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ONE YEAR REVIEW OF AGENCY, PARTNERSHIPS AND CORPORATIONS

By GERALD H. KOPEL*

Real estate brokers, a mining prospector, officers of a large corporation, an attorney who drank too much, and a lady on an operating table combined to make this an interesting year in the field of Business Associations.

AGENCY

A. *Real Estate Brokers*

In *Nunnally v. Hilderman*,[1] the supreme court affirmed the fact that the English language does not always have the same meaning in law as it does to the layman. Here was considered the authority of a bank, acting as agent, "to sell" real estate. The principal contended the bank had no authority to bind the principal to convey, and the supreme court agreed.

The Colorado Statute of Frauds provides that every instrument required to be subscribed by any party for the sale of real estate may be subscribed by the agent of such party, lawfully authorized in writing.[2]

Written instructions in general terms, "to sell" real estate, when placed in the hands of an agent confer authority upon the agent only to produce a purchaser to buy upon terms offered by the principal.[3] The agent has no authority over the title "unless he is specifically authorized in writing to bind the title or to enter into a contract binding the owner to convey the title"[4] or "to execute an executory contract for the sale of real estate."[5] As a special agent, or an agent with specific authority to deal in real estate, "any person dealing with him is bound at his peril to learn the extent of that authority."[6] The supreme court held that the agent was given no such specific authority in writing under the evidence presented, nor was there any ratification of the acts of the bank by the principal based upon knowledge of all material facts.[7]

In *Garrett v. Richards*,[8] real estate broker was granted a written, exclusive, irrevocable right for a specified period of time to sell owner's home. The agreement, accepted in writing by broker, provided that in case of sale by owner, broker, or any person during the period of the listing, broker would be entitled to his commission. Broker advertised the property and expended other efforts to produce a sale. Owner notified broker to take the property off the market because he had decided not to sell. Broker, within the specified

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1 373 P.2d 940 (Colo. 1962).
2 Colo. Rev. Stat. § 59-1-8, -9 (1953).
3 Springer v. City Bank and Trust Co., 59 Colo. 376, 149 Pac 253 (1915).
4 Stark v. Rogers, 69 Colo. 98, 106, 169 Pac. 146, 148 (1917).
5 Johnson v. Lennox, 55 Colo. 125, 129, 133 Pac 744, 746 (1913).
6 *Id.* at 130, 133 Pac. at 746.
7 Even though the principal stated in a letter that she was agreeable to a sale to purchaser for the specified price, the letter stated further that principal "does not know the contents of the agreement entered into between" bank and purchaser. "Please advise what was contracted for . . . and what is customary under similar circumstances." 373 P.2d 940, 943 (Colo. 1962).
8 369 P.2d 566 (Colo. 1962).

period of time, then produced a buyer ready, willing and able to buy upon terms set forth in the listing. Owner refused to sell. Is the owner liable to broker for the amount of commission broker would have received if the sale had taken place? The supreme court said yes, in a decision which establishes definite Colorado rules concerning irrevocable listings.

The issue is whether an "irrevocable" contract is binding, and whether it is revocable. Owner maintained the contract was "nudum pactum," unilateral and unenforceable as an executory contract because of lack of consideration as of the time he notified broker to take the property off the market. The court agreed that the contract was not binding "until some service is rendered by the broker looking to the sale of the property."[9] It becomes binding "when the broker expends money or performs services in furtherance of his own and the owners' purposes,"[10] stated the court. This partial performance of the main consideration, which is the sale, is sufficient to make the contract binding. Another factor considered by the court is that the exclusive, irrevocable contract must be for a reasonable specified time.[11]

This decision, while justifiable and equitable from the viewpoint of the broker,[12] might be considered contrary to the general spirit of principal-agency law concerning irrevocable agencies. We are not speaking of the right of a broker to receive his commission upon the production of a buyer, or to sue for damages, but rather of the power of a principal to terminate an agency. The principal, in an ordinary agency, always has the power, though not the legal right to fire an agent. The principal is, of course, liable in damages if the firing is not justified under the terms of the contract. But if the agency is irrevocable, then the principal has no power to terminate the agency.[13]

Certainly there can be no dispute with the court's con'ention that the expending of money or performance of service made this contract one that was binding and enforceable for purposes of a suit for damages. The question remains as to whether the incurring of expenses in and about the business of the agency, under terms of a contract such as this one, should bar the power (as it bars the right) of the seller to revoke the contract.

An irrevocable agency is not normally terminated by death or other operations of law which terminate an ordinary agency.[14] Query: Does this mean that an individual broker, operating under the *Garrett* rule, may die before the end of a specified time limitation of the irrevocable contract and that his estate may complete the contract and obtain the commission?

In *City of Pueblo v. Leach Realty Co.*,[15] the defendant city, having some old airport land to sell, appointed all licensed real

9 *Id.* at 568.
10 *Ibid.*
11 The listing was from January 31 to April 31, and then extended to May 31. Buyer was produced on May 27.
12 The court differentiates Garrett v. Richardson from Lambert v. Hoskins, 128 Colo. 473, 263 P.2d 433 (1953). In the Lambert case, an exclusive agency to sell did not eliminate a sale by the owner himself, and there was no liability to the broker for a commission if owner sold. The exclusive agency only forbade the sale by another agent, without a commission going to broker. The language in the Garrett contract was such that a commission was due broker no matter who sold the property.
13 12 C.J.S. *Brokers*, Section 16b, p. 46.
14 12 C.J.S. *Brokers*, Section 16c, p. 49.
15 368 P.2d 195 (Colo. 1962).

estate brokers in the city as its non-exclusive sales agents. Plaintiff submitted what amounted to an acceptance of the city's terms and conditions for purchase of the entire tract by plaintiff's client. On the same day, but apparently at a later hour, another broker submitted an offer to purchase. The second offer, combined with a third offer of another firm made at a later date, was accepted by the city council.

Plaintiff sued for his commission, and was awarded $17,535. The supreme court approved the jury verdict, holding that the transaction with plaintiff's client "failed only because the defendant failed and refused to perform its part of the agreement and not because of any act of the broker or purchaser. If a seller does not perform once a qualified buyer is produced by his broker the seller cannot escape the payment of the agreed commission."[16]

The court cites 12 CJS *Brokers,* Section 92, page 213: "Where several independent brokers are employed to effect the same transaction, only one commission is to be paid and that is to be paid in full to the broker who first succeeds and is the procuring cause of the transaction."[17]

B. Notice and Knowledge

There is a general rule in agency law, subject to some exceptions, that notice or knowledge of an agent is notice or knowledge of his principal. The Colorado Supreme Court, however, has held that this is not necessarily true, depending on who the agent is. Thus, in *Zika v. Eckel,*[18] notice of a trial setting upon attorney for the defendant, as provided by Colo. R. Civ. P. 5(b)(1), was not considered sufficient notice to the defendant "where it is generally known by both the bench and the bar of the county that the whereabouts of the party's attorney is frequently, and for extended periods of time, unknown, and that the absences from his work are many times the result of his excessive drinking . . . ."[19] In such a situation, the court should order service upon the defendant, states the supreme court.

Clients of real estate agents do not fare as well, as shown by *Dunklee v. Lederman.*[20] The seller-client of real estate broker approved an offer of purchase on December 9, 1962. Testimony at trial indicated that buyer notified broker on December 8, 1962, that the offer was withdrawn. Even if the trial testimony was disputed, broker had knowledge of the withdrawal of offer when he presented buyer's check for certification and was notified that payment had been stopped. Seller-client did not have actual knowledge of the withdrawal of the offer at the time of acceptance, but because broker "had knowledge of the fact . . . his knowledge was imputable to his principal in law if not in fact, and as such the purported acceptance was a nullity."[21]

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16 *Id.* at 196.

17 Other real estate agent cases decided in 1962 were Leece v. Griffin, 371 P.2d 264 (Colo. 1962) (statement of a real estate salesman in answer to a question by a proposed purchaser as to income, was a mere prediction of future income, and the fact that such prediction did not prove accurate was not a basis for maintenance of a fraud action); and Cherry Creek Realty Inc. v. Amter, 368 P.2d 787 (Colo. 1962) (commissions are paid for achievement, not effort).

18 372 P.2d 165 (Colo. 1962).

19 *Ibid.*

20 374 P.2d 699 (Colo. 1962).

21 *Id.* at 701.

C. *Unlawful Interference with Agency by Third Person*

Settlemeyer sued Watson[22] for unlawful interference by Watson with Settlemeyer's oral distributorship contract for Colorado, granted by Bardahl Manufacturing Corporation.[23]

Watson, who was Bardahl's New Mexico distributor, replaced Settlemeyer in Colorado under a written contract which contained several provisions concerning the ouster of Settlemeyer.

The evidence showed Watson had visited the Bardahl offices just prior to Settlemeyer's termination, and that Watson had previously attempted to trade distributorship areas with Settlemeyer. During his period as Colorado distributor, Settlemeyer had spent large sums to advertise and promote Bardahl, and at the time of his ouster, he had a considerable stock of Bardahl products and promotional materials on hand.

Watson claimed the oral contract between Settlemeyer and Bardahl was terminable at will, and therefore no possible damages could accrue. The supreme court conceded the possibility, without deciding the issue, that Bardahl might have had the right to terminate the contract at will.[24] But even so, stated the court in upholding the $7,500 damage award to Settlemeyer, "Watson had no right to induce such an act or to intentionally interfere . . . by promoting his purpose and intention to take over if Bardahl was successful in ousting Settlemeyer."[25] ". . . independent contractors or agents . . . have the right to earn a livelihood and to continue their business unmolested by unwarranted activities of third persons and are entitled to protection in equity just like the employees of any business."[26]

There has been an extremely large increase in the number of exclusive franchise contracts held by businessmen in Colorado dur-

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22 Watson v. Settlemeyer, 372 P.2d 453 (Colo. 1962).

23 Settlemeyer had attempted to sue Bardahl also, on the basis of alleged conspiracy to breach the oral distributorship contract. However, Bardahl was a foreign corporation which was not doing business in Colorado, according to the court's decision. Settlemeyer attempted to gain jurisdiction by serving Bardahl's counsel, who was present as both counsel and witness for Watson, at Watson's trial. The supreme court held that service on an attorney in open court, or on an attorney appearing specially in a state, is improper unless the attorney has been specifically authorized by his client to accept service. Further, general employment as an attorney is not sufficient grounds to serve his client by serving the attorney. (Bardahl Manufacturing Corp. v. District Court, 372 P.2d 447 (Colo. 1962). For another case on what constitutes "transacting or doing business" within Colorado for purposes of obtaining jurisdiction by service on the secretary of state under CRS 31-35-19(3), see Bay Aviation Services v. District Court, 370 P.2d 752 (Colo. 1962).

24 " . . . Settlemeyer's accounts with Bardahl were becoming delinquent and Bardahl was becoming dissatisfied with Settlemeyer." 372 P.2d 453, 455.

25 *Id.* at 456.

26 *Ibid.*

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ing the past decade, and the cases cited by the supreme court in reaching this decision should be required reading for any attorney dealing in this field of law.

D. *Liability for the Torts of Others*

In *Industrial Comm'n v. Standard Ins. Co.*,[27] plaintiff was employed as a roughneck. While so employed he sustained an accidental injury to his left arm, breaking a bone in the area of his wrist. He was treated for this injury by a physician selected by the employer. The treatment resulted in a marked deformity of plaintiff's left wrist requiring further operative procedure. The court held that in Colorado, under our Workmen's Compensation Act, the employer is liable for the unskillfulness or error of judgment of the physician furnished as required.

In *Moon v. Mercy Hospital*,[28] however, plaintiff sought to recover damages from Mercy Hospital for an alleged injurious tort. The complaint alleged that Mercy employed a resident surgeon who carelessly and negligently diagnosed, treated and operated on plaintiff, and that Mercy was responsible for the resultant damages. The district court dismissed the action as one not stating a claim upon which relief could be granted, and the supreme court upheld the decision. The court's logic is that a hospital is not licensed to practice medicine; the relationship between doctor and patient is personal; the hospital is powerless to command or forbid any act by a doctor in the practice of his profession; the hospital is not liable unless it employs those whose want of skill is known, or should be known to it, or by some special conduct or neglect the hospital makes itself responsible for their malpractice.

> It is the import of our decisions that a licensed physician is the principal when performing medical services in a hospital. When a doctor diagnoses, treats and operates on a patient in a hospital, he is in command of these functions, and the hospital and its employees subserve him in his ministrations to the patient. He has sole and final control . . . .[29]

Plaintiff made one fatal error. She should have been an employee of Mercy Hospital, injured on the job. Then Mercy would have been liable. Perhaps the distinction between the two cases makes sense under the statutes of our state, but certainly the results appear inequitable. Query: Does our supreme court really believe that a patient has any choice in the selection of a resident doctor on duty at a hospital?[30]

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[27] 370 P.2d 156 (Colo. 1962).

[28] 373 P.2d 944 (Colo. 1962).

[29] *Id.* at 945, 946.

[30] Agency cases of minor import in 1962 were Parent v. Kopanos, 368 P.2d 784 (Colo. 1962) (could be construed to state that covenants of employees not to compete are not transferable by inference upon employer's sale of the business even though the seller might remain a third-party benefiiciary of such covenant); San Miguel Basin State Bank v. Finch, 369 P.2d 544 (Colo. 1962) (small "family" bank, acting as escrow agent was held liable for wrongful distribution of funds received. The supreme court, in effect, held bank for acts of its president acting within his actual and apparent authority. Bank had clecred a debt owing to it by the wrongful distribution); Armour and Co. v. Peterson, 371 P.2d 770 Colo. 1962) (defendant was not liable to contractor's employee for injuries sustained when employee used defendant's machine to remove employee's tools after completion of job, where employee knew that machine was not in good working condition and defendant had not given employee permission to use the machine); and Berry v. American Liberty Ins. Co., 375 P.2d 93, 96 (Colo. 1962) " . . . the doctrine of estoppel cannot be invoked against any governmental agency acting in its public capacity . . were it otherwise, the state's servans could waive most of her revenue."

CORPORATIONS

A. *Breach of Fiduciary Duty*

The president of American Founders Life Insurance Company of Denver, caused the issuance of 24,000 shares of the corporation's common stock to three individuals in return for 58,750 shares of Texas Adams Oil Company stock. One year after the swap, the oil company was adjudged a bankrupt and was defunct. The 24,000 shares of American were valued at $1.60 per share, or $38,400 total. The oil company stock was finally sold for $1,000, leaving a $37,400 deficit which was assessed by the trial court against defendants jointly and severally, under suit brought by plaintiff, American Founders.

The supreme court decided the president's writ of error in *Hudson v. American Founders Life Ins. Co. of Denver*.[31] There was no question as to the fiduciary duty owed by officers and directors of corporations under Colorado law; the question was whether a duty was breached.

The president caused the stock issuance. He signed the certificates knowing they were being issued in exchange for Texas Adams; he admitted and assumed full responsibility in the minutes of the shareholders meeting of March 12, 1957 (about the time that Texas Adams went bankrupt). Issuance of the stock breached the "underwriting agreement" of plaintiff with Colorado Management Corporation, the firm which was to sell the stock for cash. The president did not bring up the transaction at any regular or special board meeting, but did do so at an informal discussion among Colorado Management officials, some of whom consented to waive the provisions of the underwriting agreement, provided the Texas Adams stock was sold and converted into cash before issuance of stock in the plaintiff corporation.

The president went ahead with the stock exchange. Eleven months (and nine meetings of plaintiff corporation) later, he discussed the Texas Adams swap with the board of directors of plaintiff. The supreme court said:

> Hudson personally caused the issuance [of stock] . . . of plaintiff corporation, not only without authority from the board of directors but without any information being imparted to the board . . . until eleven months after the Texas Adams transactions had been completed. Suffice it to say that such evidence is sufficient to establish violation of the duties and obligations of the presidency which also carried with it management of the company.[32]

One of the defenses was ratification of the Texas Adams transaction by plaintiff's board of directors at subsequent annual meetings of stockholders. The supreme court referred to the rule set forth in *Colorado Management Corp. v. American Founders Life Ins. Co.*,[33] to the effect that stockholders' approval of all lawful acts does not constitute ratification of acts which the law regards as unlawful or invalid.

In *Holland v. American Founders Life Ins. Co. of Denver*,[34] the

31 377 P.2d 391 (Colo 1962).
32 *Id.* at 395.
33 145 Colo. 413, 359 P.2d 665, more fully set forth in 39 Dicta 74-75 (1962).
34 376 P.2d 162 (Colo. 1962).

supreme court held that the secretary was not liable, jointly or severally, with the president for the $37,400. While the secretary did sign his name and affix the corporate seal on the share certificates to the three individuals, his duties in doing so were ministerial only, the supreme court stated, and his "performance of his duties as secretary and his conduct as a director was not a contributing cause of the loss sustained . . . ."[35]

> A director and officer of a business corporation is liable for his own misconduct and not for the wrongful conduct of other directors or officers unless he joined with them in perpetrating the wrong. The directors . . . are not to be held responsible for mere errors of judgment or for want of prudence short of clear and gross negligence.[36]

B. *Equitable Ownership of Stock Certificates*

In *Arfsten v. Higby*,[37] the supreme court decided that the Uniform Stock Transfer Act[38] does not prevent the equitable owner of stock certificates in a corporation from bringing an action against the corporation, where the allegation of stock ownership is necessary for the litigation. The court stated:

> We construe the sections involved[39] as dealing with legal titles, and conclude that the statute clearly recognizes the existence of equitable or beneficial ownerships or interests in shares of stock. The Act does not purport to do away with such ownerships or interests . . . . Indeed, a construction against such ownership or interest would cast doubt on the validity of the Act.[40]

Stock certificates of the plaintiff were never properly endorsed by the person appearing to be the owner; there was no delivery by that person; and no separate instrument signed by the person appearing to be the owner. The court affirms that any equitable ownership based upon those facts could not be recognized when the rights of third parties are present who might otherwise be misled.

[35] *Id.* at 165.
[36] *Id.* at 165, 166.
[37] 372 P.2d 166 (Colo. 1962).
[38] Colo. Rev. Stat. §§ 31-9-1 to -22 (1953).
[39] The court stated that Colo. Rev. Stat. § 31-9-1 (1953) "Title to a certificate can be transferred only" must be read in connection with § 31-9-21, subsections (h) andd (ii): "(h) 'Transfer' means transfer of legal title. (i) 'Title' means legal title and does not include a merely equitable or beneficial ownership or interest." 372 P.2d 166, 168.
[40] *Id.* at 168, 169.

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But majority stockholders and corporate officers are not "third parties" within the protective coverage of that term.

This was the first interpretation by the court of the effect of the present Uniform Stock Transfer Act on equitable titles in shares of stock, although prior decisions[41] under prior acts held an enforceable status for the holder of an equitable title to stock.[42]

PARTNERSHIPS

A. *Capital Contributions*

Reducing *Reidel v. Brant*[43] to its simplest terms, we have the following: Six weeks after formation, a partnership has a $65,000 operating loss. Following judgment by a creditor, partners A, B, and C agree to dissolution, winding up and termination under auspices of the court. The partnership articles provide for a 6-2-2 profit-loss ratio. Partner A was to have supplied $60,000 as the total capital for the business. B and C contend that A only supplied $48,000 and that B and C are damaged to the full extent of any amounts that might be their contribution to make up losses sustained. B and C claim they are in no manner further obligated to partner A or the partnership. The trial court agreed. The supreme court disagreed.

The supreme court held the evidence showed partner A had contributed more than the total required capital of $60,000. Even if partner A had not, the court stated in what amounts to dictum, parners B and C would still not be relieved of their duty of contribution towards the partnership losses, since there was no proof that B and C suffered any damages by reason of A's failure to supply the full capital.

This ruling appears equitable under the commercial maxim "don't throw good money after bad." This dictum, however, might afford dangerous solace to a cautious member of any partnership who withholds needed capital. It is hoped that the court's ruling will not be interpreted as a general sanction for such practice, but merely a justifiable decision based upon particular facts.

In *Thompson v. McCormick*,[44] we find the unusual situation of a plaintiff entitled to claim three million dollars without ever hav-

41 Carlton v. Camfield, 64 Colo. 373, 171 Pac. 1140 (1918); Weber v. Bullock, 19 Colo. 214, 75 Pac. 183 (1894).

42 Other 1962 cases dealing with corporations are Colorado So. Pet. Corp. v. Stone, 369 P.2d 438 (Colo. 1962) (corporation has burden of proving corporate president violated fiduciary duty); and Martinez v. Southern Ute Tribe, 374 P.2d 691 (Colo. 1962) (the tribe, by adopting incorporation under 25 U.S.C.A. § 476 and consenting to sue and be sued in courts of competent jurisdiction within the United States, has rendered itself amenable to the courts of the State of Colorado in any action of which the state courts may take cognizance. Reservation of the tribe is in La Plata and Archuleta counties, Colorado).

43 368 P.2d 771 (Colo. 1962).

44 370 P.2d 442 (Colo. 1962).

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ing placed one cent into partnership funds. Defendant individually leased mining claims from the U.S. Atomic Energy Commission. He then entered into an agreement which provided that plaintiff was to be a silent partner in McCormick Mines and that plaintiff "is depositing . . . ten thousand dollars"[45] to the enterprise's bank account. Profits and losses were to be shared equally. Defendant was to be manager and "in the eyes of the public, sole owner."[46]

Plaintiff and defendant co-signed notes totalling $10,000 in return for cash loan to the enterprise's account. Profits of $41,000 were divided until there was a "falling-out" about a year after the agreement was entered into. Defendant then denied that a partnership had ever existed.

Trial was to the court seven years after plaintiff's original complaint for appointment of a receiver and an accounting. The supreme court reversed the lower court's judgment for the defendant.

The main issue was whether the $10,000 deposit as a fixed capital contribution was a condition precedent to the formation of the partnership, assuming the co-signing of notes for that amount was not the $10,000 contemplated by defendant. The court said:

> . . . the failure by a partner to contribute his share of capital does not necessarily negative the existence of a partnership. Such failure may be waived by the other partner, where as here following execution of the agreement, [defendant] authorized and made payments of profits to plaintiff.[47]

The agreement entered into, according to the court, "clearly embodies every element necessary for the formation and creation of a partnership, and when it was executed by the parties nothing further remained to be done to legally bring about a partnership relation."[48]

"The intention of the parties and their interpretation of the contract before controversy arises is one of the best indications of their true intent."[49] Once a partnership is found to exist, the fact one partner has failed to make the required capital contribution "is no reason to impose a forfeiture when the contribution can be deducted from his share of the profits."[50]

Defendant also contended that the partnership was void as against public policy because the Atomic Energy Commission leases to individuals only. But the supreme court agreed that so long as defendant was the sole operator of the lease and the partners only divided the proceeds, there was no violation of the government lease.[51]

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45 *Id.* at 443.
46 *Ibid.*
47 *Id.* at 446.
48 *Id.* at 445.
49 *Id.* at 445, 446.
50 *Id.* at 446.
51 For another case construing government mineral leases where a partnership is involved, see Bear v. Bear, 377 P.2d 538 (Colo. 1962). The case deals with rights under a survivorship agreement and also affirms the rule that partnership business partly carried on upon the surface land owned by one partner does not make it partnership property.

One case on joint adventure is Garrett v. Kimbrel, 376 P.2d 376 (Colo. 1962). Whether parties are engaged in joint adventure is question of fact to be determined from facts and circumstances in evidence, and it is not necessary that there be shown specific, formal agreement, but it is sufficient if it be shown by parties' conduct and other factors from which it is made to appear that relaionship in fact was entered into. Acts and conduct of parties in furtherance of their purposes to form joint adventure may speak above their expressed declaraions to contrary.