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THE PROPOSED ABOLITION OF INHERENT AGENCY AUTHORITY BY THE *RESTATEMENT (THIRD) OF AGENCY*: AN INCOMPLETE SOLUTION

Gregory Scott Crespi*

I. INTRODUCTION

Over the past five years the American Law Institute (“ALI”) has engaged in drafting a *Restatement (Third) of Agency* (“*Restatement (Third)*”),¹ which is intended to supersede the influential 1958 *Restatement (Second) of Agency* (“*Restatement (Second)*”).² As of May, 2004, five Tentative Drafts of the *Restatement (Third)* have been released,³ and an ALI-endorsed Official Draft is likely to soon follow.

One significant change proposed by the *Restatement (Third)* is a different specification of the sources of authority by which an agent can commit his principal to contractual ob-

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1. See RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 1, 2000) [hereinafter Tentative Draft No. 1]; RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 2, 2001) [hereinafter Tentative Draft No. 2]; RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 3, 2002) [hereinafter Tentative Draft No. 3]; RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 4, 2003) [hereinafter Tentative Draft No. 4]; RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 5, 2004) [hereinafter Tentative Draft No. 5]. The Reporter for this effort is Professor Deborah A. DeMott, David F. Cavers Professor of Law, Duke Law School.

2. RESTATEMENT (SECOND) OF AGENCY (1958) [hereinafter RESTATEMENT (SECOND)]. The Reporter for the *Restatement (Second)* was the prominent scholar Warren A. Seavey, who was generally regarded as the leading expert of his era on agency. Tentative Draft No. 1, *supra* note 1, at ix.

3. Tentative Draft No. 1, *supra* note 1; Tentative Draft No. 2, *supra* note 1; Tentative Draft No. 3, *supra* note 1; Tentative Draft No. 4, *supra* note 1; Tentative Draft No. 5, *supra* note 1.

ligations. Under the *Restatement (Second)* framework an agent, a person who has consented to act on behalf of and subject to the control of another person, labeled the principal,⁴ can contractually commit the principal if the agent possesses either the actual authority,⁵ apparent authority,⁶ or inherent authority sufficient to do so.⁷ A principal can also become contractually obligated as a result of unauthorized agent acts if the principal subsequently ratifies those acts.⁸

However, the *Restatement (Third)* in its present draft form does not incorporate the concept of inherent authority.⁹ Instead, it relies on the combination of an expanded definition of apparent authority and broadened estoppel doctrines to address the situations that now fall either within the scope of inherent authority or under estoppel doctrines¹⁰ under the *Restatement (Second)*.¹¹

The usefulness of the concept of inherent authority has been questioned by several scholars since the drafters of the *Restatement (Second)* first used the phrase.¹² The *Restate-*

4. RESTATEMENT (SECOND), *supra* note 2, § 1.

5. *Id.* § 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 manifestation of consent to him.")

6. *Id.* § 8 ("Apparent authority is the power to affect the legal relations of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestation to such third persons.")

7. *Id.* § 8A. The precise phrase used in section 8A is "inherent agency power," presumably to make it clear that this is a form of agency authority that does not stem from either the consent of or actions of the principal. *See id.*

8. *Id.* § 82 ("Ratification is the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him.")

9. Tentative Draft No. 1, *supra* note 1, at xvii ("[T]he doctrine of inherent agency power, stated in Restatement Second, Agency § 8A, is not used in this [Third] Restatement.")

10. The *Restatement (Second)* estoppel doctrine is presented in section 8B. RESTATEMENT (SECOND), *supra* note 2, § 8B.

11. Tentative Draft No. 2, *supra* note 1, at 105 ("[T]his Restatement, does not use the concept of inherent agency power. . . . Situations that inherent agency power is said to govern are covered herein by other doctrines . . .").

12. *See, e.g.,* J. DENNIS HYNES, AGENCY, PARTNERSHIP, AND THE LLC IN A NUTSHELL, at 137-41 (2d ed. 2001); Steven A. Fishman, *Inherent Agency Powers—Should Enterprise Liability Apply to Agents' Unauthorized Contracts?*, 19 RUTGERS L.J. 1 (1987). *But see* Edward Mearns, Jr., Comment, *Vicarious Liability for Agency Contracts*, 48 VA. L. REV. 50 (1962) (arguing in favor of utilizing inherent agency authority to impose respondeat superior liability on principals for contractual obligations).

ment (*Third*)s proposed abolition of inherent authority can be regarded as an attempt to address those scholars' concerns. However, the limited commentary that this proposal has generated in law reviews has been quite critical.¹³ These recent writers have argued that the elimination of inherent authority would muddle important conceptual distinctions,¹⁴ and the new *Restatement (Third)* framework will lead to different and inferior results when applied to situations now encompassed by inherent authority principles.¹⁵

I disagree with those critics and favor the *Restatement (Third)*s proposed abolition of inherent authority, although the proposal does have its shortcomings. The proposal definitely does not merit as harsh a reception as it has received in the law review literature, where it has been criticized too strongly and for the wrong reasons.

In this introduction, I will first briefly summarize my modest and hopefully constructive criticisms of the *Restatement (Third)* proposal and the harsh reactions to it.¹⁶ In the body of this article, I will then more fully elaborate my views.¹⁷ Finally, I will propose some suggested additions to the *Restatement (Third)*s comments and reporter's notes that would address my primary concern.¹⁸ My concern is that the *Restatement (Third)* proposal shares the problem of the existing *Restatement (Second)* framework in that it is also potentially susceptible to an interpretation that would extend broad, tort-like respondeat superior liability¹⁹ to the contractual context.²⁰

13. See Kornelia Dormire, Comment, *Inherent Agency Power: A Modest Proposal for the Restatement (Third) of Agency*, 5 J. SMALL & EMERGING BUS. L. 243 (2001); Matthew P. Ward, Note, *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).

14. Dormire, *supra* note 13, at 255-56.

15. Ward, *supra* note 13, at 1621-28.

16. See *infra* Parts II and III.

17. See *infra* Parts IV and V.

18. See *infra* Part VI.

19. This is the legal doctrine that holds "an employer or principal liable for the employee's or agent's wrongful acts committed within the scope of employment or agency." See BLACK'S LAW DICTIONARY 1313 (7th ed. 1999).

20. This article will not address any of the many other changes made by the proposed *Restatement (Third)* from the *Restatement (Second)*, such as its attempt to more systematically address the specific agency law concerns raised by the increased economic role played by corporations and large partnerships, and to condense the large number of different sections and take a broader and more

The five Tentative Drafts of the *Restatement (Third)* make it clear that one of the major motivations for abolishing inherent authority, as scholars have recognized, is that the courts have had difficulty ascertaining the conceptual boundary between apparent authority and inherent authority.²¹ This is particularly the case in those situations where a principal, without making any express representations of agent authority to third parties, has placed his agent in a position whose customary scope of authority exceeds the agent's actual authority. The *Restatement (Third)* proposal solves this difficulty by eliminating the inherent authority category, thus mooted the need for this inquiry as to whether apparent authority or instead inherent authority is the precise source of agent authority.

Unfortunately, the Tentative Drafts fail to explicitly address the other major motivating factor behind the calls for the elimination of inherent authority, namely the fear that courts may someday utilize the inherent authority concept to expand principal contractual liability for unauthorized agent transactions well beyond the traditional restrictions imposed on such liability, towards the outer limits of a sweeping, tort-like respondeat superior liability obligation.²² The expansion of respondeat superior liability principles to the contractual arena would be an inefficient and unwise step for the courts to take,²³ and the inherent authority doctrine could become

generalized approach, and to recognize the encroachment of statutes and administrative rulings upon areas traditionally governed by common law principles. See generally Deborah A. DeMott, *A Revised Prospectus for a Third Restatement of Agency*, 31 U.C. DAVIS L. REV. 1035 (1998) (discussing these objectives from the perspective of the *Restatement (Third)*'s Reporter).

21. See, e.g., Dormire, *supra* note 13, at 251; Fishman, *supra* note 12, at 24-36.

22. See, e.g., *Browne v. Maxfield*, 663 F. Supp. 1193, 1199 n.6 (E.D. Pa. 1987) (expressing concern, in dicta, that application of the inherent authority concept might lead to respondeat superior principles being applied to contractual issues arising under agency law); HYNES, *supra* note 12, at 141; Fishman, *supra* note 12, at 35, 47-56 (emphasizing this concern throughout the piece and offering recommendations intended to forestall this possibility). The *Restatement (Third)* Tentative Drafts are not explicit that this fear that respondeat superior principles might be applied to contractual issues is one of the primary rationales for the proposed abolition of inherent authority, but this seems plausible. See HYNES, *supra* note 12, at 141 (stating that respondeat superior concerns are "perhaps in part" the reason for the *Restatement (Third)*'s proposal to abolish inherent authority).

23. See, e.g., HYNES, *supra* note 12; Fishman, *supra* note 12, at 21-22, 47-56.

the vehicle whereby this was accomplished.²⁴ However, the *Restatement (Third)*'s proposed framework of expanded apparent authority and estoppel concepts, despite its other advantages, unfortunately appears to be as susceptible to use as a justification for respondeat superior liability results in the contractual context as is the *Restatement (Second)*'s existing inherent authority and estoppel framework. The *Restatement (Third)* proposal should be revised to address more directly and effectively this concern.

The critics of the *Restatement (Third)* proposal to abolish inherent authority, however, have focused on issues other than the potential for imposing respondeat superior liability in the contractual context, and have failed to make a convincing case either that the proposal has serious theoretical flaws or that it would lead to undesirable results in practice.²⁵ Contrary to what one of the major critics has argued, these new provisions do not appear to be any *less* precise or coherent than the inherent authority concept they would displace,²⁶ and as noted above, would have the advantage of eliminating the need for interpretive efforts at the boundary of apparent authority and inherent authority.²⁷ Moreover, if the *Restatement (Third)* framework is applied by the courts, as is discussed below this should not change the results regarding the extent of contractual liability found to exist in any of the significant factual contexts where inherent agency is now applied, despite claims to the contrary made by another major critic of the proposal.²⁸

My conclusion that I will develop below is that the *Restatement (Third)*'s proposal to abolish inherent authority

24. See generally Fishman, *supra* note 12, at 21-22, 47-56. The *Restatement (Second)* section 8B estoppel provision also has this potential, and this concern is not addressed by the *Restatement (Third)*. I will address this matter later in this article. See discussion *infra* Part III.B.

25. See *supra* notes 13-15 and accompanying text (corresponding to the discussions of Dormire and Ward).

26. See generally Dormire, *supra* note 13.

27. It should be recognized that this interpretive difficulty presented by the *Restatement (Second)* framework is really only a relatively minor problem, relative to the much more significant problem of potential respondeat superior liability, because it affects only the rationale of the judicial rulings finding agent authority to exist and not their holdings, except to the limited extent that these issues arise with regard to "special" agents who have very limited inherent authority. See *infra* note 49.

28. See generally Ward, *supra* note 13.

stands up quite well to the specific criticisms it has received since it was first made available for public comment. But if the inherent authority or estoppel doctrines of the *Restatement (Second)* are ever used by the courts as the basis to expand principal contractual liability to the respondeat superior outer limits,²⁹ this use would raise very significant concerns, and my major criticism of the *Restatement (Third)* proposal is that it still leaves open the potential for such an expansion of contractual liability under other rubrics. I therefore recommend that the ALI engage in at least one further revision of the *Restatement (Third)* proposal. I believe that this problem can be adequately addressed without revising any of the proposed black-letter sections; all that is needed are more explicit comments and Reporter's notes for some of the proposed sections that would more clearly eliminate respondeat superior theories of contractual liability.

The remainder of this article proceeds in the following manner. Part II of the article briefly summarizes and discusses the current *Restatement (Second)* framework of actual, apparent, and inherent authority concepts, and its relation to broader estoppel doctrines.³⁰ Part III describes and discusses several important criticisms of the *Restatement (Second)* inherent authority concept.³¹ Part IV then introduces the *Restatement (Third)*'s proposal to abolish inherent authority.³² Part V follows with a presentation and discussion of various criticisms of this proposal.³³ Part VI provides my overall assessment of the proposal, and offers a number of suggestions for the inclusion of additional comments and Reporter's notes that will better address the concerns that I and others have raised.³⁴

II. THE *RESTATEMENT (SECOND)* INHERENT AUTHORITY CONCEPT

The *Restatement (Second)* contains a number of related

29. While no clear trend in this direction now exists, there are a few cases and some commentary, which I will later discuss that suggest that this remains a plausible possibility. See Fishman, *supra* note 12, at 39.

30. See discussion *infra* Part II.

31. See discussion *infra* Part III.

32. See discussion *infra* Part IV.

33. See discussion *infra* Part V.

34. See discussion *infra* Part VI.

sections that together define three distinct sources of authority under which an agent can commit his principal to contractual liability: actual authority, apparent authority, and inherent authority.³⁵ In addition there is a section which may impose contractual liability on a principal, on the basis of estoppel, for certain unauthorized transactions done by an agent for his principal's account.³⁶

Section 7 of the *Restatement (Second)* first defines the authority of an agent as "the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestation of consent to him."³⁷ Such authority based upon consent by the principal is commonly referred to as "actual authority," though that exact phrase is not used by the *Restatement (Second)*. The term "actual authority" also includes what is commonly referred to as "implied authority," which is the incidental authority necessary to accomplish the objectives the principal seeks to obtain through the authority expressly granted.³⁸

"Apparent authority," in contrast, is defined by section 8 as "the power to affect the legal relations of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestations to such third persons."³⁹ Section 8A then defines "inherent agency power" to be "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."⁴⁰

There is a well-known line of English and American cases, going back more than a century, which holds principals contractually liable on the basis of the actions of their agents even where no actual authority exists for the transaction at issue, and no express representations of agent authority have

35. RESTATEMENT (SECOND), *supra* note 2, §§ 3, 7, 8, 8A, 27, 161, 194, 195.

36. *Id.* § 8B.

37. *Id.* § 7.

38. *Id.* § 7 cmt. c. Comment c. notes that "implied authority" are those powers "implied or inferred from the words used, from "customs and from the relations of the parties." *Id.*

39. *Id.* § 8.

40. *Id.* § 8A. Note that inherent authority is defined as not overlapping apparent authority, a point that is misunderstood by Matthew Ward in his critique of the *Restatement (Third)* proposal. See discussion *infra* Part V.B.

been made by the principal to the third parties involved in the transaction that are sufficient to create apparent authority, and where imposition of liability based on estoppel is not justified.⁴¹ In response to the perceived need to explain and justify the results reached in those cases, the drafters of the *Restatement (First) of Agency of 1933* ("*Restatement (First)*") included in section 140 as bases for agent authority not only actual and apparent authority, but also the (not there specifically named) "power arising from the agency relationship and not dependent upon authority or apparent authority."⁴² The *Restatement (Second)* drafters attempted to further legitimate this basis for authority by naming it "inherent authority,"⁴³ and elaborated upon its contours a bit more fully in section 8A as a power "derived . . . solely from the agency relation,"⁴⁴ and in comments to that section.⁴⁵

The "derived . . . solely from the agency relation" language of section 8A is quite vague, but its meaning is made somewhat more clear by the comments. Comment a. identifies two rationales for the inherent authority concept; 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.⁴⁶ In accordance with the objective of promoting commercial convenience, comment a. makes clear that while the primary intended beneficiaries of the inherent authority concept are the third parties who deal with

41. The best-known of these cases are *Kidd v. Thomas A. Edison Inc.*, 239 F. 405 (S.D.N.Y. 1917), *aff'd* 242 F. 923 (2d Cir. 1917); *Thurber v. Anderson*, 88 Ill. 167 (1878); and *Wateau v. Fenwick*, 1 Q.B. 346 (1892). These cases are discussed extensively and approvingly in the literature. See, e.g., Dormire, *supra* note 13, at 247-50; Fishman, *supra* note 12, at 9-13; Mearns, *supra* note 12, at 54-55; Ward, *supra* note 13, at 1605-10, 1628-30.

42. RESTATEMENT (FIRST) OF AGENCY § 140 (1933) [hereinafter RESTATEMENT (FIRST)]. See Fishman, *supra* note 12, at 15. The Reporter for the *Restatement (First) of Agency* ("*Restatement (First)*") was the noted scholar Floyd R. Mechem, who was generally regarded as the leading expert of his era on agency law. Tentative Draft No. 1, *supra* note 1, at ix.

43. WARREN A. SEAVEY, HANDBOOK OF THE LAW OF AGENCY 17 (1964) ("The facile use of 'apparent authority' . . . conceal[s] the gradual expansion of the liability of masters and other principals. Perhaps now that a name has been given to the [inherent agency] power it will be recognized more readily.")

44. RESTATEMENT (SECOND), *supra* note 2, § 8A.

45. *Id.* § 8A cmts. a-c.

46. *Id.* § 8A cmt. a. See also Dormire, *supra* note 13, at 247; Fishman, *supra* note 12, at 17-18.

the agent,⁴⁷ the concept of inherent authority also is intended to benefit “the business world and hence [be] to the advantage of employers as a class”⁴⁸ because it allows persons who deal with their employees to rely upon the fact that those employees will have agency powers of the usual scope. Section 8A is not limited in application to any particular type of agency relationship, and therefore applies broadly to both “general” and “special” agency relationships.⁴⁹

There are several other relevant sections of the *Restatement (First)*—specifically sections 161, 194 and 195—that were carried forward both in their numbering and in their content by the *Restatement (Second)*.⁵⁰ These sections further explain the nature and extent of inherent agency authority, though they are by no means models of clarity as to their scope of application and taken as a group may not exhaust the possibilities for the creation of inherent authority under section 8A.⁵¹ Section 161 more specifically confers inherent authority upon general agents who are acting for fully or partially disclosed principals when they enter their principal into contracts through acts which “usually accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, the other party reasonably believes that the agent is authorized to do them and has no notice that he is not so authorized.”⁵² This provision appears to specify the extent of inherent authority in those situations where a partially or fully disclosed principal creates inherent authority solely by putting a gen-

47. RESTATEMENT (SECOND), *supra* note 2, § 8A cmt. a.

48. *Id.*

49. See RESTATEMENT (SECOND), *supra* note 2, § 3. The *Restatement (Second)* section 3(1) defines a “general agent” as “an agent authorized to conduct a series of transactions involving a continuity of service,” and section 3(2) defines a “special agent” as “an agent authorized to conduct a single transaction or a series of transactions not involving continuity of service.” *Id.*

50. *Id.* §§ 161, 194, 195. However, the comments to section 161 were stated more broadly in the *Restatement (Second)* with regard to the relative importance of the goal of promoting commercial convenience than they were in the *Restatement (First)*. See Fishman, *supra* note 12, at 17 n.90.

51. See, e.g., *Croissant v. Watrud*, 432 P.2d 799 (Or. 1967).

52. RESTATEMENT (SECOND), *supra* note 2, § 161. Section 161 is based upon the result reached in the classic case of *Thurber v. Anderson*. See *Thurber v. Anderson*, 88 Ill. 167 (1878). Comment h. to section 161 makes clear that special agents may also have inherent authority powers, but to a much more limited extent than general agents. See RESTATEMENT (SECOND), *supra* note 2, § 161 cmt. h.

eral agent into a position which reasonably suggests to third parties some customary scope of agency authority and without the principal making any express representations of the scope of agent authority to those third parties.⁵³

Section 194, in more specific terms, confers some inherent authority upon general agents acting on behalf of undisclosed principals, when those agents are actually authorized by their principal to enter into some transactions, or when they enter their principal into contracts through acts "usual or necessary in such [actually authorized] transactions, although forbidden by the principal to do them."⁵⁴

Section 195 confers some inherent authority on any kind of agent, general or special, who is acting on behalf of an undisclosed principal when that agent is entrusted to manage the business of his principal and the agent then enters his principal into a contract "usual in such businesses and on the principal's account, although contrary to the direction of the principal."⁵⁵ These latter two sections can also be regarded as providing guidance for finding inherent authority to exist, and for defining its scope to include customary transactions in circumstances where an agent is placed in a position that does not involve the express representation of agent authority by the principal to third persons, as does section 161, rather applicable only to undisclosed principal situations.⁵⁶

Finally, section 8B of the *Restatement (Second)*, under several different circumstances listed, holds a principal liable on the basis of estoppel for unauthorized agent transactions with third parties who believed that those transactions had

53. Fishman, *supra* note 12, at 18 n.97. *But see* RESTATEMENT (SECOND), *supra* note 2, §§ 27, 27 cmt. a. Section 27 is a little-known and rarely cited provision that suggests that the act of a principal placing an agent into a position of customary authority creates to that extent apparent rather than inherent authority, thereby contradicting the thrust of section 161.

54. RESTATEMENT (SECOND), *supra* note 2, § 194. Section 194 is based upon the result reached in the classic case of *Watteau v. Fenwick*. *See* *Watteau v. Fenwick*, 1 Q.B. 346, 346-49 (1892).

55. RESTATEMENT (SECOND), *supra* note 2, § 195. Section 195 also addresses the situation that arose in the classic case of *Watteau v. Fenwick*. *See* *Watteau*, 1 Q.B. at 346-49. Special agents entrusted with a business have much more limited inherent agency powers. *See also* RESTATEMENT (SECOND), *supra* note 2, § 195A.

56. *See* RESTATEMENT (SECOND), *supra* note 2, §§ 161, 194, 195. *But see* *supra* note 53.

been authorized by the principal.⁵⁷ The broadest and most significant situations addressed by section 8B are when the principal, without either conferring actual authority on the agent to enter the principal into a particular transaction, or making a manifestation to third parties sufficient to create apparent authority that covers such a transaction, and under circumstances that do not justify finding inherent authority to exist, either intentionally or carelessly causes a belief to be formed by the third party that such authority exists on the part of the agent, or at least knows of the belief and does not take reasonable measures to correct the situation.⁵⁸

Let me briefly summarize the import of these numerous related *Restatement (Second)* provisions, which operate together in a complex, comprehensive and not entirely consistent fashion. The scope of an agent's actual authority to contractually commit his principal is defined by what authority the principal has directly conferred on the agent.⁵⁹ The scope of an agent's apparent authority, if any, with respect to a particular third party is defined by the nature of the "manifestation" of agent authority that has been made by the principal to that third party. The existence of apparent authority is mooted if the manifestation of agency authority made by the principal to that third party is no broader than the scope of the agent's actual authority. However, where such manifestation of authority exceeds the scope of the agent's actual authority then the additional apparent authority thereby conferred can be legally significant as an independent basis for imposing contractual liability.

The scope of an agent's inherent authority begins where actual and apparent authority taken together leave off,⁶⁰ and extends to include that additional authority that is necessary to protect the interests of persons dealing with the agent, or

57. RESTATEMENT (SECOND), *supra* note 2, § 8B.

58. *Id.*

59. This actual authority would also include the "implied" authority incidental to carrying out those actually authorized transactions. In other words, "implied" authority differs from apparent authority or inherent authority in that it is an aspect of authority that is actually conferred by the principal upon the agent. *See* discussion *supra* Part II.

60. RESTATEMENT (SECOND), *supra* note 2, § 8A ("Inherent agency authority is a term used . . . to indicate the power of an agent which is derived *not from authority, apparent authority or estoppel*, but solely from the agency relation" (emphasis added)).

to promote general commercial convenience, but does not include any contractual liability that might be imposed on the principal based on an estoppel theory.⁶¹ Therefore, for situations falling into the zone defined at one extreme by the border of an agent's actual authority or apparent authority, and at the other extreme by the outer extent of inherent authority, the inherent authority concept is to be used to determine if principal contractual liability exists for the transactions at issue. Outside of that zone of inherent authority are actual authority and apparent authority situations, and the various estoppel-based liability situations, and of course the many circumstances where a principal is not held contractually liable on the basis of actions taken by his agent.

Those are the general contours of the inherent authority concept, but the *Restatement (Second)* at sections 161, 194 and 195 also gives somewhat more precise guidance concerning the existence and scope of inherent authority in certain commonly-recurring circumstances where a principal places his agent in a position to enter into certain transactions, but does not confer the actual authority for the agent to enter the principal into those transactions, nor make representations of such authority to third parties.⁶² In those specific situations where the other party to a contract knows that a general agent is acting as an agent for a fully or partially disclosed principal, the scope of the agent's inherent authority will extend to include those transactions outside of the scope of actual authority that the other party reasonably (though erroneously) believes are within the actual authority of the agent, solely on account of the nature of the agent's position.⁶³

Likewise, in those specific situations where the principal is undisclosed, and the third party consequently is not aware that a general agent is acting as an agent rather than on his own behalf, the scope of the agent's inherent authority will

61. *See id.* § 8B. Where no actual, apparent or inherent authority exists, but where a third party erroneously believes that an agent has sufficient authority to enter into the transaction at issue either for a principal or for his own account, and that belief is intentionally or carelessly caused by the principal, or where the principal knows of the belief and does not take steps to correct it, then principal contractual liability will exist under the estoppel provision of section 8B for transactions within that zone of authority defined by the scope of that belief. *See id.*

62. *See id.* §§ 161, 194, 195. *But see supra* note 53.

63. RESTATEMENT (SECOND), *supra* note 2, § 161.

extend to include those transactions that are usual in such businesses as the agent is operating on behalf of the undisclosed principal, since the other party will reasonably (though erroneously) believe they are being done by the agent for his own account.⁶⁴

When either a general or a special agent is managing the business of an undisclosed principal, the scope of the agent's inherent authority will extend to include those transactions outside the scope of the agent's actual authority but nevertheless usual for that sort of business, for the same reasons.⁶⁵

Finally, under an estoppel theory a principal may even be held liable for agent transactions lacking any form of authorization at all, on an estoppel basis, under those circumstances where the principal bears some responsibility for the third party's reasonable (though erroneous) belief that the transaction was in fact authorized by the principal, or was done by the agent for his own account, or when the principal knows of the belief and does not take any efforts to correct it.⁶⁶

III. CRITICISMS OF THE *RESTATEMENT (SECOND)* INHERENT AUTHORITY CONCEPT

Let me now summarize and discuss the major criticisms of the *Restatement (Second)*'s inherent authority and estoppel framework which have previously been offered in the law review literature. In my opinion the definitive critique of the *Restatement (Second)*'s inherent authority concept is Steven Fishman's comprehensive 1987 *Rutgers Law Journal* article.⁶⁷ Several other writers have offered some limited comments regarding the inherent authority concept.⁶⁸ Fishman's article, however, is the only sustained assessment of the evolution and operation of this aspect of the *Restatement (Second)*. The other literature critiquing the inherent authority concept offers no additional criticisms not presented by Fishman, nor presents nearly as fully developed an analysis. Therefore, I will first address Fishman's work, and then offer some addi-

64. *Id.* § 194.

65. *Id.* § 195.

66. *Id.* § 8B.

67. Fishman, *supra* note 12.

68. See, e.g., HYNES, *supra* note 12; Aaron Lipson, *Whose Fool Is It Anyway: Updating Apparent Authority for Today's Business World*, 33 GA. L. REV. 1219 (1999); Mearns, *supra* note 12.

tional and related criticisms of the *Restatement (Second)* that go beyond Fishman's arguments.

A. *The Fishman Critique of Inherent Authority*

Fishman's primary contention is that section 8A, comment a.'s emphasis on the "underlying purposes of promoting fairness and commercial convenience and the parallel between inherent agency power and vicarious liability of masters for the torts of their servants"⁶⁹ suggests that the drafters of the *Restatement (Second)* may have intended "to expand the liability of a principal for unauthorized contracts . . . even though the substantive language of the [*Restatement (First)*] sections is unchanged."⁷⁰ In Fishman's view, such an expansion of liability is undesirable. He believes that the apparent authority jurisprudence that existed prior to the promulgation of the *Restatement (Second)* on the whole properly balanced the competing interests of principals and third parties in situations where actual authority was absent.⁷¹ Fishman argues that the *Restatement (Second)*'s inherent authority concept was "designed to increase the impact of inherent agency power,"⁷² and consequently has the potential to disturb that balance by leading to judicial importation of the expansive respondeat superior liability concepts that have been developed and applied in the tort context into the contractual arena, thereby unduly favoring the interests of third parties

69. Fishman, *supra* note 12, at 17-18. See also *id.* at 22 ("The comments to the Second Restatement state that '[t]he basis of the extended liability stated in . . . [section 161] is comparable to the liability of a master for the torts of his servant.") (citing RESTATEMENT (SECOND), *supra* note 2, § 161 cmt. a.).

70. *Id.* at 18. See also SEAVEY, *supra* note 39, at 16 ("These inherent agency powers have been created by the courts in accordance with what they believed to be for the benefit of the entire community."). Seavey also notes that "[t]he extension of liability upon contracts to cases in which there is neither authority nor apparent authority reacts ultimately to the benefit of the business community, in that it tends to facilitate business transactions, now almost entirely conducted by agents." *Id.*

71. Fishman, *supra* note 12, at 34 ("This interpretation emphasizes the protection of the third party as the key to inherent agency power and thus ignores the balancing between the obligations of the principal and the third party, which is a major part of traditional agency principles."). Fishman also notes that "[i]t can be argued that the drafters of the Restatement (Second) intended this result, even though the operative language of the sections did not go this far." *Id.* at 34 n.161.

72. *Id.* at 17.

over those of principals in such situations.⁷³

It is apparent in reading Fishman's article that he was reacting very strongly against what he regarded as unduly expansive comments to the *Restatement (Second)*, and against a brief but provocative 1962 Virginia Law Review article by Edward Mearns.⁷⁴ Mearns argued that under the *Restatement (Second)*, respondeat superior liability should be broadly applied under the inherent authority concept to hold principals liable for all agent acts, contractual as well as tortious, that are "within the scope of the agent's agency power."⁷⁵ Fishman regards Mearns's article as advocating the use of an expansive respondeat superior liability criterion in contractual contexts that was "substantially the same as the rule applied to determine the tort liability of masters."⁷⁶ Fishman was very concerned that this interpretation of the inherent authority concept would fail to "maintain a balance between the losses borne by the principal and the third party,"⁷⁷ which resulted from agent contractual transactions lacking actual authority. Fishman argued strenuously throughout his article that this interpretation failed to recognize the important distinction between consensual contracting parties and non-consensual tort victims that made respondeat superior liability an often inefficient⁷⁸ and generally unwise doctrine to apply to contractual liability issues.⁷⁹

It is possible, however, to read Mearns's article more narrowly as advocating an interpretation of inherent authority that falls well short of imposing respondeat superior liability upon principals for all unauthorized agent contracts. Mearns does state that since the *Restatement (Second)* has now provided courts with the concept of inherent authority, the next logical step for the courts "is to make contracts follow the path of torts . . . [by] recogniz[ing] that the principal's liability

73. *See id.* at 34.

74. Mearns, *supra* note 12.

75. Fishman, *supra* note 12, at 23.

76. *Id.* at 23. *See also id.* at 2-3 ("Some scholars have argued that the principal should be held liable for unauthorized contracts on an 'enterprise liability' theory comparable to a master's liability for unauthorized torts of its servants under the doctrine of respondeat superior.") (citing Mearns, *supra* note 12, at 56-57).

77. *Id.* at 23.

78. *Id.* at 21-22, 49-53.

79. *Id.* at 47-56.

in contracts, as in tort, should be vicarious.”⁸⁰ However, Mearns then qualifies his position significantly by calling for the development of a complementary limiting principle—closely analogous to the “scope of employment” limitation on respondeat superior liability in the tort context—to prevent an undue expansion of contractual liability.⁸¹ He offers the limiting language “scope of the agent’s power” as a first attempt to formulate such an appropriate restriction.⁸²

Fishman did not specifically discuss this limitation that was proposed by Mearns, and likely was of the opinion that such a limitation would not prove to be an effective constraint if the *Restatement (Second)* inherent authority concept was understood to impose the general principle of vicarious liability in the contractual area.

Fishman concludes his article with a call for abolishing the concept of inherent authority, and in its place relying on a much broader definition of what conduct by a principal would constitute a “manifestation” sufficient to create apparent authority.⁸³ The expansion of the definition of “manifestation” that Fishman calls for is to regard the simple placing of an agent into a position by the principal without more as a “manifestation” of authority sufficient to confer upon that agent the apparent authority to enter the principal into transactions with third parties that are customary for an agent of that sort, even where the existence of a principal is undisclosed.⁸⁴ He also argues that this expansive definition of

80. Mearns, *supra* note 12, at 51.

81. *Id.*

82. *See id.*

83. Fishman, *supra* note 12, at 46. Fishman suggested that the approach taken in his article:

[W]hile somewhat imprecise, has the advantage of retaining the terminology of apparent authority and being consistent with the way courts are presently dealing with the issues. It is not a change in the existing doctrine. Instead, the approach expressly acknowledges the expansion of the term “manifestation” which has been implicitly adopted by the court. It expressly retains the traditional balance between the principal’s interests and the third party’s interests as reflected in the doctrine of apparent authority. As a result of the confusion reflected in the application of inherent agency power, the approach suggested in this article seems to be more desirable.

Id. at 46.

84. *Id.* at 13. Fishman also considers:

[W]hether cases of this nature [the classic inherent authority cases] can be decided legitimately without resort to inherent agency power. It is

the term "manifestation is sufficiently close to a common sense meaning of the term so that application should not be difficult for the courts,"⁸⁵ and that this approach is consistent with existing court practice.⁸⁶ He recognizes that such a broad definition of "manifestation" is not without some significant conceptual problems,⁸⁷ but regards those problems as much less serious than the potential harm that could be created by a respondeat superior interpretation of the inherent authority concept. Fishman also notes that under his approach it would no longer be necessary for courts to make the often difficult distinction between general and special agents that is commonly necessary under the current *Restatement (Second)* provisions to apply the inherent authority concept.⁸⁸

Fishman, to his credit, did concede that his comprehensive review of the inherent authority cases, decided in the almost thirty years that had by then elapsed since the promulgation of the *Restatement (Second)*, did not indicate that the courts were using the doctrine to extend principal liability for unauthorized transactions on a tort-like respondeat superior basis. This is contrary to what he believed the more expansive *Restatement (Second)* comments and Mearns had advocated.⁸⁹ However, he remained concerned that if the inherent

possible to explain each of these cases based on apparent authority if the requirement that the principal make a manifestation to the third party is not interpreted technically. In cases involving both disclosed and undisclosed principals, placing the agent in a position where he appears to have certain authority could be viewed as a manifestation by the principal to each person dealing with that agent that he has the customary authority of a person in a similar position to the agent.

Id. at 13.

85. *Id.* at 14.

86. *Id.* at 14 n.74, 41-42.

87. *Id.* at 42-43. Fishman notes, for example, that regarding the placing of an agent in a position as a "manifestation" of authority sufficient to create apparent authority, while not similarly regarding the limitations placed on the agent's authority by the principal as part of the same "manifestation," may lead to difficulties for courts determining the limits of the broader manifestation concept he advocates. He also notes there may be conceptual difficulties in regarding the placing of an agent into a position by an undisclosed principal as a "manifestation" of authority sufficient to create apparent authority when the third parties who contract with the agent are not even aware the agent is acting as an agent rather than on his own account. *See id.*

88. *Id.* at 44-45.

89. Fishman, *supra* note 12, at 39 ("[T]he application of inherent agency power does not appear to have increased the burden on the principal for losses resulting from the unauthorized acts of agents.").

authority concept remained viable it could possibly serve as the basis for an unduly expansive imposition of contractual liability on a respondeat superior basis.⁹⁰ Therefore, he argued that it would be prudent to replace inherent authority with expanded apparent authority based upon a very broad yet manageable and appropriately constrained definition of what constituted a "manifestation" of authority by a principal.⁹¹

B. Additional Critiques of the Inherent Authority Concept

Let me now offer some additional criticisms of the *Restatement (Second)* framework which were not the focus of Fishman's article. The inherent authority concept operates within a zone bounded at one extreme by actual or apparent authority, and at the other extreme by the limits of inherent authority.⁹² The breadth of this zone of inherent authority is unclear because courts have found each of these borders difficult to locate.

First, regarding the border between apparent authority and inherent authority, courts have grappled inconsistently with classifying the situation where a principal places a general agent into a position with a customary scope of authority that exceeds the agent's actual authority.⁹³ Courts have had difficulty deciding whether this is best regarded as an implicit manifestation through conduct of agent authority of customary scope, sufficient to create apparent authority for transactions within that scope under section 8, or whether merely placing an agent in a position with a customary scope of authority is not such a "manifestation," but instead an act that gives rise to inherent authority for transactions within that customary scope under section 8A in order to protect third

90. *Id.* ("[A few] cases . . . have suggested a more expansive interpretation of inherent agency power and thus plant the seeds for a more expansive interpretation of the doctrine."). See *Croissant v. Watrud*, 432 P.2d 799 (Or. 1967) (having potential respondeat superior implications); discussion *infra* Part V.B.1. However, I was not able to locate any opinions decided since the publication of Fishman's article that embraced respondeat superior liability in the contractual context, and there is at least one recent case which in dicta cautions against such an expansive interpretation of the scope of inherent authority. See *Browne v. Maxfield*, 663 F. Supp. 1199, 1199 n.6 (E.D. Pa. 1987).

91. See Fishman, *supra* note 12, at 56-57.

92. See discussion *supra* Part II.

93. Fishman, *supra* note 12, at 44.

parties who reasonably expect the agent to have customary authority and in order to promote commercial convenience.

The *Restatement (Second)* does not provide clear and consistent guidance on this question. The term "manifestation" used in the section 8 apparent authority definition is not defined in the *Restatement (Second)*. Sections 161, 194 and 195, as discussed above, all suggest, although not explicitly, that placement of a general agent into a position of customary authority should be regarded as creating inherent rather than apparent authority, and that apparent authority should require a more express manifestation of authority by the principal to the third party.⁹⁴ However, section 27 and its accompanying comment a. suggest the contrary position that merely placing an agent into a position of customary authority is sufficient to create apparent authority.⁹⁵ In addition, sections 161 and 194 are expressly limited in their scope as to general agents, perhaps suggesting that the placement of a special agent into a position of customary authority should be regarded as creating apparent rather than inherent authority.

The *Restatement (Second)* is unclear as to what type of agency authority is created when an agent is placed in a position of customary authority that exceeds his actual authority. The *Restatement (Third)*'s proposed abolition of inherent authority resolves this problem. However, regardless of whether the perceived basis of agent authority is apparent authority or inherent authority, the result under the *Restatement (Second)* is the same: the principal will be held contractually liable for the transactions performed by the agent on the principal's behalf within the customary scope of authority for the agent's position.⁹⁶ This ambiguity in the *Restatement (Second)* agency authority framework, while leading to an untidy jurisprudence as to the rationale for imposing liability, has not affected the results of the cases.

94. RESTATEMENT (SECOND), *supra* note 2, §§ 161, 194, 195. *See also* SEAVEY, *supra* note 39, at 16 ("There is neither estoppel nor apparent authority present . . . where a general agent, disclosing his principal, deals with a third person who knows nothing of his authority, and binds his principal by an unauthorized contract."). This quotation paraphrases the position taken by the *Restatement (Second)* Reporter, Warren Seavey. *See id.*

95. *See supra* note 53.

96. One exception possibly is under circumstances where the agent is merely a special agent.

At the other border of the zone of inherent authority, under section 8A and the supporting comments, inherent authority extends only as far as is necessary to fairly protect third persons dealing with the agent and to promote commercial convenience.⁹⁷ Beyond that point, a principal will only be held contractually liable on an estoppel theory, if at all. Fishman's concern is that under the *Restatement (Second)* inherent authority might some day be interpreted broadly to incorporate respondeat superior liability. This concern may be overblown. The courts may continue to extend inherent authority only as far as the customary authority associated with the agent position at issue, since that is all that is specifically called for by sections 161, 194, and 195, and this appears to be a sufficient extension to fairly protect the reasonable expectations of third parties who are aware of the customs involved. It must be conceded, however, that Fishman has made a strong argument that the alternative "commercial convenience" rationale for inherent authority stated by the comments to section 8A could conceivably be invoked to read this section more broadly as calling for further extension of liability on a respondeat superior basis beyond what may be the customary expectations of third parties.

Finally, there is an even more plausible doctrinal basis existing under the *Restatement (Second)* for the incorporation of respondeat superior liability into the contractual context that was not addressed by Fishman. This doctrinal basis is the section 8B estoppel provision, which is partially limited in scope by the combined inherent authority-creating effects of sections 8A, 161, 194, and 195.⁹⁸ Under the *Restatement (Second)* framework, the line here is apparently to be drawn between those situations where the principal has without more simply placed an agent in a position having a customary scope of authority, thus creating inherent authority to that extent,⁹⁹ and those situations where the principal has in some manner gone beyond placing his agent in this position, so as

97. This section would arguably extend only as far as the customary authority given agents who hold the position. The broader definition of "manifestation" discussed above in the text would effectively eliminate inherent agency authority as a meaningful concept.

98. RESTATEMENT (SECOND), *supra* note 2, §§ 8A, 8B (limiting liability to when a person is "not otherwise liable"), 161, 194, 195.

99. Or, for those courts who interpret the "manifestation" term of the *Restatement (Second)* broadly, thus creating apparent authority to that extent.

to intentionally or carelessly lead a third party to believe that the agent had greater authority than this, or at least knew of this erroneous belief on the part of the third party and did not take steps to correct it, thus justifying imposing contractual liability on a principal on an estoppel basis.

It is clear that section 8B applies to situations where the principal learns, or should reasonably have come to learn, that his agent is purporting to a third party to have authority which goes beyond any actual, apparent, or inherent authority that exists, or where the principal learns of these false representations but does not take any action to correct the situation.¹⁰⁰ However, it is less clear how to apply section 8B to the simple "placing an agent into a position of customary authority" situations. Under these circumstances, the agent presumably has under section 8A inherent authority to the extent of the customary authority associated with the position, but no more.¹⁰¹ It is unclear whether the principal would then potentially be liable for agent transactions which go beyond the scope of this customary authority, on the basis that he intentionally placed the agent in this position, and thereby caused the particular third party involved to somehow come to believe that the principal would be obligated by all agent transactions, or at the least knew of such erroneous belief. Therefore third party beliefs as to principal liability for transactions exceeding customary authority may be regarded as unjustified beliefs not worthy of legal protection by estoppel or otherwise.

The haziness of the boundaries of section 8B in my opinion poses as serious a concern for the possible extension of respondeat superior liability into the contractual context as does the potential broad reading of section 8A inherent authority that Fishman fears. Given the history of result-oriented applications of estoppel doctrines in contract law,¹⁰² it would seem that estoppel is a likely vehicle whereby respondeat superior doctrines might be extended. Therefore, if Fishman's concern as to the potential incorporation of respondeat superior liability into the contractual context is to be addressed by the *Restatement (Third)*,¹⁰³ not only will in-

100. See RESTATEMENT (SECOND), *supra* note 2, § 8B cmt. c., illustration.

101. *But see Croisant*, 432 P.2d 799.

102. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§ 89, 90, 139 (1979).

103. I must concede that I am not aware of any cases decided since Fishman

herent authority have to be restricted in its potential scope or eliminated altogether and replaced by an authority basis less open to such expansion, but also the estoppel doctrines will have to be more clearly stated and circumscribed so as to also exclude the potential for imposing respondeat superior liability on an estoppel basis.

IV. THE PROPOSED *RESTATEMENT (THIRD)* ABOLITION OF INHERENT AUTHORITY

The first Tentative Draft of the *Restatement (Third)* proposed the abolition of the inherent agency concept.¹⁰⁴ It would be replaced by the combination of a broader concept of apparent authority and expanded estoppel doctrines separately articulated for the disclosed principal and undisclosed principal situations.¹⁰⁵ The second Tentative Draft made some technical changes to the wording of the relevant sections, comments and Reporter's notes, primarily shortening the black-letter sections by moving some of the clarifications and qualifications to the comments.¹⁰⁶ It also added a new and relevant section 3.03 titled "Creation of Apparent Authority."¹⁰⁷ However, these minor edits left the balance of the proposed framework essentially unchanged. The more recent third, fourth and fifth Tentative Drafts deal only with other portions of the proposed *Restatement (Third)* and do not address the matter of the sources of agency authority, leaving the sec-

published his article in 1987 that suggest judicial enthusiasm for applying the inherent authority concept to impose respondeat superior liability.

104. Tentative Draft No. 1, *supra* note 1, at xvii ("[T]he doctrine of inherent agency power . . . is not used in this Restatement [Third].") See discussion *supra* Part II.B.

105. See generally *id.* at xiii-xxiii, 54-88, 129-207, 212-32.

106. See generally Tentative Draft No. 2, *supra* note 1, at xvii-xxi, 72-91, 151-215, 236-79. The most significant changes made from the first Tentative Draft by the second Tentative Draft in the black-letter provisions with regard to the proposed abolition of inherent authority are that a new section 3.03 addressing the creation of apparent authority was added, the "power resulting from being placed in a position" guidance was removed from section 2.03 and was placed in the comments to new section 3.03, and the definition of "manifestation" was significantly shortened and renumbered section 1.03 rather than section 1.02. *Id.*

107. *Id.* at 236. Section 3.03 states that "[a]pparent authority, as defined in § 2.03, is created by a person's manifestation that another has authority to act with legal consequences for the person who makes the manifestation, if a third party reasonably believes the actor to be authorized and the belief is traceable to the manifestation." *Id.*

ond Tentative Draft as the latest formulation in this regard.

The proposed *Restatement (Third)* framework of black-letter sections that is scheduled to replace the inherent authority concept of the *Restatement (Second)* is succinct. The pivotal provision is section 2.03, which sets forth a much broader apparent authority concept than that of the *Restatement (Second)*: "Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."¹⁰⁸ The scope of section 2.03 hinges on the breadth of the definition of "manifestation," which, as discussed earlier, is not a defined term under the *Restatement (Second)*. "Manifestation" is defined indirectly and very broadly in the proposed *Restatement (Third)* at section 1.03: "A person manifests assent or intention through written or spoken words or other conduct."¹⁰⁹

The first two Tentative Drafts make clear in numerous places that the "other conduct" phrase of section 1.03 is intended to include manifestations sufficient to create apparent authority in those instances where a fully or partially disclosed principal, without making any express representations of agent authority to third persons, simply places an agent in a position that would lead third parties to reasonably (though erroneously) believe that the agent had a certain customary scope of authority.¹¹⁰ Sections 2.03 and 1.03 taken together obviate the need for the use of the inherent authority concept

108. *Id.* at 151.

109. *Id.* at 72.

110. *See, e.g.*, Tentative Draft No. 1, *supra* note 1, at xvi. The first Tentative Draft's version of the "manifestation" definition:

[D]efines manifestation broadly and explains how the concept applies when a person is appointed to a position. Illustration 1 is intended to put to rest the justification for the doctrine of inherent agency power in the context of a disclosed principal who appoints an agent to a known or customary position.

Id. *See also id.* at 65 ("The definition of manifestation in this section is intended to be broader than that assumed to be operative at points in the Restatement Second of Agency. The principal consequence of this breadth is to eliminate the rationale for a distinct doctrine of inherent agency power applicable to disclosed principals. . . ."); Tentative Draft No. 2, *supra* note 1, at 73-74 ("Absent notice to third parties to the contrary, placing the agent in such a position [whose holders customarily have authority of a certain scope] constitutes a manifestation that the principal assents to be bound by actions by the agent that fall within that [customary] scope.").

to find agent authority in the “placing the agent into a position” situations. Additionally, sections 2.03 and 1.03 displace *Restatement (Second)* section 161 and extend apparent authority to cover those situations that were formerly resolved by application of the inherent authority concept, but only for disclosed principal circumstances.¹¹¹ The *Restatement (Third)* makes clear that it is to remain the case, as it is now under the *Restatement (Second)*,¹¹² that statements or other conduct of the agent alone cannot create apparent authority, unless the agent’s conduct was at the direction of the principal or otherwise can reasonably be imputed to the principal based on the principal’s conduct.¹¹³

The fifth Tentative Draft issued in 2004 proposes a new and comprehensive Chapter 7 that covers tort liability issues.¹¹⁴ Section 7.08 and the associated comments and Reporter’s notes call for imposing liability on principals for their agents’ *torts* on a respondeat superior (“vicarious liability”) basis where the actions of the principal have given rise to apparent authority on the part of the agent.¹¹⁵ However, neither section 7.08 nor the associated comments and Reporter’s notes address the issue of the appropriateness of utilizing respondeat superior theories of liability in an apparent authority context to impose *contractual* liability.

This broadened concept of apparent authority is not applicable with regard to an undisclosed principal.¹¹⁶ In the undisclosed principal situation, inherent authority will be replaced with expanded estoppel doctrines that will reach all the way back to the “boundary” with actual authority. The first Tentative Draft makes this intention clear:

When a relationship of agency exists, circumstances in which a principal is estopped to deny the existence of authority are often ones in which the origin of the third party’s belief, or the explanation for it, furnishes a dividing line between the elements requisite to estoppel and those requisite to proving apparent authority as defined in

111. Tentative Draft No. 1, *supra* note 1, at xxi (“Apparent authority is not present when the principal is undisclosed.”).

112. RESTATEMENT (SECOND), *supra* note 2, § 8 cmt. a.

113. See Tentative Draft No. 1, *supra* note 1, at 132-33.

114. See Tentative Draft No. 5, *supra* note 1, at 1-187.

115. *Id.* at 148-87.

116. Tentative Draft No. 1, *supra* note 1, at xxi (“Apparent authority is not present when the principal is undisclosed.”).

§ 2.03. Apparent authority is not present unless the third party's belief is traceable to the principal's own manifestations, which may include placing the agent in a position that will lead third parties to believe that the agent has authority consistent with the position. Estoppel does not require as close a fit between affirmative acts of the principal and the third party's belief because it may protect third parties who reasonably believe an actor to be authorized as an agent when the belief cannot be shown to follow directly from the principal's own manifestations.¹¹⁷

The proposed *Restatement (Third)* contains two related estoppel sections, 2.05¹¹⁸ and 2.06,¹¹⁹ that together are to replace *Restatement (Second)* section 8B. Section 2.05 closely tracks section 8B(1) and is to apply to situations where a fully or partially disclosed principal has not made any manifestations of authority to third parties sufficient to create apparent authority, even under the broad new definition of "manifestation," but where the principal because of his actions (or, upon occasion, inaction) nevertheless should be held responsible for the third parties' belief that such authority existed.¹²⁰

Section 2.06 is a new estoppel provision with no *Restatement (Second)* equivalent. This latter section applies to undisclosed principal situations, and holds the principal liable for transactions that the third party would "reasonably believe" were within the scope of the agent's authority, had the third party been aware that the agent was acting for a

117. *Id.* at 218.

118. Tentative Draft No. 2, *supra* note 1, at 198. Proposed section 2.05 is titled "Estoppel to Deny Existence of Agency Relationship" and states that:

[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 liable 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.

119. *Id.* at 206. Proposed section 2.06 is titled "Estoppel of Undisclosed Principal" and states the following: "[a]n undisclosed principal may not rely on instructions given an agent that qualify or reduce the agent's authority to less than the authority a third party would reasonably believe the agent to have under the same circumstances if the principal had been disclosed." *Id.*

120. *Id.* at 198-206.

principal rather than for his own account.¹²¹ It is intended to displace the operation of sections 194 and 195 of the *Restatement (Second)*,¹²² and is drafted more broadly than is section 2.05 in that the reasonable belief of the third party need not necessarily be derived from intentional or careless action or inaction of the principal according to its text.

The key distinction made in the *Restatement (Third)* between apparent authority and estoppel situations is that the creation of apparent authority requires a manifestation by the principal, but not reliance thereupon on the part of the third party. Estoppel is applicable where there is no manifestation by the principal, and even when the principal is not disclosed, but the third party nevertheless reasonably believes that the agent has the authority to enter into the transaction at issue either as an agent or on his own account, and the principal is somehow responsible for this belief.¹²³

The contours of the *Restatement (Third)* proposal to abolish inherent authority are relatively clear in their broad outlines. Many of the situations now addressed under the *Restatement (Second)* by the inherent authority concept are to be incorporated as apparent authority situations under the broad new definition of "manifestation," particularly those recurring situations where a fully or partially disclosed principal has placed his agent in a position that has a customary scope of authority that exceeds the scope of the actual authority conferred.

The question of possible agency authority in other situations in which a fully or partially disclosed principal has not created actual or apparent authority sufficient to cover the transaction at issue, but where the principal may bear some culpability for a reasonable (though erroneous) belief on the part of third parties as to the scope of agent authority, are to be addressed under section 2.05's formulation of the estoppel doctrine rather than under the inherent authority doctrine.

121. *Id.* at 207-15. Section 2.06 does not incorporate the same limitations based upon the principal's actions or inactions as are contained in *Restatement (Second)* section 8B and in proposed *Restatement (Third)* section 2.05. See discussion *infra* Part V.B.2.

122. *Id.* at 211 Reporter's note a. ("The coverage of this section corresponds to *Restatement Second*, Agency [sections] 194 and 195.")

123. See Tentative Draft No. 1, *supra* note 1, at 138-39, 185. This would be required at least under section 2.05, although this would perhaps not be required under section 2.06.

The question of possible agency authority for an agent for an undisclosed principal who exceeds his actual authority is to be addressed under section 2.06's "reasonable belief" formulation of the estoppel doctrine, rather than under the inherent authority doctrine under *Restatement (Second)* sections 194 or 195.

V. CRITICISMS OF THE *RESTATEMENT (THIRD)* ABOLITION OF INHERENT AUTHORITY

The *Restatement (Third)*'s proposal to abolish inherent authority and replace it with a combination of broadened apparent authority and more expansive use of estoppel doctrines has motivated two comprehensive critiques; one by Kornelia Dormire published in 2001,¹²⁴ and one subsequently published by Matthew Ward in 2002.¹²⁵

A. *The Dormire Critique*

The Dormire article is a student-authored comment that was written before the publication of any of the *Restatement (Third)*'s five Tentative Drafts,¹²⁶ but the author did have access to the proposal's conceptual framework from an earlier prospectus published in 1998 by *Restatement (Third)* Reporter Deborah A. DeMott,¹²⁷ and from discussions with DeMott.¹²⁸ After summarizing the rationale for the *Restatement (Second)*'s inherent authority concept and discussing its roots in earlier case law and its post-*Restatement (Second)* application,¹²⁹ Dormire concludes that "inherent agency power is a concept more usefully kept separate rather than folded into actual implied authority or conceivably into apparent authority."¹³⁰ She recognizes that the most straightforward means of incorporating inherent authority into a broader conception of apparent authority "would be to stretch the word 'mani-

124. Dormire, *supra* note 13.

125. Ward, *supra* note 13.

126. Dormire, *supra* note 13, at 252. Dormire notes that "nothing authoritative regarding the Restatement (Third) yet exists." *Id.* (citing Telephone Interview with Deborah A. DeMott, David F. Cavers Professor of Law, Duke Law School (Nov. 8, 1999)).

127. Dormire, *supra* note 13, at 251 n.49 (citing "A Revised Prospectus for a Third Restatement of Agency," *supra* note 20).

128. *Id.* at 252 n.52.

129. *Id.* at 246-54.

130. *Id.* at 255.

fest."¹³¹ Although Dormire cited Fishman's article as support for this interpretation,¹³² she still reasoned that Fishman's recommendation would be an unwise step for the drafters of the *Restatement (Third)* to take:

[T]o include inherent agency power into apparent authority will only serve to muddy the now clear concept. The Restatement (Second)'s categories are a practical place to draw the line so one does not confuse actual actions by a principal with concepts of reasonable assumptions on the part of third parties. What is most useful to those who use a Restatement is a straightforward analytical tool. A stretching of the word 'manifest' will not serve to clarify or simplify the concept of apparent authority because apparent authority requires actual belief. It is not a good idea to start down the path of making exceptions to that requirement. The very nature of the third category of inherent agency power is that it is different [from apparent authority] not in degree but in kind.¹³³

Note that Dormire is reacting to the general idea of expanding the definition of "manifestation" to encompass within apparent authority all those situations now addressed by inherent authority principles, as was strongly advocated by Fishman.¹³⁴ She does not focus her critique on the specific (and slightly more limited) *Restatement (Third)* proposal, which was not yet available at the time she wrote her article. The *Restatement (Third)* embraces this broader "manifestation" approach only with regard to disclosed principal circumstances, and utilizes broader estoppel doctrines to displace inherent authority under those circumstances where the principal is undisclosed. Dormire's central criticism of the proposed new definition of "manifestation" is that it conflates authority based upon the actual intentions of the principal, expressed by his conduct or communications, with authority based not on the principal's conduct but upon protection of the reasonable expectations of third parties arising from customary agent practices. This criticism is equally applicable to the *Restatement (Third)*'s approach as it is to the more sweeping recommendation made earlier by Fishman.

131. *Id.*

132. *Id.* at 256 n.73 (discussing Fishman, *supra* note 12, at 42).

133. Dormire, *supra* note 13, at 256.

134. *See generally* Fishman, *supra* note 12.

Dormire places too much importance on retaining the ordinary definition of "manifestation." She is clearly correct that there is an important conceptual distinction between the situation where a third party's belief as to the extent of agent authority is based upon express representations made by the principal, and the situation where the belief is based solely on the third party's reasonable expectation that an agent placed into a position will have the customary scope of authority for that position. In practice, however, these situations shade into one another. The courts have been unable to consistently determine where along this continuum to classify the situation where a principal, without more, simply places his agent into a position of customary authority: is this a "manifestation" of authority or not?¹³⁵ If the liability of the principal hinged on this classification then this conceptual distinction would have to be maintained, however difficult to apply. However, since both apparent authority and inherent authority are sufficient bases for principal liability, then the difficult distinction between the two is unnecessary and can and should be discarded.¹³⁶

B. *The Ward Critique*

Matthew Ward had access to the first three Tentative Drafts of the *Restatement (Third)* when he wrote his article.¹³⁷ His theoretical analysis of the *Restatement (Third)*'s proposal and its relationship to the *Restatement (Second)*'s categories suffers from errors in his understanding of the basic relationship between apparent authority and inherent authority under the *Restatement (Second)*.¹³⁸ Nevertheless, his analysis is

135. See discussion *supra* Part III.B.

136. Again, the distinction is occasionally of significance where the agent at issue is a "special" rather than a "general" agent. See *supra* note 49.

137. Ward, *supra* note 13, at 1597.

138. For example, Ward claims that "apparent authority is a subset of inherent agency." *Id.* at 1596. This is incorrect because, as discussed above, under section 8A of the *Restatement (Second)* "inherent agency power" is "derived not from . . . apparent authority . . . but solely from the agency relation . . ." RESTATEMENT (SECOND), *supra* note 2, § 8A; see discussion *supra* Part II; see also SEAVEY, *supra* note 29, at 15 ("*Inherent agency power* . . . is a term first used . . . to explain the liability of the principal in cases in which the agent who conducts a transaction has neither authority nor apparent authority and there are no estoppel elements.").

Apparent authority and inherent authority are not nested one within the other, but instead are mutually exclusive bases for agency authority. Ward

important to consider because of his claim that the proposed *Restatement (Third)* framework narrows the scope of liability for principals because they would no longer be held liable for contracts entered into on their behalf by their agents under some circumstances in which they are held liable under the *Restatement (Second)* inherent authority concept.¹³⁹ In support of this claim, Ward discusses several cases that have held a principal liable on an inherent authority theory. He believes that under the proposed *Restatement (Third)* framework these cases would be decided differently and in favor of the principal escaping liability.¹⁴⁰

Ward may be correct that even under the broad *Restatement (Third)* formulation of the scope of apparent authority there would be no apparent authority found in some or all of these cases, and of course under this formulation no inherent authority basis would be available for imposing liability. However, he perhaps is overlooking the significance of proposed sections 2.05 and 2.06.¹⁴¹ These estoppel provisions are intended specifically to complement the expansion of apparent authority by replacing the inherent authority doctrine as a basis for imposing liability for situations that merit liability, but that do not fit into the expanded apparent authority framework.

1. *Croisant v. Watrud*

The most significant of these cases that Ward notes in his article is *Croisant v. Watrud*,¹⁴² a well-known opinion in which an accounting partnership was held liable for a contract en-

later claims that since "apparent authority is a subset of inherent agency," an expansion of apparent authority, no matter how substantial, "could not have overtaken inherent agency . . ." Ward, *supra* note 13, at 1602-03. This does not follow logically, even were apparent authority nested within inherent authority, because a subset could be expanded more than enough to encompass the entire set that it falls within.

139. Ward, *supra* note 13, at 1587-88. Ward comments that the *Restatement (Third)* "claims to expand the definition of 'manifestation,' thereby broadening apparent authority to include everything that inherent agency currently regulates." *Id.* Ward then rebuts this claim of the *Restatement (Third)* "by arguing that apparent authority under the draft of the *Third Restatement* does not, and cannot, embrace all of the cases in which a principal would be liable based on inherent agency." *Id.*

140. *Id.* at 1623-26.

141. See discussion *supra* Part IV.

142. 432 P.2d 799 (Or. 1967).

tered into on its behalf by one of its accountants, Watrud, who was the managing partner of a local branch office of the firm. The plaintiff Croisant previously engaged the firm to do her taxes, and the work had been done by Watrud. Watrud later entered into another agreement with Croisant under which he was to collect payments made in connection with a sale of one of the plaintiff's properties, and later to maintain her financial records. The accounting firm never authorized Watrud to assume these particular responsibilities nor represented to the plaintiff that it had. The court found no basis for determining that services provided by Watrud were customary accounting services, and analyzed the issue of the firm's potential liability under general agency law principles, rather than by considering the possible applicability of the Oregon partnership statutes to impose liability upon a partnership for a partner's acts.¹⁴³ The court then found that no actual authority existed for the transaction and that no manifestations of authority had been made by the principal to the plaintiff, which would have created apparent authority. The court held the accounting firm liable under *Restatement (Second)* section 8A on an inherent authority basis.¹⁴⁴

The *Croisant* case embraces a very expansive interpretation of the scope of inherent authority and thereby lends credence to Fishman's concerns. The opinion goes beyond simply finding inherent authority to exist for those transactions that are customary for an agent placed into a particular position, taking the view that such a limitation of scope may well apply under the section 161 inherent authority provision, but not to section 8A which more broadly serves to promote fairness and commercial convenience,¹⁴⁵ and declares that under section 8A, inherent authority exists with regard to any transaction

143. *Id.* at 801. The lower court in this case held that Watrud's contract with Croisant was an "independent trustee employment" that was "separate and distinct from the activities in which the partnership was engaged." *Id.* Thus, the contract eliminated partnership liability for partner acts done in the ordinary course of partnership as a theory of liability, leaving only the possibility of principal liability under general agency law principles, which it determined did not exist. *Id.* The Oregon Supreme Court reversed this lower court ruling, but did so only on the basis that the lower court had misapplied agency law, and not on the arguably equally if not more plausible basis that partner Watrud's actions were done in the ordinary course of partnership business, which it did not consider. *See id.*

144. *See id.* at 801-02.

145. *See id.* at 802-03.

that the third party "reasonably believes" is within the agent's scope of authority, even if the transaction is not within the customary scope of authority for an agent placed in that position.¹⁴⁶

Ward argues that the *Croisant* case would have a different outcome under the proposed *Restatement (Third)* framework.¹⁴⁷ First, he claims that "the draft of the Third Restatement arguably does not broaden the manifestations that create apparent authority,"¹⁴⁸ by which he appears to be saying that courts, as a matter of practice, are already utilizing the broader manifestation definition proposed by the *Restatement (Third)*. Ward is correct when he concludes that even under the expansive *Restatement (Third)* definition of "manifestation," Watrud would lack apparent authority, since the firm made no representations as to his authority to engage in the transactions at issue, and the conduct he engaged in was not regarded by the court as customary for an accountant.¹⁴⁹ However, Ward then erroneously concludes that since under the *Restatement (Third)* proposal Watrud would still lack both actual and apparent authority, and inherent authority would be abolished, then the accounting partnership would have escaped liability under the *Restatement (Third)*.¹⁵⁰

The *Croisant* circumstances appear to me to be exactly the sort of disclosed principal situation that the proposed section 2.05 estoppel provision is intended to address. Having engaged Watrud's firm to do her taxes, as the *Croisant* court notes,¹⁵¹ the plaintiff would reasonably expect Watrud to have the firm's authorization to engage in any further accounting-related financial services that he offered to perform for her, even those payment-handling services that were not customary for an accountant to perform. The firm was arguably careless in not reviewing Watrud's acts to see that he did not exceed his authorization.¹⁵² Therefore, it is unlikely that the

146. *See id.* at 803.

147. Ward, *supra* note 13, at 1624.

148. *Id.*

149. *See Croisant*, 432 P.2d at 801.

150. Ward, *supra* note 13, at 1624.

151. *Id.* at 803-04.

152. Fishman, *supra* note 12, at 34 n.161 ("[T]he amount of the payments might have put the accounting firm on notice that more services were being rendered than normal services.").

firm would have escaped liability under the *Restatement (Third)* framework; instead, liability would have been imposed on an estoppel rather than an inherent authority basis. For that matter, a better rationale in *Croisant* for holding the principal liable under the *Restatement (Second)* framework would have been to apply estoppel under section 8B, again on the basis that the principal intentionally or carelessly caused the third party's erroneous belief.¹⁵³

2. *Kahn v. Royal Banks of Missouri and Menard Inc. v. Dage-MTI, Inc.*

Another case offered by Ward in support of his argument is *Kahn v. Royal Banks of Missouri*.¹⁵⁴ The agent there made a representation of agency authority to the third parties, and the position in which the agent was placed by the principal was not one where the third party would customarily expect him to have the requisite scope of authority for the transaction at issue. The court in *Kahn*, as an alternative basis to imposing apparent authority liability, found inherent authority to exist that was as broad in scope as the agent's representations of authority.¹⁵⁵ It reasoned that the commercial convenience rationale of section 8A justified placing the risk of an agent's dishonesty upon the principal.¹⁵⁶

Ward also discusses *Menard Inc. v. Dage-MTI, Inc.*¹⁵⁷ A corporation president there had represented to a third party that he had the authority to enter the corporation into a specific transaction. The third party then proceeded with the transaction even though the third party was aware that for

153. Although, perhaps an even more plausible doctrinal basis would have been to hold the firm contractually liable under the applicable partnership statutes, which generally hold partnerships liable for contracts entered into on their behalf by a partner in the ordinary course of partnership business. In this case, they would show that the financial services performed by Watrud were in fact ordinary and customary accounting services.

Cange v. Stotler & Co., Inc., 826 F.2d 581 (7th Cir. 1987), is another case noted by Ward that is similar to *Croisant* in that the position in which the disclosed principal placed the agent was not the type that would customarily have the authority to engage in the transaction at issue. Thus, there would likely be no apparent authority even under the *Restatement (Third)*. However, once again, the circumstances would probably give rise to estoppel liability under section 2.05 of the *Restatement (Third)* framework.

154. 790 S.W.2d 503 (Mo. Ct. App. 1990).

155. *Id.* at 508-09.

156. *Id.* at 509.

157. 726 N.E.2d 1206 (Ind. 2000).

prior comparable transactions specific board authorization was required to bind the corporation.¹⁵⁸ The court ruled that the third party's awareness of the limitations imposed on the president's authority precluded a finding that apparent authority existed,¹⁵⁹ but nevertheless ruled that because the president was in the position of sole corporate negotiator of the transaction he had the inherent authority to bind the firm.¹⁶⁰

Kahn and *Menard* are additional cases that support Fishman's argument that the inherent authority doctrine has the potential to be applied to impose respondeat superior contractual liability upon a principal in a contractual context. It seems likely that even under the broad *Restatement (Third)* formulation as to what conduct by a principal comprises the requisite "manifestation" apparent authority would be lacking in these two cases. However, the principals in both *Kahn* and *Menard* probably each bore sufficient culpability for the third party's belief of authorization to justify holding these principals liable under an expansive reading of the section 2.05 estoppel provision.¹⁶¹ Such a determination of culpability seems a somewhat closer call in *Menard* than in *Kahn* given the questionable reasonableness of the third party's belief in the former case.

3. Conclusion

Ward is accurate if his claim regarding these three cases is limited to the narrow proposition that the expanded scope of apparent authority under the proposed *Restatement (Third)* is not sufficient to impose principal contractual liability in all situations where liability has previously been imposed through invocation of inherent authority principles. However, if his claim is understood as the much broader one that the overall *Restatement (Third)* framework would operate to allow a class of principals now being held liable on inherent authority grounds to escape liability,¹⁶² he is incorrect because he overlooks the operation of the proposed new sec-

158. *Id.* at 1214.

159. *Id.*

160. *Id.*

161. *See id.* at 1214; *Kahn v. Royal Banks of Missouri*, 790 S.W.2d 503, 508-09 (Mo. Ct. App. 1990).

162. *See* the discussion and criticism of Ward's analysis *supra* note 138.

tions 2.05 and 2.06. The proposed *Restatement (Third)* abolition of inherent authority and expansion of apparent authority and estoppel-based liability can perhaps be criticized in some regards, but not on the basis that it would reduce the liability of principals to less than that imposed under the *Restatement (Second)*.

C. *Additional Criticisms of the Restatement (Third) Proposal*

At this point I will offer a few additional criticisms that I have of the *Restatement (Third)*'s proposal to abolish inherent authority that were not made by either Dormire or Ward. The first of these criticisms is not a substantive criticism of the merits of the proposal, but instead is a stylistic criticism of the incomplete manner in which the rationale for the proposal is presented in the Tentative Drafts. The latter two criticisms that I offer are substantive.

1. *Stylistic Criticism*

There is not a single reference to Fishman's article in any of the five Tentative Drafts that have been released. This is a striking omission, since Fishman's article is, in my opinion, unquestionably the definitive critique of the *Restatement (Second)*'s inherent authority concept. Moreover, Fishman advocated abolishing the concept of inherent authority using a very similar expanded definition of "manifestation" approach as has been used by the *Restatement (Third)* proposal. The Tentative Drafts, both in the comments and in the Reporter's notes, do cite a large number of articles that address some particular aspect of the inherent authority question,¹⁶³ but some discussion of or at least reference to Fishman's cri-

163. See, e.g., Tentative Draft No. 1, *supra* note 1, at 229 (citing Randy Barnett, *Squaring Undisclosed Agency Law with Contract Theory*, 75 CAL. L. REV. 1969, 1996 (1987) (relating to undisclosed principal liability questions)), 231 (citing DENNIS HYNES, AGENCY AND PARTNERSHIP 400-01 (5th ed. 1998) (relating to "placing an agent in a position" issues), and MELVIN EISENBERG, AN INTRODUCTION TO AGENCY AND PARTNERSHIP 16 (2d ed. 1995) (relating to inherent agency power)); Tentative Draft No. 2, *supra* note 1, at 84 (citing Aaron Lipson, *Whose Fool Is It Anyway: Updating Apparent Authority for Today's Business World*, 33 GA. L. REV. 1219, 1247 (1999) (relating to expanding the definition of apparent authority)), 85 (citing Grace M. Giesel, *Enforcement of Settlement Contracts: The Problem of the Attorney Agent*, 12 GEO. J. LEGAL ETHICS 543, 561 (1999) (regarding inherent authority in the lawsuit settlement agreement context)).

tique and proposal is called for.¹⁶⁴

To the extent that the Tentative Drafts do attempt to justify the proposed abolition of inherent authority, this is accomplished almost exclusively through numerous hypothetical illustrations and other discussions that suggest that the goal of the *Restatement (Third)*'s proposal is to simplify the work of courts while maintaining the contractual liability of principals in all situations where such liability has previously been imposed under the inherent authority concept. There are also references made to cases that already embrace the broad definition of manifestation favored by the *Restatement (Third)* in the "placing an agent into a position" context,¹⁶⁵ and to cases already embracing the proposed section 2.06 estoppel principle for undisclosed principal circumstances,¹⁶⁶ which together suggest that the proposal is largely tracking actual court practice. These are all strong arguments in favor of the *Restatement (Third)* proposal.

The Tentative Drafts, however, should also contain discussion of Fishman's concerns that the inherent authority concept may be used to import respondeat superior liability into the contractual context, and of his recommendation to avoid this specter by substituting an expanded concept of apparent authority based on a broader definition of "manifestation." The Tentative Drafts should also explain the decision made to not adopt Fishman's sweeping proposal, but to instead utilize the new definition of "manifestation" only in the disclosed principal context and rely on reformulated estoppel doctrines in undisclosed principal situations. There should also be a comprehensive discussion of why this new definition of "manifestation" is not as susceptible to use by a court as a basis for imposing respondeat superior liability as the inher-

164. This omission will likely be remedied somewhat, since writing this article I have been assured by Deborah A. Demott, the Reporter for the *Restatement (Third)*, that the final official text will include some citations to Fishman's work. Email message from Deborah A. DeMott, David F. Cavers Professor of Law, Duke Law School, to Gregory Crespi, Professor of Law, Dedman School of Law, Southern Methodist University (Aug. 16, 2004) (on file with author).

165. Tentative Draft No. 1, *supra* note 1, at 179 ("Many cases also tie the significance of custom closely to apparent authority based on the position occupied by the agent."). See also DeMott, *supra* note 20, at 1047 ("[T]o the extent some contemporary cases broadly define the circumstances that warrant a finding of apparent authority, this development may have overtaken the doctrine of inherent agency power.").

166. Tentative Draft No. 1, *supra* note 1, at xxii-xxiii.

ent authority concept it replaced.

Fishman offers a powerful argument that the *Restatement (Second)* inherent authority concept, grounded as it is not in the representations made by a principal to third parties but instead in an assessment of what scope of agency authority is fair to third parties and best promotes commercial convenience in light of the reasonable expectations of all concerned, is an extraordinarily vague and flexible doctrine that is not a trustworthy constraint on judicial discretion. His concerns about the potential for the imposition of respondeat superior liability in the contractual context through this doctrine are reasonably plausible, despite the limited evidence to date that the courts are inclined to go beyond imposing contractual liability for transactions done within the customary scope of agent authority and impose respondeat superior liability.¹⁶⁷ These concerns should be addressed in the rationale presented for the proposal.

2. Substantive Criticisms

This stylistic criticism leads to my two substantive criticisms of the *Restatement (Third)* proposal, both of which relate to the potential respondeat superior liability concern. First, it is possible that the courts will someday embrace Mearns' arguments (in their more absolute formulation as characterized by Fishman)¹⁶⁸ that the appropriate balance to be struck in application of the inherent authority doctrine is to broadly impose liability on principals in a manner akin to respondeat superior tort liability. Given this possibility, it would be wise for the drafters of the *Restatement (Third)* to attempt to preclude such an outcome. However, the very broad definition of "manifestation" which is proposed by the *Restatement (Third)* as a replacement for most inherent authority situations, while it solves the problem of the conflicting jurisprudence at the border of apparent authority and inherent authority, appears to be just as open to expansive, result-oriented application at its outer extreme as is the inherent authority doctrine it would replace. As noted by Dormire, this broad definition of "manifestation" juxtaposes un-

167. *But see Menard*, 726 N.E.2d 206; *Kahn*, 790 S.W.2d 503; *Croissant*, 432 P.2d 799.

168. *See discussion supra* Part III.A.

der its linguistic umbrella two sources of agent authority— inherent authority and apparent authority—that differ fundamentally in kind from one another.¹⁶⁹ This non-intuitive grouping undercuts the ability of the new definition of “manifestation” to serve as a precise and reliable bulwark against expansive respondeat superior rulings that would extend liability beyond the scope of customary agent authority since it now has lost its congruence with established judicial understanding of what it means for a person to make a manifestation of agent authority through his conduct.

The second and related substantive criticism is that the *Restatement (Third)*'s proposed estoppel sections and their comments and reporter's notes also do not appear to have been drafted with the danger in mind of their potential expansive application to impose respondeat superior liability in the contractual context. Section 7.08 addresses vicarious liability, but by its terms it only applies to tort liability issues.¹⁷⁰ Section 2.05 largely tracks section 8B(1) of the *Restatement (Second)*. Section 2.06 only extends the estoppel doctrine to cover circumstances involving an undisclosed principal, and moreover does so without expressly incorporating the section 8B limitations based on the principal's conduct.¹⁷¹ Neither of these sections nor their accompanying comments attempts to clarify that estoppel should not be used to impose respondeat superior liability upon principals.

VI. ASSESSMENT OF THE *RESTATEMENT (THIRD)* PROPOSAL AND SUGGESTED REVISIONS

A. Overall Assessment

My overall assessment of the *Restatement (Third)* proposal to abolish inherent authority should by now be clear to anyone who has had the patience to read this far. The *Restatement (Second)*'s inherent authority and estoppel framework has several problems: a minor problem of conceptual difficulties encountered when classifying situations along the border of apparent authority and inherent authority, leading

169. Dormire, *supra* note 13, at 256.

170. See discussion *supra* Part IV.

171. Tentative Draft No. 2, *supra* note 1, § 2.06. Though it does limit liability to the extent of the relying third party's “reasonable” belief, which might be used to accomplish the same ends. *Id.*

to inconsistent judicial rationales for imposing liability; and a more serious problem of having the potential for being applied to extend broad respondeat superior liability to the contractual context. If the *Restatement (Third)* proposal is adopted, which seems likely, it will resolve this minor conceptual classification difficulty. This is a positive point, but the respondeat superior concerns will continue to persist even if the *Restatement (Third)* proposal is endorsed by the ALI and subsequently embraced by the courts.

By eliminating the concept of inherent authority, the *Restatement (Third)* proposal does remove the possibility that the inherent authority concept will be applied expansively to impose respondeat superior liability in the contractual context. However, this respondeat superior concern will persist because of the manner in which inherent authority has been displaced by a significant expansion of the scope of apparent authority through the use of a very broad definition of "manifestation." Freed from its linguistic moorings in common usage, this new and artificial definition has no intuitive limits and could easily be broadened further by the courts so as to impose respondeat superior liability in the contractual context.¹⁷² The potential respondeat superior liability problem will still exist, simply incorporated under a different linguistic formulation. This is a significant shortcoming of the *Restatement (Third)*'s proposal. Presented below are a number of complementary suggestions as to how this potential problem could be more effectively avoided through inclusion of additional and more explicit comments and illustrations.

The other major shortcoming of the *Restatement (Third)*'s proposal to abolish inherent authority is that the proposal fails to address the possible use of the estoppel doctrines to impose broad respondeat superior liability on principals for unauthorized agent contractual transactions. The revised formulation of the estoppel doctrines presented by sections 2.05 and 2.06 may be even more susceptible to such an interpretation than is *Restatement (Second)* section 8B. The proposal should therefore be modified in an attempt to

172. A careful reading of the comments and Reporter's notes to sections 1.03, 2.03, 3.03 and 7.08 suggests that this is not the intent of the drafters. See Tentative Draft No. 2, *supra* note 1, at 72-91, 151-88, 236-79; Tentative Draft No. 5, *supra* note 1, at 148-87. However, their intent is difficult to ascertain and needs to be made much more explicit.

forestall the possibility that estoppel liability will be extended. This is particularly necessary because the elimination of inherent authority and the clarification of the intended scope of apparent authority will channel the pressures to expand liability into the estoppel provisions, and history shows that the courts have been willing to apply estoppel doctrines broadly and flexibly as needed to achieve their desired objectives.¹⁷³

When drafting restatement provisions, one always faces the choice between including detailed clarifications and qualifications directly in the black-letter section provisions, thus risking that those provisions will become too cumbersome and complex to provide useful guidance, or drafting the section provisions in sparse and general language and instead providing the necessary clarifications and qualifications in comments, illustrations or Reporter's notes, or all of the above, where they may unfortunately be overlooked. The approach taken by the drafters of the *Restatement (Third)* is to utilize succinct black-letter section provisions supported by extensive commentary.¹⁷⁴ I will abide by this stylistic choice, and also offer my suggestions regarding the new estoppel provisions in the form of additional commentary rather than proposed revisions of the black-letter sections at issue.

B. Suggested Changes in the Restatement (Third)

1. Clarifying the Scope of Apparent Authority

Let me begin with the problem of the potential for interpretation of the new broad "manifestation" term to impose respondeat superior liability under the apparent authority provision. Section 1.03 only indirectly defines the term, and in very terse fashion.¹⁷⁵ While sections 1.03, 2.03, and 3.03 are each followed by extensive commentary,¹⁷⁶ that commentary

173. See *supra* note 105.

174. See generally DeMott, *supra* note 20, at 1041 (criticizing the 528-provision structure of the *Restatement (Second)* on the basis that it "emphasizes detailed treatment at the occasional expense of a general articulation of principles," and thereby sacrifices "the opportunity that generalization presents to explore underlying rationales more fully.")

175. Tentative Draft No. 2, *supra* note 1, at 72 ("A person manifests assent or intention through written or spoken words or other conduct.")

176. *Id.* at 72-91, 151-88, 236-79. The official comments and reporter's notes to proposed *Restatement (Third)* sections 1.03, 2.03, and 3.03 are twenty, thirty-

does not clearly enough rule out a respondeat superior liability interpretation of the new apparent authority concept. Additional language should be added to the comments and Reporter's notes for proposed new *Restatement (Third)* sections 1.03, 2.03 and 3.03, respectively, which will make sufficiently clear that the intent of the drafters of the *Restatement (Third)* is that this broad new concept of apparent authority should not be utilized to impose respondeat superior liability. Presented below are six specific suggestions along these to address these concerns.

First, I would insert into the fourth paragraph of comment b. to section 1.03 (this paragraph is set forth below in its entirety) the following underlined phrases:

Moreover, an agent is sometimes placed in a position in an industry or setting in which holders of the position customarily have authority of a specific scope. Absent notice to third parties to the contrary, placing the agent in such a position constitutes a manifestation that the principal assents to be bound by actions by the agent that fall within that scope, but does not constitute a manifestation that the principal assents to be bound by actions that fall outside of that customary scope of authority, even if the third party believes that the principal has so assented. A third party who interacts with the person, believing that manifestation to be true, need not establish a communication made directly to the third party to the principal to establish the presence of apparent authority as defined in Section 2.03. For further discussion, see Section 2.03, Comment d, and Section 3.03, Comment b.

Second, I would add to the end of the second paragraph of Reporter's note b to section 1.03 the following underlined material:

For a discussion of how the use of this broader definition of manifestation for apparent authority purposes can serve to limit the possibility that respondeat superior liability can be imposed upon principals that might extend beyond the customary scope of authority for those positions in which principals place their agents, see generally Steven A. Fishman, *Inherent Agency Power—Should Enterprise Liability Apply to Agents' Unauthorized Con-*

tracts?, 19 Rut. L. J. 1 (1987).

The original formulation of *Restatement (Third)* section 2.03 presented in the first Tentative Draft included the sentence set forth immediately below, which was then removed in the second Tentative Draft and replaced by commentary to new section 3.03,¹⁷⁷ apparently in accordance with the drafters' preference for sparse, general black-letter language accompanied by extensive commentary:

When an agent holds a position within an organization, or has been placed in charge of a transaction or situation, a third party acts reasonably in believing that agent has authority to do acts consistent with the position the agent occupies absent knowledge of circumstances that would lead a reasonable third party to inquire into the existence, extent, or nature of the agent's authority.¹⁷⁸

Since the specific language above that addresses the implications of placing an agent into a position of customary authority no longer appears in the black-letter formulation of section 2.03, it is very important that the comments make that clear. The seventh paragraph of comment d. to section 2.03 fairly clearly limits the scope of apparent authority to customary authority,¹⁷⁹ and is followed by three helpful illustrations,¹⁸⁰ but it does not state the limitation as directly and unmistakably as it might. Moreover, there is no illustration presented based on the troubling *Croissant v. Watrud* opinion discussed above which would rule out finding apparent authority under such circumstances.¹⁸¹ Given the prominence of

177. *Id.* at xx.

178. Tentative Draft No. 1, *supra* note 1, at 129.

179. Tentative Draft No. 2, *supra* note 1, at 162 ("The fact that it is customary for participants in an industry to be represented by agents does not invest an agent with apparent authority to do acts other than those customary to the agent's position.").

180. *Id.* at 163-64.

181. The facts presented in the *Croissant* opinion admittedly do not provide a "clean" illustration for clarifying the limits of apparent authority, given that the inherent authority issues are presented and resolved in *Croissant* in a context where partnership liability under the partnership statutes is arguably present as well, and where tort liability as well as contract liability are present. I am grateful to Deborah A. DeMott for calling my attention to these nuances of the *Croissant* opinion. E-mail message from Deborah A. DeMott, David F. Cavers Professor of Law, Duke Law School, to Gregory Crespi, Professor of Law, Dedman School of Law, Southern Methodist University (Aug. 16, 2004) (on file with author).

that case as the leading example of an expansive view of the scope of inherent authority, an illustration clearly distinguishing it from circumstances that would give rise to apparent authority under the new *Restatement (Third)* framework would be desirable. As a third suggestion, I would add after the end of illustration number 7 in comment d. to section 2.03 two new paragraphs with the following underlined material:

A manifestation by a principal that consists solely of placing an agent in a position having customary authority does not create apparent authority that extends beyond the scope of such customary authority for the position.

ILLUSTRATION:

8. A, a partner in P partnership, an accounting firm, provides accounting services to firm clients. A enters into a contract with client T on behalf of P and within the scope of his authority, and performs the required services under the contract. A later enters into another contract with T that is outside of his scope of authority, and outside of the scope of authority customary for partners or for agents of a partnership placed in his position. P was not aware of this second contract at the time that it was entered into. P by placing A in his position as P's agent has not made a manifestation creating apparent authority for the second contract.

Fourth, I would add at the end of the eighth paragraph to Reporter's note d. to section 2.03 the following underlined material:

Illustration No. 8 is based on *Croissant v. Watrud*, 432 P.2d 799 (Or. 1967), a case finding a principal partnership liable for partner acts done outside of the scope of the partner's actual or apparent authority, on an inherent authority basis, and is intended to make clear that a finding of apparent authority is not called for under those circumstances where an agent placed into a position without further manifestation of authority by the principal exceeds the scope of authority customary for agents placed in such a position.

Fifth, I would add to the end of the second paragraph of comment b. to section 3.03 the following underlined material:

A manifestation by a principal that consists solely of placing an agent in a position having customary authority does not create apparent authority that extends beyond

the scope of such customary authority for the position.

Finally, I would add a comment to section 7.08 to the general effect that the imposition of respondeat superior liability upon principals for agent torts in apparent authority contexts under that section is *not* intended to imply that it is also appropriate to impose contractual liability upon principals for agent transactions that exceed the scope of the apparent authority conferred. Something along the following lines should suffice:

Section 7.08 is intended to apply only to impose vicarious tort liability upon principals where appropriate, and should not be taken to suggest that such imposition of vicarious liability is an appropriate basis for imposing contractual liability on principals as a result of their agents' conduct.

2. Clarifying the Scope of the Estoppel Doctrines

Let me also offer some suggested modifications to the *Restatement (Third)* proposal aimed at assuring that the section 2.05 and 2.06 estoppel provisions will not become vehicles for imposing respondeat superior liability in the contractual context. The comments to sections 1.03, 2.03, and 3.03, as discussed above, show that considerable thought was given to the question of the scope of apparent authority, even if one agrees that the commentary is not quite clear enough with regard to this potential for imposing respondeat superior liability. However, the comments to sections 2.05 and 2.06 are much less extensive,¹⁸² and they do not appear to have been drafted with the potential respondeat superior liability problem in mind.

Section 2.05 carries forward from *Restatement (Second)* section 8B(1) the limitation that estoppel-based liability is only appropriate where either the principal has intentionally or carelessly caused the third party's belief as to agent authorization, or at least knew of the third party's erroneous belief and failed to correct it.¹⁸³ The comment to section 2.05

182. See Tentative Draft No. 2, *supra* note 1, at 198-206, 207-15. The combined official comment and Reporter's notes to proposed *Restatement (Third)* sections 2.05 and 2.06 are only nine pages for each section, and together contain a total of only eight illustrations. *Id.*

183. *Id.* at 204 ("This section [2.05] corresponds in operative respects to *Restatement Second*, Agency [section] 8B(1).").

states that the principal under this section may be liable for transactions on the basis of a “failure to use reasonable care . . . to prevent circumstances that foreseeably led to the belief” by the third party that the agent had sufficient authority to enter the principal into the transaction at issue.¹⁸⁴

This language gives rise to the concern that a principal who could foresee that a third person might somehow believe that an agent had authority that exceeded the scope of customary authority for the position, and does not learn of this erroneous belief until after the transaction at issue has been entered into, might be held liable under this provision. This concern should be addressed more clearly. Leaving this black-letter section as is, some additional language should be added to the comment to clarify that the mere placing of an agent into a position of customary authority, without doing any more to influence a third party’s belief as to the scope of the agent’s authority, should not be regarded as a basis for imposing liability on the principal using estoppel basis for agent transactions that exceed the scope of the customary authority for the position. Specifically, at the end of the first paragraph of comment a. to section 2.05 should be added a second paragraph containing the following underlined material:

The placing by a principal of his agent into a position having a customary scope of authority, without more, should not be regarded as a basis for imposing liability on the principal under this section for a transaction with a third party which exceeds this customary scope of authority, unless the principal subsequently becomes aware that the third party has a justified but erroneous belief as to the scope of the agent’s authority, and once becoming aware does not take reasonable efforts to correct that belief prior to the third party entering into that transaction.

Section 2.06 is somewhat more problematic than section 2.05 because it speaks only of imposing liability to protect a third party who “reasonably believes” that an agent has sufficient authority to enter the principal into the transaction at issue. Section 2.06 does not expressly require that the beliefs be grounded in the actions or inactions of the principal, or, perhaps more importantly, have any particular relationship

184. *Id.* at 199.

to the customary scope of agent authority for the position in question. It might be preferable to include in the black-letter formulation the same limitations on principal liability that are now contained in *Restatement (Second)* section 8B(1) and carried forward in proposed section 2.05. However, a more modest and sufficient approach to properly limit the scope of this provision would be to leave proposed section 2.06 as it now is, but add the following underlined material as a clarifying and limiting comment to the end of the first paragraph of comment c. to section 2.06:

An undisclosed principal should not be held liable under section 2.06 for transactions that exceed the customary scope of authority for agents placed in such a position, regardless of whether the third party involved would reasonably believe that the agent was so authorized had the principal been disclosed

VII. CONCLUSION

The proposal to abolish inherent authority in the *Restatement (Third)* is a step in the right direction, and addresses some of the jurisprudential concerns that the inherent authority concept has raised. However, the proposal does not go far enough to eliminate the lurking respondeat superior liability possibilities that exist under both the inherent authority and estoppel provisions of the *Restatement (Second)*. While these remaining concerns could be addressed by changing the proposed black-letter provisions, some relatively minor additions to the relevant comments and Reporter's notes along the lines suggested above will suffice.

I hope that the drafters of the *Restatement (Third)* will take these suggestions seriously. If they do not, and the ALI then endorses an Official Draft of the *Restatement (Third)* that does not better address these concerns, then I hope that the courts to the extent they embrace the *Restatement (Third)* will take into account the considerations identified in this article and resist any pressures to impose respondeat superior liability in the contractual context, whether those pressures arise under the apparent authority doctrine or under the estoppel doctrines.