LIABILITY OF AN INNOCENT PRINCIPAL FOR MISREPRESENTATIONS OF A REAL ESTATE AGENT

Substantially the same problem has arisen in four cases within the past five years.

In *Light v. Chandler Improvement Co.*[1] *A* (agent), a real estate broker with whom the land was listed to find a purchaser, fraudulently misrepresented the fertility of the soil. *P* (principal) without knowledge of the agent's misrepresentations signed a contract of sale and took a mortgage as part of the purchase price. When *P* sought to foreclose the mortgage, *T* (third person) claimed recoupment for fraud. *Held*, no recoupment.

In *Lemarb v. Power*[2] *P* authorized *A*[3] to find a purchaser for a plot of land with a store building upon it. *A* fraudulently misrepresented to *T* (1) that the store was entirely upon the plot, (2) that the Standard Oil Co. was seeking a ten-year lease of the corner of the lot. In fact, the store extended slightly into the public way and *T* was forced to pay sixty-one dollars to rectify this error. The Standard Oil Co. had not offered to lease the property. Upon discovery of the deception *T* brought this action for fraudulent misrepresentation against *P* who was innocent. *Held*, *T* could recover damages for the misrepresentation about the location of the store, but not for that concerning the fictitious lease.

In *Friedman v. New York Telephone Co.*[4] *A* had written authority to find a purchaser for property. He falsely represented to *T* that the heating and plumbing system in the building was good. *T* brought an action for damages against *P* who was innocent. *Held*, *T* could not recover.

In *Taylor v. Wilson*[5] *A* without *P*'s knowledge falsely represented that the premises in question had a good cesspool on them, "a mighty good one." *T* sued *P* for fraudulent misrepresentation. *Held*, *T* could recover, one judge dissenting. The two opinions differ on a question of fact which neither seems to consider important, yet which, it is submitted, is the controlling factor, both in

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tory judgment bill was introduced into the House of Representatives and debated upon, June 27, 1932. H.R. 4624, 72nd Cong., 1st Sess. See 75 Cong. Rec. 726 (1932). This bill was passed on December 19, 1932. H.R. Rep. 4624, 72nd Cong., 2nd Sess.; see 76 Cong. Rec. 726 (1932). On December 20, 1932, it was referred to the Senate Committee on Judiciary. 76 Cong. Rec. 753 (1932).

It may be of interest to compare the procedural device embodied in 180, Judicial Code (284 U.S.C. 287). This seems to provide for a declaratory judgment as to those persons indebted to the United States. See Frankfurter and Katz, Cases on Federal Jurisdiction and Procedure, 93.

[1] 33 Ariz. 101, 261 Pac. 969, 57 A.L.R. 107 (note) (1928).

[2] 151 Wash. 273, 275 Pac. 561 (1929).

[3] The representations were made by a sub-agent, but since this does not affect the result the simpler notation is followed.

[4] 256 N.Y. 392, 176 N.E. 543 (1931); reversing 246 N.Y.S. 741, 231 App. Div. 830 (1930).

[5] 183 N.E. 541 (Ohio App. 1932).

this case and in the three previous cases. The majority opinion speaks of the agent as having authority to complete a contract,[6] whereas the dissenting judge specifically states that the agent had authority only to find a purchaser.[7]

This case illustrates the primary cause of the apparent confusion of the cases—a failure to isolate the agency problem from other questions involved:

1) Failure to distinguish the question of what constitutes fraud in a particular jurisdiction from the agency problem is the factor which causes the most difficulty. Whether a certain misrepresentation is fraudulent or not may depend on whether the court follows *Derry v. Peek*[8] or *Matteson v. Rice*,[9] but this does not determine whether *P* is to be held for such misrepresentations if made by his agent. The substantive law of torts does not as an original matter determine the question of vicarious liability. To illustrate with an example from a field of physical torts in which the conflict is more sharply defined than in that of fraud: suppose that *A* while driving a truck for *P* negligently stops so close to *T* that *T* suffers from nervous shock. *T* sues *P*. If the state in which the action is brought does not allow recovery for fright, the issue is settled before any problem of agency arises. That this distinction between the *scope* of the liability for a tort and vicarious liability has not been so obvious in the fraud cases is due to the anomalous character of the common law idea of fraud, partaking as it does of both contract and tort characteristics. The same anomaly helps to explain the lag in the growth of the scope of liability for fraud, as compared with that of physical torts.

2) The second contributing cause of the haze which hides the agency problem is the question of procedure. Many courts and lawyers do not appreciate the difference between an affirmative action for fraudulent misrepresentation and a defensive plea of fraud or a bill in equity to rescind because of fraud.[10] Essen-

[6] "We are of the opinion that the agents of defendants had implied authority to do more than just find a buyer and make the representations about the cesspool described in the petition. Defendants admit that their agents negotiated the transaction between the plaintiff and the defendants. In other words they do not claim that said agents were employed merely to find a buyer or to bring the parties together." Lemert, J., *supra*, note 5, at 542.

[7] "To my notion it is a matter of common knowledge that a real estate agent's authority is limited, in that it ends when he has procured a purchaser willing, able, and ready to enter into a contract of purchase. It is also the common understanding that the vendor usually reserves to himself the power to conclude the sale. This was what followed in this case." Sherick, P. J., dissenting, *supra*, note 5, at 543.

[8] 14 App. Cases 337, 58 L.J.Ch. 864, 61 L.T. 265 (1889).

[9] 116 Wis. 328 (1903). The various views on what constitutes fraud are not strictly within the scope of this article. See Bohlen, Misrepresentation as Deceit, Negligence, or Warranty, 42 Harv. L. Rev. 733 (1929); Carpenter, Responsibility for Misrepresentation, 24 Ill. L. Rev. 749 (1930); Williston, Liability for Honest Misrepresentation, 24 Harv. L. Rev. 415 (1916). See also articles cited therein.

[10] Thus in Light v. Chandler Improvement Co., *supra* note 1, in which *T* (defendant) claimed recoupment for fraud of *A*, *P* (plaintiff) cited Mayo v. Wahlgreen, 9 Colo. App. 506,

tially this is a question of substantive law, though masquerading under the form of procedure. Some states which do not allow an affirmative action for deceit against an innocent principal will permit the agent's deceit to form the basis for an equitable action for rescission or a defensive recoupment.[11] In others an innocent misrepresentation by the agent is sufficient ground for a proceeding for rescission,[12] while in a third group even fraudulent misrepresentations by the agent are not a sufficient basis for rescission as against an innocent principal.[13]

Having disposed of these preliminary inquiries, we can focus our attention upon the comparatively simple agency problem which divides itself into (*a*) the question of general and special agents, and (*b*) the "apparent "authority or "scope of authority."

The distinction between a general and special agent is still an active principle in our law[14] though it is gradually breaking down.[15] None of the principal cases discussed here, for example, consider it as an independent factor. The general view on the question can be expressed in the words of *Haskell v. Starbird*,[16] "There is no distinction in the matter of responsibility, for the fraud of an agent authorized to do business generally, and of an agent employed to conduct a single transaction, if, in either case, he is acting in the business for which he was employed by the principal, and had full authority to complete the transaction." In other words the doctrine of ostensible or apparent authority applies alike to general and special agents, and if the power of the latter to bind the principal is more limited than that of the former it is only because a third party acting as a reasonable man would not be justified in ascribing to him such broad powers as a person entrusted with more duties would be likely to have.

As far as agency law is involved, therefore, our determination of the four principal cases depends on the answer to a single question. What representations concerning land could a third person reasonably believe an agent had au-

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50 Pac. 40 (1897) and Freyer v. McCord, 165 Pa. 539, 30 Atl. 1024 (1895) which were affirmative actions for deceit. And in Taylor v. Wilson, *supra* note 4, the dissent cited Light v. Chandler which represents a defensive use of fraud.

[11] *Supra*, note 1; Martin v. Ince, 148 S.W. 1178 (Tex. 1912); McNeile v. Cridland, 168 Pa. 16, 31 Atl. 939 (1895); 57 A.L.R. 107, 115; Cook, Rescission for Innocent Misrepresentation, 27 Yale L. Jour. 929 (1918); 28 *ibid.* 178.

[12] Ebbs v. St. Louis Union Trust Co., 153 S.E. 858 (N.C. 1930).

[13] Luff v. Nevirs, 106 N.J.Eq. 386, 150 Atl. 834 (1930). Cf. N.Y. Life Ins. Co. v. Marotta, 57 F. (2d) 1038 (C.C.A. 3rd 1932) which distinguishes the defense of fraud in law from that in equity.

[14] Blackwell v. Ketcham, 53 Ind. 184 (1876); Hatch v. Taylor, 10 N.H. 538, 541 (1840); Waldron v. Cutley, 105 N.J.Eq. 586, 144 Atl. 447 (1929); Bowles v. Rice, 107 Va. 51 (1907).

[15] Watts v. Howard, 70 Minn. 122 (1897); Haskell v. Starbird, 152 Mass. 117, 119 (1890); 1 Mechem, Agency (2d ed. 1914), 39, par. 61 ff, 520, par. 737.

[16] *Supra*, note 15.

thority to make, if such agent's duties consisted of finding a purchaser and showing him the land, the contract itself being made by the third person and principal personally? In view of the general custom in America of listing real estate with numerous brokers at the same time, without giving authority to complete a contract,[17] the decisions in the principal cases seem sound in holding that such agent's power is quite limited. His apparent authority does not extend to making representations concerning the character and quality of the real estate. His principal is bound only by unauthorized misrepresentations concerning the location and quantity of the land.[18] This is clearly illustrated in both of these aspects in *Lemarb v. Power*, *supra*, where the court allowed recovery for the misrepresentation concerning the quantity of the land, but refused to permit damages for the false statements about the Standard Oil lease. *Friedman v. New York Telephone Co.*, *supra*, also clearly falls within this principle, the agent having misrepresented the character of the plumbing. Applying the same principle to the *agency* problem in *Light v. Chandler Improvement Co.*, *supra*, the principal would not be liable in an affirmative action for fraud, since the agent's misrepresentation concerned the quality of the land (fertility). But since the fraud was pleaded as a defense, we apply our analysis of the procedural problem and decide as the court did in that case, that fraud can be so pleaded. It is necessary, however, that the party seeking recoupment bring to the attention of *P* the fraud of the agent, and offer to rescind. This was not done in *Light v. Chandler Improvement Co.* so the court found for the plaintiff.

It should now be apparent why the importance of a simple question of fact was stressed as the controlling point in the case of *Taylor v. Wilson*, *supra*. If, as the majority supposed, the agent had authority not only to find a purchaser but also to close the deal, it would be reasonable to suppose that he had more authority than a broker whose power was limited to finding a purchaser. Consequently his apparent authority would include the making of representations concerning the quality and character of the property.[19] Assuming the majority opinion is correct in its statement of the facts, therefore, all four principal cases are consistent.

To sum up and collate the rules presented we can state the liability of an inno-

[17] See excellent discussion of this point in Light v. Chandler Imp. Co., *supra*, note 1.

[18] Location of land: Brennen v. Kent, 206 Ala. 561, 90 So. 790 (1921) (to set aside conveyance); Ballard v. Lyons, 114 Minn. 264, 131 N.W. 320, 38 L.R.A. (N.S.) 301 (1911) (to recover money paid on a contract); Green v. Worman, 83 Mo. App. 568 (1900) (fraud); Firebaugh v. Bentley, 65 Ore. 170, 130 Pac. 1129 (1913) (rescission); 57 A.L.R. 107, 117.

Quantity of the land: Griswold v. Gebbie, 126 Pa. 353, 17 Atl. 673, 12 Am. St. Rep. 878 (1889); Farris v. Gilder, 115 S.W. 645 (Tex. 1908) (to recover value); Mason v. Crosby, 1 Woodb. & M. 342, Fed. Cas. No. 9234 (1846); 57 A.L.R. 107, 117.

[19] "The proper application of this rule [that *P* is liable for the misrepresentations of *A* within his apparent authority] may depend on questions of fact and may vary with the circumstances of each case. Thus it may appear that a real estate broker was also an agent to sell and convey." Pound, J., in Friedman v. N.Y. Telephone Co., *supra*, note 4.

cent principal for fraudulent misrepresentations of his agent concerning land as follows:

1. In an affirmative action of deceit by T against P.

a) If A is merely authorized to find a purchaser, he has power to bind P only by representations concerning the location and quantity of the land, and not for those concerning character or quality of the land.

b) If A has authority to complete a contract, he can bind P by representations concerning quality and character.

2. But although A whose authority is limited to finding a purchaser has no apparent authority to make representations concerning the character of the land, T can rescind or recoup in such a case if he notifies P of the fraud and offers to rescind.

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