.07 is to define when an employer is liable for the tortious acts of an employee.²⁵⁶ In order to fulfill this purpose, section 7.07 presupposes an employment relationship because, without one, there is no scope of employment. However, this underlying assumption is what makes including the perceived agency language in section 7.07 problematic. The doctrine of perceived agency is a question of liability where no actual agency exists, but the purpose of section 7.07 is to answer a question that presumes an agency relationship. Because section 7.07 and the doctrine of perceived agency are attempting to answer greatly different questions, they are at odds with one another. However, eliminating the doctrine of perceived agency from the *Restatement Third* is not the only change that must be made in order to maintain continuity within the law of agency and specifically answer the question of when to hold people responsible for the acts of non-agents.

²⁵² RESTATEMENT (THIRD) OF AGENCY parallel tbls.

²⁵³ *Id.*

²⁵⁴ RESTATEMENT (THIRD) OF AGENCY § 7.07.

²⁵⁵ *See supra* Part III.A.2.

²⁵⁶ RESTATEMENT (THIRD) OF AGENCY § 7.07.

C. *Proposed Amendment to Restatement (Third) of Agency § 2.05*²⁵⁷

§ 2.05 Estoppel To Deny Existence Of Agency Relationship

A person ~~who has not made a manifestation that an actor has authority as an agent and~~ who is not otherwise liable as a party to a transaction purportedly done by the actor on that person's account is subject to liability to a third party who justifiably is induced to make a detrimental change in position ~~because the transaction is believed to be on the person's account,~~ if

(1) the person, *through manifestations to the third party, intentionally caused such belief,* or

(2) *the person, through lack of due care, carelessly caused such belief,* or

~~(2)~~(3) *having notice of such belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts.*

Comment: . . .

c. In general. The estoppel stated in this section protects third parties who justifiably rely on a belief that an actor is an agent and who act on that belief to their detriment. The doctrine is applicable when the person against whom estoppel is asserted has made no manifestation that an actor has authority as an agent but *because of manifestations or a lack of due care by the person* is responsible for the third party's belief that an actor is an agent and the third party has justifiably been induced by that belief to undergo a detrimental change in position. ~~Most often~~ *Many times* the person estopped will be responsible for the third party's erroneous belief as the consequence of a failure to use reasonable care, either to prevent circumstances that foreseeably led to the belief, or to correct the belief once on notice of it. . . .

d. Rationale. . . ~~Estoppel~~ *In cases where the third party's belief is caused by a lack of due care estoppel is analyzed with doctrinal elements similar to those*

²⁵⁷ The proposals are the contribution of the author. Specifically, the proposed insertions are in italics and the deletions are struck out.

applicable to a claim of negligent misrepresentation. See Restatement Second, Torts § 552. . . .

Illustrations.

1. Hospital H hires an independent firm F to manage the emergency room personnel. All doctors that work in the emergency room are independent contractors and not employees of H. T brings her daughter to the emergency room for care. B, an emergency room doctor, treats the girl negligently. Had T known the doctors in the emergency room were not employees of H she would have taken her daughter to another hospital. If it is found that H had notice that individuals using the emergency room believed the doctors were employees of H and H failed to correct those beliefs, H could be liable despite a lack of an agency relationship.

2. Same facts as 1, except that T would have used the emergency room no matter who the emergency room doctors worked for. H is not liable because T has not detrimentally changed position.

3. Franchisor M engages in a national advertising campaign to promote patronage to its franchisee's restaurant. M does not retain control over its franchisees although it offers suggestions and tips on how its franchisees may improve its business. Further, although M does not own the franchisee restaurants it does not require franchisee to notify customers in any way that the restaurant is not owned by M. Customer C, relying on a perceived uniformity of service and products at M restaurants, dines at a M restaurant which is franchised to K. C is burned by negligently produced coffee. C would not have dined at the restaurant if he had known it was not owned by M. M is liable because it held out to the public that M restaurants were a commonly owned enterprise and carelessly caused the belief that all M restaurants were owned by Franchisor M.

4. Same facts as 3, except that M requires all franchisees to prominently display signs that state the restaurant is not owned by Franchisor M. M is likely not liable because they have placed C on notice that they are not the principal of K.

5. *Same facts as 3, except that C would have eaten at the M restaurant even if he had known that it was actually owned by K. M is not liable since C did not detrimentally rely on M's holding out.*

D. Commentary

These revisions expand the scope and discussion of estoppel within the *Restatement Third*. In designing section 2.05, the drafters were guided by two principals. First, anytime estoppel and another section of the Restatement are applicable, estoppel is submissive and the other section is controlling.²⁵⁸ Second, given estoppel's submissive role in the *Restatement Third*, section 2.05 was drafted narrowly to avoid as much overlap with other sections as possible. As a result, section 2.05 and its illustrations are focused on situations where the principal has negligently caused the belief or negligently failed to correct a belief.²⁵⁹ However, if perceived agency was eliminated from the *Restatement Third* it would be necessary to expand the language of section 2.05 to include situations traditionally thought to fall under the doctrine of perceived agency.

The above revisions to section 2.05 expand the doctrine of agency by estoppel. The two illustrations are based on actual cases.²⁶⁰ The first illustration is based on *Gasbarra v. St. James Hospital*²⁶¹ and the second is based on *Miller v. McDonald's Corp.*²⁶² *Gasbarra* and *McDonald's Corp.* represent the two contexts in which perceived agency and/or agency by estoppel are most often used: employer-employee and franchisor-franchisee. These revisions will help courts accurately apply agency by estoppel in the future and allow the doctrine to fill the void in agency law created by removing perceived agency from the *Restatement Third*.

V. CONCLUSION

Although the doctrines of perceived agency and agency by estoppel operate in substantially the same manner, they differ in the level of reliance required to apply them. The law of agency could operate with only one of the doctrines, as they both apply to situations where a principal is somehow responsible for the beliefs of an innocent third

²⁵⁸ See *supra* notes 122-23 and accompanying text (stating that estoppel is a subservient doctrine to the other sections of the *Restatement Third*).

²⁵⁹ RESTATEMENT (THIRD) OF AGENCY § 2.05.

²⁶⁰ See *infra* notes 262-63.

²⁶¹ See generally *Gasbarra v. St. James Hosp.*, 406 N.E.2d 544 (Ill. App. Ct. 1980).

²⁶² See generally *Miller v. McDonald's Corp.*, 945 P.2d 1107 (Or. Ct. App. 1997).

party. As such, the doctrine of perceived agency should be eliminated from the *Restatement Third* and an expansive view of agency by estoppel should be adopted. Estoppel's clear requirement of detrimental reliance will aid courts that try to apply the doctrine and prevent plaintiffs from recovering for actions they would have taken regardless of the principal's manifestations or negligence. Furthermore, because estoppel is an equitable doctrine, courts may consider fairness to all parties in deciding whether to impose liability rather than following a formalistic rule that mandates liability if certain conditions are met. This freedom would allow courts to punish the most egregious defendants for their misrepresentations while giving businesses permission to experiment with different and new forms of business organizations which may have unforeseen consequences on their agency relationships.

Chad P. Wade²⁶³

²⁶³ J.D. Candidate, Valparaiso University School of Law (2008); B.A., Economics, University of Wisconsin—Eau Claire (2005). There are simply too many people I should thank to list them all, but I must mention a few. First, to Angela, thank you for inspiring me each day to be better at everything. Second, to my family, thank you all for encouraging me through this process and always supporting me in whatever path my life has taken. Last, I must thank Professor Telman for his guidance and suggestions through this process; Professor Morrisson for being a mentor and friend; Professor Kemp for teaching me to question; and Professor McAleer for teaching me to wonder. After completing this process I realize that “[i]f I have seen further it is because I stand upon the shoulders of giants.” Letter from Isaac Newton to Robert Hooke (February 5, 1675), <http://www.bartleby.com/66/18/41418.html>.