

THE DYNAMICS OF AGENCY RELATIONSHIPS IN LEGAL AND BUSINESS CONTEXTS

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Abstract

This article examines agency relationships, where agents act on behalf of principals to engage third parties, crucial for modern business and legal operations. It discusses the formation of agency through explicit and implied agreements, necessity, estoppel, and ratification. Key agent duties, including task execution, care, conflict avoidance, and accountability, are explored alongside agents' personal liability in disclosed and undisclosed agencies. The article also covers the termination of agency relationships through legal or mutual actions, emphasizing their role in efficient business functioning.

Keywords: agency law, principal-agent relationship, implied authority, fiduciary duties, ratification, termination of agency.

Introduction

An agency relationship involves a principal and an agent, where the agent is authorized to establish agreements between the principal and third parties. The third parties include anyone the agent engages with on the principal's behalf. Agents can be employees, like a cashier in a supermarket forming sales contracts between customers and the store, or independent contractors, such as insurance or stockbrokers. In partnerships, partners act as agents for each other and the firm. Company directors represent their companies. Agents may serve multiple principals, like real estate agents handling transactions for various sellers. This relationship typically supports business transactions but can also occur informally, such as when a friend or relative manages another's affairs.

The Role of Agency in Modern Legal Systems

Agency is a fundamental aspect of all modern legal systems, facilitating a division of labor in both national and international economies. It enables principals to extend their activities through agents, making business operations more efficient. This is particularly crucial for large business entities like partnerships, companies, or corporations, which often require transactions conducted at a distance. Additionally, continental law recognizes legal representatives for minors or incapacitated persons, a concept less prevalent in common law systems.

In early Roman law, the concept of agency as it is known today did not exist. The Roman legal system viewed contractual obligations as deeply personal, requiring the presence and actions of the contracting parties themselves. This perspective began to change as business

needs evolved, leading to the gradual acceptance of agents acting on behalf of principals, although true agency relationships remained limited.

During the Middle Ages, legal scholars and the Roman Catholic Church's canon law helped develop the principle of agency to overcome practical commercial challenges. In England, the roles of the ballivus and attornatus emerged, laying the groundwork for modern agency law by expanding the authority of agents in commercial transactions.

By the 17th century, legal theorists like Hugo Grotius argued for agency based on natural law principles, influencing subsequent legal codifications. In the 18th and 19th centuries, agency law evolved further in England and the United States, adapting to the needs of commercial law and allowing for the concept of undisclosed principals, where agents could act without revealing their principal's identity.

In continental European legal systems, agency typically requires agents to act openly in the name of their principals. This transparency ensures that the principal alone is bound by the agent's actions. Various types of agents, such as commission agents, commercial agents, brokers, and sales representatives, operate under specific legal frameworks designed to protect both principals and third parties involved in transactions (William L. Burdick, *The principles of Roman Law and their relation to Modern Law*, 1938, pp.424).

In contrast, Anglo-American law allows for more flexibility, including the concept of undisclosed agency. Here, an agent can contract without revealing the principal, who can later be held accountable. This approach accommodates practical business needs and recognizes different types of agents, from factors and brokers to real estate and traveling salesmen.

For a contract to be binding on a principal when an agent deals with a third party, the agent must have the legal authority to act on the principal's behalf. This authority typically arises from an agency relationship, often established through an explicit agreement, though it can be informal. Additionally, an agency relationship can be implied if denying it would be unjust to the third party or agent. A principal can also ratify a contract, making previously unauthorized transactions by the agent enforceable by and against the principal (S. Mitkus and V. Jurkevičius, 2014).

Express Agreement

The most prevalent way to establish an agency relationship is through an express agreement between the principal and the agent. This agreement provides the agent with actual authority to act on the principal's behalf, either for specific transactions or for a broader range of tasks. While such appointments are often documented in writing, they can also be made orally. For instance, a homeowner might appoint a real estate agent via a contract to sell their property, agreeing to pay a commission if a sale results from the agent's efforts (Stimmel Law).

In some situations, the appointment must be formalized by a deed—a signed, witnessed document—especially if the agent is to execute deeds for the principal. This typically

includes transactions involving the transfer of land or buildings, where the agent must have a “power of attorney” granted by deed.

However, not all agency agreements result in a binding contract, particularly when the agent acts without expecting payment, termed a gratuitous agent. For example, someone who agrees to manage rent collection for a friend’s property without compensation acts as a gratuitous agent. Even in these cases, the duties associated with agency still apply, as demonstrated when a friend helping to find a car was deemed an agent, thereby incurring the responsibilities of that role.

Implied Agreement

An implied agency relationship arises from the circumstances and the nature of the parties’ interactions, suggesting that the principal has granted the agent authority to act on their behalf. This typically occurs when the agent holds a specific position that inherently provides such authority. For instance, in employer-employee relationships, an employee may have the implied authority to enter into contracts for their employer. Similarly, in corporate settings, a company secretary may have the inherent power to handle administrative tasks for the company due to their role.

Agency by Necessity

An agency relationship can be established by necessity when an emergency situation compels someone to act to protect another’s interests, even without prior agreement. This often happens when the agent has control over the principal’s property, and immediate action is needed to prevent harm or loss. The agent, acting in good faith, must be unable to obtain instructions from the principal due to the urgent nature of the situation. For example, if a railway company must decide what to do with livestock during a crisis without owner instructions, an agency by necessity arises. The agent is entitled to reimbursement for any expenses incurred while protecting the principal’s property. However, conditions for this include control over the principal’s assets, impossibility of contacting the principal, and acting in the principal’s best interests during the emergency.

Agency by Estoppel

Agency by estoppel occurs when the principal’s actions or statements lead a third party to reasonably believe that someone is authorized to act as the principal’s agent. Consequently, the principal is legally prevented (or estopped) from denying the agent’s authority later. For this to apply, the principal must have made representations, either through words or behavior, suggesting the agent’s authority. The third party must rely on these representations and believe the agent has the necessary authority to act, without any reason to doubt this belief. In such cases, even though the agent lacks actual authority, they possess apparent authority, thereby binding the principal to the contract made with the third party. For instance, if a company presents an individual as its managing director, the company cannot later refute this individual’s authority when a third party, acting in good faith, enters

into a contract based on this representation. Thus, the principal must honor the agreement as if the agent had full authority from the outset.

In essence, agency by estoppel safeguards third parties who rely on a principal's implied endorsement of an agent's authority, ensuring that principals cannot unfairly withdraw from obligations created by their own representations.

Ratification

Ratification occurs when a principal approves an agreement made by someone who acted as their agent without initial authority, or who exceeded their authority. At the time of the agreement, no agency relationship exists, and thus the principal is not initially bound by the contract, which is between the third party and the person claiming to act as an agent. However, if the principal later decides to ratify the agreement, they endorse and accept the terms retroactively, thereby creating a binding agency relationship. Ratification can be explicit or inferred from the principal's actions and is entirely at the principal's discretion. This approval effectively validates the agent's previous unauthorized acts, making the agreement enforceable as if the agent had been authorized from the beginning.

To ratify an agreement, several conditions must be satisfied:

The individual must have claimed to act as an agent and either explicitly named the principal or made it possible for the third party to identify the principal. Ratification is impossible if the third party cannot identify or recognize the principal.

In practical terms, this means that the third party must understand that someone acting as an agent for a specific or identifiable principal made the agreement. If these conditions are met, the principal can choose to endorse the agreement, making it legally binding.

All agency relationships are inherently fiduciary, founded on faith and trust. This means that agents are legally obligated to act with honesty and good faith, avoid conflicts of interest, and refrain from making secret profits or accepting bribes. The law of agency grants agents specific rights, and typically, the agency relationship also involves a contractual aspect that outlines the rights and duties of both the agent and the principal, either explicitly or implicitly. Even agents who work without compensation (gratuitous agents) must adhere to these fiduciary duties under the law.

Duties of an Agent

Duty to perform agreed tasks and follow instructions

An agent with a contractual agreement must execute all lawful tasks they have committed to perform for the principal and must adhere to the principal's directives. The scope of these instructions can vary; some agents may be granted significant discretion regarding their actions, while others receive specific directives, such as when to sell a property and the minimum acceptable price. Regardless of personal judgment or beliefs, the agent is required to follow these instructions precisely, even if they think another approach might benefit the principal more.

Duty to Personally Perform Agreed Tasks

Agents are generally expected to carry out their duties personally and are not typically allowed to delegate their responsibilities to others. However, there are exceptions to this rule. Delegation is permissible if the principal explicitly authorizes it or if it is customary based on industry practices. Additionally, delegation is acceptable when unforeseen circumstances necessitate it or if the tasks involved are routine and require minimal skill, such as filling out forms.

Duty to Exercise Care and Skill

Agents are required to perform their responsibilities with reasonable care and skill. Those with specific professional or trade skills are expected to uphold the standards typical of their profession. For instance, an estate agent must perform with the competence and care that a reasonably skilled estate agent would provide. Failure to do so can result in liability to the principal for not meeting the expected level of skill and diligence in fulfilling their duties.

Duty to Account

An agent is obliged to provide a thorough report of all transactions conducted on the principal's behalf and to account for all related financial benefits. This includes maintaining separate records and property from the principal's assets. If the agent mixes their property with the principal's, the principal may claim all the property unless the agent can clearly identify what belongs to them. The agent must keep detailed records of all dealings for the principal, who has the right to review these records.

Duty to Avoid a Conflict of Interest

Agents must ensure they do not engage in activities where a conflict of interest with the principal might occur, unless they have informed the principal about the potential conflict. Once informed, the principal can decide whether the agent should proceed. For example, an agent assisting in the purchase of property or shares must disclose if they intend to sell their own assets to the principal, even if the terms are fair, to avoid conflicts of interest.

An agent may represent two principals with conflicting interests only if both principals consent to this arrangement. Alternatively, this is permissible if it is understood, based on the nature of the agent's business, that the agent customarily acts for multiple principals. For example, estate agents often represent various clients simultaneously, which is generally accepted in their line of work.

Duty Not to Make a Secret Profit

An agent must not leverage their position to gain personal financial benefits without the principal's awareness and approval. This prohibition includes profits derived from using the principal's assets or exploiting information acquired through their role. The courts rigorously enforce this duty, ensuring that agents cannot profit secretly, even if their actions

also benefit the principal. This safeguard maintains the integrity and trust necessary in the principal-agent relationship.

Duty Not to Take a Bribe

An agent must not accept any secret commission or inducement from a third party in exchange for influencing contracts between the third party and the principal. This includes situations where an agent receives financial or other incentives to favor a particular supplier. Such acts are considered bribes and undermine the agent's duty of loyalty to the principal. Accepting bribes is strictly prohibited to ensure that agents act solely in the principal's best interests without any improper external influence.

Agent's Personal Liability on Contracts

In certain cases, an agent may be personally liable on a contract even if they are acting within their authority. The rules for liability vary based on whether the third party is aware the agent represents a principal or if the agent appears to be acting independently. When the third party knows the agent is acting for a principal (disclosed principal), the principal is typically liable. However, if the third party believes the agent is acting on their own behalf (undisclosed principal), the agent may be personally liable for the contract.

Disclosed Agency

In a disclosed agency, the agent explicitly or implicitly communicates that they are acting on behalf of a principal. The principal's name does not need to be revealed to the third party; it is sufficient that the third party understands the agent does not intend to be personally liable. Instead, any contract made is intended to bind the principal. Consequently, the agent typically bears no personal liability, except in cases where they have explicitly accepted liability or if the principal does not exist.

Undisclosed Agency

In an undisclosed agency, the third party is unaware of the principal's existence and believes the agent is acting independently. Initially, both the agent and the third party can sue and be sued on the contract. However, if the agent had authority, the principal can usually step in to enforce the contract. Exceptions exist, such as if the third party can prove they would have declined the contract knowing the true principal, or if the agent falsely claimed they were not acting for a principal. Additionally, if the contract explicitly excludes or contradicts agency, the principal cannot intervene.

Termination of Agency

An agency relationship can end either by operation of law or by the parties involved. A principal generally retains the right to revoke the agent's authority at any time, subject to certain limitations. However, if the principal fails to notify third parties of the revocation, the agent may still possess apparent authority, which allows them to continue binding the

principal in transactions with those unaware of the change. This highlights the importance of clear communication to avoid unintended obligations after termination.

Operation of the Law

An agency relationship inherently relies on trust and good faith, and thus it automatically terminates upon the death of either the principal or the agent. If the agent unknowingly continues to act after the principal's death, they may be personally liable for any resulting contracts. Additionally, the agency relationship typically ends if either party becomes bankrupt, as the financial incapacity undermines the ability to maintain the trust and functionality required for the agency.

Mental incapacity of the agent automatically terminates the agency relationship, as they can no longer fulfill their duties. Similarly, if the principal becomes mentally incapacitated, the agency relationship typically ends. However, if the agent has been granted a Lasting Power of Attorney under the Mental Capacity Act 2005, which must be registered with the Office of the Public Guardian, they can continue to act on the principal's behalf even after the principal's mental incapacity.

An agency agreement can be frustrated under the same conditions that apply to other contracts. This occurs when the performance of the contract becomes impossible or when an event makes the contract illegal, thereby nullifying the agreement and ending the agency relationship.

Termination by Parties

Some agencies are established for a specific duration and will conclude once this fixed term ends. Similarly, others are created for a particular purpose and terminate upon the completion of that task.

The agency relationship can end if both parties agree to terminate it, typically with reasonable notice given.

One party may end the agreement by notifying the other, even if the other party wishes to continue. However, unless the principal informs third parties about the revocation, the agent might still have apparent authority to act on the principal's behalf in future dealings. Unilateral termination can lead to a breach of contract, allowing the affected party to seek damages. For an employee-agent, it might also constitute unfair dismissal unless justified, such as in cases of the agent accepting a bribe.

Agency relationships are crucial for effective business and legal transactions, allowing principals to delegate authority to agents for managing various interactions. The dynamic nature of these relationships, governed by explicit agreements, necessity, and principles such as estoppel and ratification, underscores the importance of clear communication and adherence to fiduciary duties. Understanding the complexities of both disclosed and undisclosed agency, along with the mechanisms for termination, ensures that agency functions are conducted efficiently and ethically within the framework of modern legal systems.

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