December 31, 2018

The Naughty List - Responsibility for Rogue Elements

by Markus Esly

When should a company, partnership or principal be liable for fraud committed by their employee, partner or agent? In answering this question, the law has to strike a balance between the interests of those who conduct their business through representatives and third parties who deal with those representatives, often without knowing the true position or authority given to the intermediary.

In *Winter v Hockley Mint Ltd* [2018] EWCA Civ 2480, the Court of Appeal overturned the High Court, finding that the judge had applied the wrong legal test when grappling with the issue. The agent had fraudulently induced a company to enter into a contract – committing the tort of deceit. Holding the principal liable for the deceit of the agent, the judge had applied a modern unified test rather than following earlier authorities specifically concerning dishonesty (as opposed to other misconduct by agents). Arguably, on the High Court judge's approach, it would be easier to hold a principal liable for an agent's dishonest schemes. However, the Court of Appeal reaffirmed the earlier test. It remitted the case for a re-trial (which might yet result in the principal being liable anyway).

This article reviews the relevant legal principles and considers whether the Court of Appeal's decision is to be applauded.

The fraudulent scheme

Winter v Hockley Mint Ltd was about a company, Hockley Mint, having been duped into signing a contract which would, allegedly, allow it to use rented postal equipment to send out all its mail and make a handy profit. Hockley Mint is a jewellery manufacturer specialising in gold and silver wedding rings. The company incurs significant postage costs which it wanted to reduce. In 2015, Hockley Mint came across a Mr Ramsden, the dishonest agent in the piece. Mr Ramsden proposed that Hockley Mint lease postal equipment which he would procure, in return for hire payments. However, Mr Ramsden promised that if the company used this equipment to process its mailings, this would cause Royal Mail to generate 'postage credits'. Those credits would ultimately be applied for Hockley Mint's benefit, completely covering the hire payments with a potential upside for the company.

All of this was a lie. There were no 'postage credits' from Royal Mail. Instead, Mr Ramsden arranged for Hockley Mint to enter into tri-partite leasing agreements between the company, BNP Paribas and the ultimate supplier of the postal equipment, a business called 'Erskine Hathaway'. Erskine Hathaway was the chosen trading name of a Mr Winter, by all accounts a sole trader who would play the role of the principal. Mr Winter had sold the postal equipment to BNP Paribas, at a considerable profit. BNP Paribas then entered into the lease agreements with Hockley Mint. The hire charges were substantial, seeing that they had to cover Mr Winter's mark-up on the equipment and the bank's margin. This was an expensive deal for Hockley Mint. During the first year, Mr Winter would make certain payments, which would be passed back to Hockley Mint. However, rather than being 'postage credits', these payments just came out of the profit that Mr Winter had made on the sale to BNP Paribas. These payments stopped after the first year, leaving Hockley Mint with the expensive equipment and substantial hire payments to BNP Paribas which would continue for several years.

When this became apparent, Hockley Mint commenced proceedings against Mr Ramsden and Mr Winter, alleging (among other matters) deceit, as Mr Ramsden has fraudulently induced Hockley Mint to sign up to the

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scheme by promising that there would be ‘postage credits’. The company argued that Mr Winter was liable as a principal, because Mr Ramsden had acted within the scope of his authority when implementing the fraudulent scheme.

The judge’s findings

In the High Court, the late HHJ Purle QC made a number of findings. He concluded that Mr Ramsden had deliberately misled Hockley Mint, and the company had relied on Mr Ramsden’s fraudulent assurances when entering into the lease agreements with BNP Paribas. Mr Winter, however, was found to have been unaware of these misrepresentations. As Mr Winter had not been dishonest, he was not personally liable for deceit. It seems that Mr Winter came across well in the witness box.

Even though Mr Winter knew of the terms of the BNP Paribas agreements, and subsequently paid the ‘rebates’ to Hockley Mint against invoices referring to these payments as “*savings on postal agreement”*, the judge accepted that he was not personally complicit in the fraud. Hockley Mint had relied on the inherent improbability of the deal as implicating Mr Winter, arguing that there was no good commercial (or innocent) reason why Mr Winter should sell on the equipment at such a substantial profit, only for then to pay back some of that profit as an apparent inducement for the transaction. HHJ Purle QC noted that striking a profitable deal was not, of itself, sufficient to cast any doubt on Mr Winter: making a profit was the reason why he was in business, and he had held up his end of the bargain by supplying the equipment on the agreed terms.

Turning to the agency relationship between Mr Ramsden and Winter, the judge found that Mr Winter had given Mr Ramsden the contractual documents that Mr Ramsden then negotiated with Hockley Mint. Mr Winter also gave Mr Ramsden an Erskine Hathaway email address, from which Mr Ramsden then proceeded to communicate with Hockley Mint. Mr Winter monitored these exchanges. He also gave Mr Ramsden Erksine Hathaway notepaper with a logo on it. Mr Ramsden used that logo when writing to Hockley Mint. Mr Winter even went so far as insisting that when communicating from Erskine Hathaway, Mr Ramsden should assume a pseudonym. He was to pretend to be the fictitious Mr ‘Karl Hansen’. Mr Winter required this because he was concerned that Mr Ramsden had an ‘unsavoury reputation’, and did not want the Erskine Hathaway name to be tainted by association.

The ‘sufficiently close connection’ test applied by the High Court

The judge reviewed the authorities, including the well-known decision of the House of Lords *Armagas Ltd v Mundogas SA* [1986] 1 AC 717 (of which more below), and concluded that there was one unified test for determining whether a principal was liable for the deceit of an agent, a test which applied to all intention torts (including deceit or fraud). The question was whether there was a sufficiently close connection between the agent’s wrongdoing and the ‘class of acts’ which the agent had been employed to perform, such that it was just and fair for liability to be imposed on the principal.

Based on the findings concerning the relationship between Mr Winter and Mr Ramsden, the High Court concluded that the test was satisfied. Mr Winter had plainly tasked Mr Ramsden with concluding a deal with Hockley Mint. Mr Ramsden’s misrepresentations about the fictitious postal credits had been key. The judge held that:

> “*… taking the test as the broad one and looking at the closeness of the connection between Mr Ramsden’s authorised activities and the representations he made, they were all an integral part of the same selling process. It is unreal … to separate the representations which he made about postal savings and the like from the actual selling of the equipment. I cannot do so.*

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Mr Ramsden was carrying out authorised activities in the way he saw fit. He was authorised to enter into and complete the transactions. He must have been authorised also to hold himself out as authorised by Erskine Hathaway, which in fact he was.

Mr Ramsden … was undoubtedly acting for Mr Winter because he was the ultimate supplier. He stood to gain from these transactions and the representations were made as an integral part of the selling process from which the gain derived. In those circumstances, it seems to me right and just that vicarious liability should apply."

Vicarious liability: strict liability justified on public policy grounds

In reaching that conclusion, the judge distinguished the House of Lords decision in *Armagas v Mundogas*. He preferred to apply a test that has been formulated to deal with vicarious liability, a principle that is usually concerned with the liability of the employer for acts done by an employee 'in the course of their employment.' Vicarious liability is secondary or indirect liability for wrongs committed by someone else. Lord Sumption explained the underlying principles as follows in *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23:

"*Vicarious liability does not involve any attribution of wrongdoing to the principal. It is merely a rule of law under which a principal may be held strictly liable for the wrongdoing of someone else. This is one reason why the law has been able to impose it as broadly as it has. It extends far more widely than responsibility under the law of agency: to all acts done within the course of the agent's employment, however humble and remote he may be from the decision-making process, and even if his acts are unknown to the principal, unauthorised by him and adverse to his interest or contrary to his express instructions … indeed even if they are criminal …*"

Imposing such strict liability can be justified on public policy grounds. Employers, firms or principals are more likely to have the financial resources to compensate victims than those individuals who commit the wrong. The 'sufficiently close connection' test determines whether the act in question was 'in the course of employment' such that strict liability attaches, or was instead a frolic of the employee – in which case the employer is not liable. To give an example, vicarious liability will attach where the employee, in the course of transferring petrol into a tank, lights a cigarette and throws the match on the floor, with predictable consequences. The employee may not have been specifically authorised to light the match (or indeed smoke), but there is still a sufficient connection between the employee's duties and the ensuing fire to hold the employee liable (*Century Insurance Co Ltd v Northern Ireland Road Transport Board* [1942] AC 509). The same result was reached where the employer's security guard set fire to the factory that he was meant to be patrolling and protecting (*Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827) – though that case is better known for the exclusion clause that was upheld and thus came to the employer's rescue.

Vicarious liability has also been found to exist where the employee or agent committed a fraud. In *Lloyd v Grace, Smith & Co* [1912] AC 716, a firm of solicitors employed a conveyancing clerk. He was left to practice unsupervised. The clerk succeeded in inducing a client of the firm to convey two cottages to the clerk himself. The client in question was Mrs Lloyd, a widow. Mrs Lloyd had fallen into poverty. She was of such limited means that the original law reports gave the name of the case as "*Lloyd (Pauper) v Grace, Smith & Co*". Mrs Lloyd's last remaining asset was a cottage which she rented out. She went to see the defendant solicitors because she was unhappy about the return she was making. The conveyancing clerk suggested she sell the cottage, went into a back room and returned with deeds that would convey the cottage into his own name. He presented these papers without comment. Mrs Lloyd signed without reading them, thinking they were paperwork that had to be completed before a sale could proceed. The firm had authorised the clerk to run its conveyancing business,

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including handling deeds and executing transactions, and had held the clerk out as being so authorised to the firm's clients. The firm argued, however, that it should not be liable for the clerk's fraud, because he had acted purely for his own benefit. The House of Lords disagreed. Provided that the agent was acting within their authority, it did not matter that the fraud was committed purely for the agent's gain. The principal would nonetheless be liable.

In 1912, English law had not yet fully developed the notion of apparent, or ostensible, authority of an agent. Such apparent authority arises where an agent appears to be acting on behalf of the principal but does not in fact have the principal's actual authority to do the act in question. The third party, dealing with the agent, will usually not know the true position as regards the agent's authority. Instead, they will have to rely either on some representation or holding out by the principal to the effect that the agent has authority, or on statements made by the agent himself that they are properly acting for the principal – the agent's warranty of authority. Where the agent warrants his own authority, the principal is (generally) not bound. Where, however, there has been a holding out by the principal, and the third party reasonably relies on this, the principal is bound by virtue of the agent having 'apparent' or 'ostensible' authority. In *Lloyd v Grace, Smith & Co*, all that Lord MacNaghten said about this issue was that acting within his authority', 'acting in the course of his employment', and 'acting within the scope of his agency' all meant the same thing. The House of Lords was not troubled by any argument that the clerk had not been authorised to procure fraudulent transfers of properties into his own name.

The need for apparent authority where the agent was fraudulent: *Armagas v Mundogas*

Some sixty years later, the House of Lords dealt with another fraudulent agent in *Armagas v Mundogas*. That was the case which the judge in *Winter v Hockley Mint* felt able to distinguish. It is an important decision on the limits of ostensible or apparent authority, particularly in cases of deceit: *Armagas* v *Mundogas* is often cited as support for the proposition that agents cannot self-authorise, by proclaiming that they are acting within the scope of their authority. Instead, the principal is only liable where there has been some communication or act emanating from the principal, on which the third party has relied.

Mundogas had chartered a vessel called the 'Ocean Frost'. Under the charterparty, Mundogas had an option to buy the vessel at the end of the term, at a specified price. Mr Magelssen, Mundogas's chartering manager, saw an opportunity. He thought the market was such that Mundogas could exercise the option and quickly sell the Ocean Frost on to someone else at a decent profit. Mr Magelssen started to discuss such a potential on-sale with a firm of shipbrokers: Mr Johannesen was his counterpart. Mr Johannesen found a prospective buyer, Armagas, but that buyer only wanted to acquire the Ocean Frost if it was immediately chartered back to Mundogas for three years, at an appropriate rate of hire. The problem was that Mr Magelssen had no authority to commit Mundogas to charterparties with a three-year term – that was an unusually long contract. Mr Magelssen was only permitted to sign off on charterparties for one year, which was the usual position for someone at his level in the industry.

Magelssen and Johannsen then concocted a fraudulent scheme. They conspired to have Mr Magelssen, purporting to act as agent for Mundogas, sign a three-year charterparty with the buyers, at the rate of hire that Armagas had asked for. This contract would be kept secret from Mr Magelssen's colleagues at Mundogas. Before signing the contract, Mr Magelssen fraudulently told the buyers directly that he had sought and obtained specific authorisation to commit Mundogas to this longer charterparty (he said: "*As I thought, I got it*"). Mr Johannesen and Mr Magelssen also agreed to split some of the profits from the sale of the vessel. To keep their scheme afloat, the two fraudsters would have to lead Mundogas to believe that it was entering into three successive one-year charterparties with the buyers (recall that Mr Magelssen's authority extended to such shorter agreements), each one at the rate of hire which the buyers expected to be paid under the (fraudulent) three-year contract. However, the bottom soon fell out of the market. Mr Magelssen found himself unable to get

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even a one-year contract at a rate of hire that would have satisfied the buyers, by then very significantly above market, past his superiors.

Both the Court of Appeal and the House of Lords held that Mundogas was not bound by the three-year charterparty. In the House of Lords, Lord Keith drew a distinction between dishonest conduct and other misconduct (such as, for instance, intentionally or negligently causing physical injury). He held that:

> "*… the essence of the employer's liability is reliance by the injured party on actual or ostensible authority. … At the end of the day the question is whether the circumstances under which a servant has made the fraudulent misrepresentation which has caused loss to an innocent party contracting with him are such as to make it just for the employer to bear the loss. Such circumstances exist where the employer by words or conduct has induced the injured party to believe that the servant was acting in the lawful course of the employer's business. They do not exist where such belief, although it is present, has been brought about through misguided reliance on the servant himself, when the servant is not authorised to do what he is purporting to do, when what he is purporting to do is not within the class of acts that an employee in his position is usually authorised to do, and when the employer has done nothing to represent that he is authorised to do it.*"

On the facts of the case, Armagas's representatives knew that Mr Magelssen did not have authority to enter into three-year charterparties. Mundogas had done nothing to engender any belief to the contrary.

The Court of Appeal's criticism of the judge in *Winter v Hockley Mint*

Returning to the *Hockley Mint* case, the Court of Appeal considered that the judge had misread *Armagas v Mundogas*, extracting from it a much wider principle based on Lord Keith's comment (in the passage quoted above) that the question, at the end of the day, was whether it was just for the employer or principal to be held liable. The Court of Appeal found that the judge's wider test had overlooked the "*… essential ingredients if vicarious liability of a principal for the deceit of his agent …*", being the (necessary) holding out or any representation by the principal, to the effect that the agent was duly authorised.

Other decisions on which the judge had placed reliance concerned acts done by employees or agents in the ordinary course of business, and the Court of Appeal evidently felt that Mr Winter's case did not fall into that category. One such case, concerning the drafting of agreements for a fraudulent purpose, was *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48. The House of Lords found a firm of solicitors liable for having dishonestly assisted the fraudster in his breach of fiduciary duty. The senior partner had drafted the contracts by which the fraudster managed to extract about US$ 50 million from the Dubai Aluminium Company. The company had not, however, ever dealt with the senior partner or the firm directly. There had been no 'holding out' by the firm that the senior partner had any kind of authority to assist with implementing the fraud. He had, however, been acting within the firm's usual course of business, by drafting legal agreements, and had in fact acted in furtherance of the firm's business, having charged fees for this work. The innocent partners were therefore vicariously liable. It did not matter that the agreements were drafted, and then used, for the unauthorised purpose of defrauding a third party. Lord Nicholls held that:

> "*… the wrongful conduct must be so closely connected with acts the partner or employee was authorised to do that, for the purpose of the liability of the firm or the employer to third parties, the wrongful conduct may fairly and properly be regarded as done by the partner while acting in the ordinary course of the firm's business or the employee's employment.*"

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However, Hockley Mint's position was different. They (unlike the Dubai Aluminium Company) *had* dealt with the fraudulent agent. Following the Court of Appeal's reasoning, Hockley Mint was therefore arguably in a worse position, and had to show a 'holding out' by Mr Winter in order to bind him as the principal. The Court of Appeal in *Hockley Mint* stressed that:

> "… *it is well established that merely providing the opportunity for wrongdoing is not sufficient without more to give rise to vicarious liability, absent a holding out of the wrongdoer as having authority to act for the defendant sought to be made vicariously liable …*"

Discussion

Why should this rule exist for cases of fraud or deceit? We have already seen that vicarious liability for equitable wrongs such as dishonest assistance of a breach of trust can arise without any 'holding out' – *Dubai Aluminium Company v Salaam*. Recall also that in *Lloyd v Grace, Smith & Co*, Mrs Lloyd signed the fraudulent deeds without comment or question. She relied on having met the clerk at the firm's offices, and on the clerk's conduct in simply giving her the deeds he had drafted in the back office after she had mentioned that she wanted to sell her cottage. What would have happened if she had read the deeds, found them unclear or suspicious, and asked the clerk to confirm that he was properly authorised to prepare contracts of this nature, and if she would not be better off speaking to a partner in the firm? If the clerk had then assured her that he was properly authorised and all was in order, would Mrs Lloyd's claim be doomed to fail following *Armagas v Mundogas* because an agent cannot usually self-authorise? Or would the clerk's presence on the firm's premises be sufficient to constitute a holding out by the firm?

To understand why these authorities have required a holding out or a representation by the principal, it may help to consider the law of contract, and specifically how companies are bound by contracts. A company must always act through representatives or agents. If they act within the scope of their authority (actual or apparent), then the company is bound. In *Armagas v Mundogas,* the Court of Appeal noted that if the Mundogas's liability were not limited by the scope of the agent's authority, then an odd situation would arise: the company *would* be liable to compensate Armagas for the fraud, but it *would not* be liable to perform the contract procured by misrepresentation, or pay damages for breach of contract (because a company is not bound by a contract that exceeds the agent's authority). This point, made by Stephenson LJ in *Armagas v Mundogas*, was expressly noted by the Court of Appeal in *Hockley Mint.*

But should the law require that liability in tort and contract must both arise? In this regard, a further principle of the law of agency is relevant. Agents will have actual authority to do whatever it is the principal in fact wishes them to do. However, as a matter of law, a grant of actual authority will always be subject to an implied limitation that the agent cannot act against the principal's best interests. In *Hopkins v T L Dallas Group Ltd* [2004] EWHC 1379 (Ch), Lightman J stated the principle in the following terms:

> "*[I]f an act is carried out by an agent which is not in the interests of his principal, for example signing onerous unconditional undertakings, then the act will not be within the scope of the express or implied grant of actual authority. As a result there cannot be actual authority:*
>
> *the agent is simply not authorised to act contrary to his principal's interests: and hence … an act contrary to those interests is outside his actual authority. The transaction is therefore void unless the third party can rely on the doctrine of apparent authority ….*"

It follows from this that no fraudulent agreement, which is palpably not in the principal's best interest, could ever fall within the agent's actual authority (leaving aside the perhaps unlikely scenario of the principal having

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expressly authorised the agent to sign up counterparties by lying to them). Every victim of the deceit of a fraudulent agent must, following *Armagas v Mundogas,* establish apparent authority. If, rather than procuring a fraudulent agreement, the agent physically stole the money from the victim, then the principal would be bound regardless of whether there was apparent authority, provided the 'sufficient connection' test is satisfied: the requirement for apparent authority only applies to deceit, but not to other intentional torts such as trespass or conversion.

The principle that agents cannot have actual authority to act against the best interests of the principal has been criticised by Professor Worthington ("*Corporate Attribution and Agency: Back to Basics*", Law Quarterly Review, 133 (2017)). She argues that while actual authority is a matter of agreement as between the principal and agent, a third party is not privy to this agreement: the acts of a disloyal agent who exceeds the authority as agreed with the principal could still be attributed to the principal, who would be bound even though there has been a breach of the agent's actual authority.

Negligent misstatement: an easier ride for claimants

It is also worth recalling that the Court of Appeal has held that the 'close connection', or 'ordinary course of employment' test applies to determining vicarious liability for negligent misstatement (and not the 'apparent authority' test): *So v HSBC Bank Plc* [2009] EWCA Civ 296. Like deceit, the tort of negligent misstatement also requires that the claimant relied on the false statement. However, if the employee or agent in question has been merely careless, the claimant must merely show that they relied on the statement in question, and they do not have to go further and also show that they relied on the employee or agent having been authorised to make that statement in respect of the particular transaction.

In *So v HSBC*, the bank sought to escape vicarious liability by arguing that the employee who had carelessly stamped a letter of instruction and written reference 'approved' (suggesting that the bank would comply with the instruction) did not have authority to approve documents in relation to bond trading (the type of transaction that ultimately caused the claimant's loss). Counsel for HSBC sought to extend *Armagas v Mundogas* to negligent misstatement, arguing that the claimant should have realised that the bank's employee was exceeding her authority. The judge accepted this, but the Court of Appeal did not, finding that the bank was vicariously liable. In reaching that conclusion, the Court of Appeal was not critical of *Armagas v Mundogas*, simply noting that the case showed that different public policy considerations applied to dishonest conduct. Presumably, the concern is to protect the principal, who might be as much a victim of a rogue employee or agent as the third party as the victim of the fraud. Still, the result is that the claimant in a fraud case has more of an uphill struggle than the claimant in a case of negligent misstatement. That seems counter-intuitive, and arguably wrong.

Conclusion

It is not easy to see how the Court of Appeal in *Winter v Hockley Mint* could have reached a different conclusion, bearing in mind that it was bound by the decision of their Lordships in *Armagas v Mundogas*. However, there are good reasons to welcome deceit and fraud into the fold of torts to which the unified 'sufficiently close' connection test applies. In some cases, the result may be the same no matter which test is applied. *Winter v Hockley Mint* may yet be one of those cases. After the untimely passing of HHJ Purle QC, whom the author recalls as a formidable and charismatic advocate, another judge will now decide whether Mr Winter was guilty of the requisite holding out. There is some suggestion in the judgment of the Court of Appeal that such a conclusion might yet be reached, though that court felt unable to evaluate the evidence and considered that the case had to return to the High Court.

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