Disclaiming an Agency Relationship – Can it be Done?

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Agency disclaimers are an important tool used in contracts to limit potential liability. These disclaimers appear in a wide variety of contexts – agreements between hospitals and physicians, agreements between franchisors and franchisees, and supply agreements. One modern context for agency disclaimers is in software agreements, agreements which pervade everyday life. In fact, we all have clients that have ongoing needs for increased technological advances to run their businesses, and they are not merely purchasing software from a box to serve these needs. Instead, clients turn to Enterprise Resource Planning ("ERP") software to serve as the businesses' corporate backbone, and it is used to run all aspects of their businesses from accounting through warehouse management. Companies ranging in size from Fortune 100 companies to small Mom and Pop organizations use this type of sophisticated software. ERP software,

however, requires customization to handle the needs of any given business. Due to its high level of customization and integration, ERP Software is a major capital investment for a business that could run into the millions of dollars to purchase, and if it fails, result in very significant damages. Because of the way in which ERP Software is distributed, it is important to understand the impact of agency disclaimers.

In the ERP context, ERP Software Developers ("Developers" or "Purported Principals") frequently work solely through a distribution channel of qualified Resellers ("Resellers" or "Purported Agents"), and do not deal with the ultimate Purchaser directly. Instead, the Developer will rely on the Reseller to interface directly with the Purchaser.

During this process, the Reseller will make representations to the Purchaser about the ERP Software's abilities, limitations, hardware requirements, etc. Typically, if the ERP software fails, a Purchaser will likely argue that it relied on the Reseller's representations and that the Reseller served as the Developer's agent. The Purchaser will do this in an attempt to bring more defendants (and a deeper pocket) to the table.

However, the agency argument may well be contrary to disclaimers contained in documents signed by the Purchaser which may include development agreements, license agreements or other contracts with the Developers or Resellers. These documents will govern the relationship, and perhaps, the allocation of potential liability. Accordingly, principles of agency law and the impact of any disclaimers will come into play in the event the software fails to perform as represented and litigation ensues.

When analyzing this for a client, you must consider: (1) Are Resellers working as the ERP Developers' agents? (2) If so, does that mean that Developers may be held liable for Resellers' actions or representations? (3) And, importantly, can an ERP Developer prevent potential liability for its Resellers' actions or representations through an agency disclaimer with either the Reseller or the Purchaser of the ERP software? Whether you represent the Developer, Reseller or Purchaser, this article provides a look into the law of agency and the effect of disclaimers so that companies might become aware of the protection, or lack of protection, that disclaimers provide.

A. The Reseller May Well Be The Developer's Agent

Despite the cutting-edge nature of the product being sold, legal liability in this situation is determined by, and rests upon, the application of agency law, which has existed for over a century. Whether an agency relationship exists is a question of fact, and is determined under one of three theories: actual authority, apparent authority, or agency by estoppel.[1] Actual authority is just that – the principal expresses an intent for

[1] *See, e.g., Brainard v. Am. Skandia Life Assur. Corp.*, 432 F.3d 655, 661 (6th Cir. 2005).

the agent to act on behalf of the principal, and the agent understands that intent.[2] Even if the agent is not "authorized," a principal's liability for an agent's acts and contracts is not limited to those which are expressly authorized. Apparent authority exists when "the principal held the agent out to the public as possessing sufficient authority to act on his behalf and that the person dealing with the agent knew these facts, and acting in good faith had reason to believe that the agent possessed the necessary authority" and the determination must be based on acts of the principal, not the unilateral acts of the purported agent.[3] Agency by estoppel is closely related to agency by apparent authority: agency by estoppel prevents a party from disclaiming an agency relationship if the party has allowed circumstances to exist which reasonably lead a third person to believe they were dealing with an agent of the party, and a third party detrimentally relied on that belief.[4]

In a recent Ohio district court case, the Court addressed whether the facts were sufficient for the Reseller of ERP software to be the Developer's agent.[5] In this case, a Distribution Company purchased ERP Software based, in large part, on the representations by the Reseller that the software could handle up to several hundred users. When the ERP software failed to perform as promised, the Distribution Company filed suit against both the Developer and Reseller. Notably, the agreement between the Developer and Reseller disclaimed an agency relationship. However, the claims against the Developer survived, because the Distribution Company claimed the Reseller was the Developer's agent, and provided factual support for its position. In reaching its conclusion, the Court recognized that there was no "indication that the [Distribution Company] was aware of these agreements [and disclaimers]," and, further, "factual issues" remained as to whether the Developer "could be found liable through a theory of apparent agency or agency by estoppel." [6] In ruling on the summary judgment, the Court concluded the "evidence is sufficient to support a finding by reasonable jurors that [Developer], directly and/or through third parties that it held out as agents and/or partners, represented" that the ERP Software could handle the user size.[7]

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[2] *See Williams v. Caterpillar Inc.*, 940 F. Supp. 2d 840, 845 (C. D. Ill. 2013).

[3] *Ohio State Bar Assn. v. Martin*, 118 Ohio St.3d 119,126, 886 N.E.2d 827 (Ohio 2008).

[4] Restatement (Third) of Agency § 2.05 (2006); *See also, Cullen v. BMW of North America, Inc.,* 490 F. Supp. 249, 253 (E.D.N.Y. 1980) (stating that although no actual agency relationship exists, such an agency may arise where the party charged as principal permits the putative agent to act in such manner that a reasonable man might infer that an agency relationship in fact existed); *Karavos Compania Naviera S.A. v. Atlantica Export Corp.,* 588 F.2d 1, 11 (2d Cir. 1978)(agency by estoppel may arise if the person sought to be charged intentionally or carelessly caused the plaintiff to believe in the authority of the purported agent.").

[5] *Hodell Natco Industries, Inc. v. SAP America, Inc.*, 13 F. Supp.3d 786, 806 n. 7 (N.D. Ohio 2013)

[6] *Id.*

[7] *Id*. at 808.

As with any agency determination, surrounding facts were considered. In this decision, the Court noted that the Purported Agent admitted that they were the Developer's "Partners" authorized to market and service the ERP software, and further admitted in discovery that they were the Developer's agents.[8]

In sum, the Court considered all surrounding facts and, construing them in the light most favorable to the Distribution Company, concluded the case was not appropriate for summary judgment.

In considering whether an agency relationship exists, practitioners should look at all the materials that exist between the parties. This includes marketing materials given by the Reseller to the Purchaser – how is the Developer described? Is the Developer described as a "partner" to the Reseller or other similar term? Does the Developer's logo appear prominently on the marketing materials along with the Reseller's logo? Do the materials indicate that the Developer has "certified" or "authorized" the Reseller? What about invoices, correspondence, or training materials? Again, do these documents indicate that the Developer and Reseller have a "partnership" or show that the Developer has permitted the Reseller to claim that it is working on behalf of the Developer and make product representations? Another key piece of information to review would be the actual agreement between the Developer and Reseller. In this contract, what has the Developer authorized the Reseller to do on its behalf? Finally, is the Reseller the only contact for the Purchaser and are all product representations made solely through the Reseller? Again, this may support a finding that the Reseller has been authorized to do so by the Developer and lead to a finding of an agency relationship.

B. Can the Developer Effectively Disclaim an Agency Relationship?

The above case is an example of how a disclaimer simply will not always serve to prevent liability. Can liability be avoided through disclaimers under any circumstances? The short answer is that it depends.

The Restatement provides that a contractual provision attempting to define whether certain parties are or are not in an agency relationship "is not controlling" of a court's determination of that issue.[9] Most jurisdictions are in accord with the Restatement's reasoning.[10] Rather, in determining whether an agency relationship

[8] *Id.* at note 7.

[9] *See* Restatement (Third) of Agency § 1.02 (2006). Such provisions may be relevant factors to guide the court's consideration, but they are not dispositive. *See id.* at Comment b ("Although such statements are relevant to determining whether the parties consent to a relationship of agency, their presence in an agreement is not determinative and does not preclude the relevance of other indicia of consent.").

[10] *See, e.g., Hodell Natco Industries, Inc.,* 13 F.Supp.3d at 806 n. 7; *Bartholomew v. Burger King Corp.*, 15 F. Supp. 3d 1043, 1049 (D. Haw. 2014) ("a disclaimer of agency in a franchise agreement will not, by itself, defeat liability where the

exists, "the fact finder must examine the facts surrounding the relationship to see if a true principal-agent relationship existed" rather than simply enforcing a clause negating agency in a written contract.[11] And"[i]n the absence of any express authority, the question depends upon a review of the surrounding facts and .the inference that the court might properly draw from them."[12] In other words, the disclaimer alone will not serve to obviate a finding of a principal/agent relationship if other factors support such a conclusion.

If disclaiming an agency relationship between the Developer and Reseller fails, what happens when the Developer notifies the Purchaser directly, through a license agreement, that the Reseller is not the Developer's agent? In other words, will .directly disclaiming an agency relationship between the principal and the third party obviate potential liability? Many cases show that the Restatement rule is also applicable to purported disclaimers of agency directly between the alleged principal and third party, and courts will often consider the circumstances of the particular case rather than simply enforcing the disclaimer.

As one example, the Washington Supreme Court did consider this issue in a malpractice case involving a hospital, physician and patient. In *Mohr v. Grantham*, 172 Wn.2d 844, 262 P.3d 490, 498 (Wash. 2011), the plaintiffs had signed a form which provided that the defendant doctor was not an agent of the defendant hospital. Noting "other relevant considerations," such as discharge instructions that included the hospital's name, the fact that the doctor's name tag also included the hospital's name, and the plaintiffs' receipt of billing statements from the hospital for the service rendered by the doctor, the Supreme Court of Washington held that a genuine issue of material fact existed as to whether the doctor was in fact an agent of the hospital, and the disclaimer was "but one factor to consider." *Id*. This rationale has been applied in other factual settings as well.[13]

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circumstances indicate that the requisite control exists"); *Gulf Ins. Co. v. Transatlantic Reins. Co.*, 69 A.D.3d 71, 886 N.Y.S.2d 133, 151-52, (N.Y. App. Div. 2009) (disregarding an disclaimer of an agency provision because a review of the contract showed that the "true relationship" of the parties was "that of principal and agent"); *Shaw v. Delta Airlines, Inc.*, 798 F. Supp. 1453, 1457 (D. Nev. 1992) ("it is clear that a clause negating agency in a written contract is not controlling"); *See also, In Re Microsoft Antitrust Litigation*, 214 F.R.D. 371, 375 (D. Md. 2003)(considering various factors, including disclaimer of license agreement, and concluding that large account resellers are not Microsoft's agents).

[11] *Shaw*, 798 F. Supp. at 1457. In *Board of Trade v. Hammond Elevator Co.*, 198 U.S. 424, 438, 25 S. Ct. 740 (1905), the United States Supreme Court applied equitable principle, stating that "the relations between the [disclaiming parties] are, as between themselves, expressly disclaimed to be those of principal and agent, [but] is not decisive of their relations so far as third parties dealing with them upon the basis of their being agents are concerned."

[12] *Id*. at 438 (quoting *Mutual Life Ins. Co. v. Spratley,* 172 U.S. 602, 615 (1899)).

[13] In *C&J Vantage Leasing Co. v. Outlook Farm Golf Club, LLC*, 784 N.W.2d 753 (Iowa 2010), the

C. Avoiding Liability

In light of the Restatement rule and the various decisions interpreting and applying the rule, companies should be aware that a disclaimer alone will not necessarily mean that an agency relationship does not exist. While disclaimers are advisable and likely useful, the facts and circumstances will likely dictate whether an agency relationship exists and whether liability attaches.

defendant golf club had signed an acknowledgement that a supplier of golf carts was not an agent of the plaintiff leasing company. The Iowa Supreme Court held that "such a contractual statement is not necessarily conclusive as to the non- existence of such a relationship." *Id*. at 760 (quotation marks and citations omitted). Instead, evidence that the supplier had negotiated the terms of the deal between the leasing company and the club, and had provided "the paperwork used in the transaction," created a genuine issue of material fact as to whether the supplier was the leasing company's agent. *Id*. Further, in *Colonial Pac. Leasing Corp. v. McNatt*, 486 S.E.2d 804 (Ga. 1997), the defendant business had signed finance leases which stated that employees of an equipment supplier were not agents of the plaintiff finance company. The Supreme Court of Georgia stated that the disclaimer of agency provision was not dispositive of the issue, but held that no agency relationship existed because there was no evidence that the employees of the supplier acted as anything more than "aconduit of information between" the business and the finance company. *Id*. at 270-71. *But see,Potomac Leasing Co. v. Thrasher*, 181 Ga. App. 883, 354 S.E.2d 210 (Ga.Ct.App. 1987), which came to the opposite holding based on similar facts. The *Thrasher* court held that a disclaimer of agency by the finance company in that case did not overcome the fact that the supplier's salesmen were provided with blank copies of the finance company's leasing documents and instructions on how to fill the documents out, and were authorized to negotiate leases with customers on the finance company's behalf. *Id*. at 212-213.