

Legal Brief



Who's in Control? Limiting Your Potential Liability From Constructive Agencies

We've written in the past about the liability that you can incur when your "agent" causes harm to a third party. The rationale for that liability is that you control how your agent is performing his or her work.

Remember, an agent is someone you authorize to act on your behalf. Your employees are considered your agents. So are individuals such as brokers or sales representatives. By engaging these agents (whether they are employees or independent contractors), you are empowering or "authorizing" them to deal with third persons on your behalf.

However, there are circumstances in which you may become liable because of the acts of a party you never perceived to be your "agent." This "constructive agency" arises in circumstances where you assume control over the conduct of another.

Case Study

Consider *Jenson Farms v. Cargill, Inc.*, 309 N.W. 2d 285 (Minn. 1981). Cargill is one of the world's largest producers and marketers of agricultural products. Among the services that Cargill provides to its agricultural customers is financial assistance.

Warren Grain & Seed Co. ("WGS") was an enterprise that operated a grain elevator, purchasing grain from local farmers and reselling it to grain companies.

In 1964, WGS applied for financing from Cargill, Inc. Cargill reviewed the operations of WGS and thereafter provided working capital to WGS on an "open account." Under this arrangement, WGS paid its expenses by issuing drafts drawn on Cargill's banks. Proceeds from WGS's sales would then be deposited with Cargill and be credited to WGS's account. As part of the arrangement, Cargill enjoyed the first right to purchase grain sold by WGS.

In 1967, a new contract was negotiated that enlarged WGS's financing. As part of this arrangement, Cargill was given more control over WGS's operations including a veto right over certain business decisions.

The relationship continued and, by 1976, Cargill was buying 90 percent of all grain handled by WGS. Given its economic power, Cargill was now dictating to WGS how to handle its receivables and inventories. Cargill was even "suggesting" what business lines WGS should pursue.

However, in early 1977, problems were discovered. An audit revealed that WGS's financial statements had been falsified. WGS immediately ceased operations, stiffing 86 farmers to the tune of \$2 million for unpaid grain transactions. Those farmers did not go away quietly. They filed suit against Cargill, Inc. claiming that there was an "agency" relationship between WGS and Cargill and that Cargill was liable as "principal" for WGS's wrongdoing.

Perhaps not surprisingly, a Minnesota jury found in favor of the farmers. But Cargill appealed, contending that the elements of an agency relationship could not exist because Cargill never consented to an agency. However, the Supreme Court of Minnesota disagreed holding:

"Agency is a fiduciary relationship that results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.... In order to create an agency there must be an agreement, but not necessarily a contract between the parties....

An agreement may result in the creation of an agency relationship although the parties did not call it an agency and did not intend the legal consequences of the relationship to follow.... The

existence of the agency may be proved by circumstantial evidence which shows a course of dealing between the two parties." (emphasis added) 309 N.W. 2d at 290.

The key finding was that Cargill had undertaken control of WGS's internal operations. It was not merely the fact that Cargill financed WGS (a borrower is not the agent of a bank). It was the evidence of control that tipped the scale in favor of the farmers and against Cargill.

Worth Noting

Certainly, there are not many instances where the party can exercise the type of control that Cargill did with WGS, but the lesson is that the foundation of the agency relationship, and the potential liability that the principal bears, is the control that the principal exercises. Even when there is no express agreement creating an agency, the element of control can create potential liability. ☆

For more information on limiting your liability from constructive agencies, contact Patrick Delaney at MacDonald, Illig, Jones and Britton LLP at 814/870-7658 or wdelaney@mijb.com.

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