

## 3 Stone Buildings Seminar – 8<sup>th</sup> March 2006

### Vicarious liability for agents

By Andrew Twigger

#### Introduction

1. Vicarious liability is normally associated with an employer's responsibility for the acts of his employees. Such liability frequently arises in personal injury actions where, for example, a haulage company is held liable for the negligence of one of its drivers in running over a pedestrian. The application of the legal principles to such cases is normally relatively straightforward.
2. The purpose of this paper is to explore the application of the principles of vicarious liability to a commercial situation where:-
  - (1) The tort involved is not negligence but deceit; and
  - (2) The person making the deceitful representation is employed by someone other than the party alleged to be liable.
3. The fundamental issue is whether the boundaries of vicarious liability extend so far as to render a wholly innocent party liable for the frauds of someone who is employed by a third party, especially where:-
  - (1) The third party is not himself an agent of the innocent party;
  - (2) The innocent party cannot be said to have any real control over the conduct of the fraudster; and
  - (3) The representations made by the fraudster related to matters which were plainly not within the innocent party's knowledge.
4. These issues were considered in MAN v Freightliner [2005] EWHC 2347 (Comm), decided in October 2006 by Moore-Bick LJ (in which Geoffrey Vos QC and I were instructed on behalf of the Defendant). In what follows I shall:-
  - (1) Briefly explain the relevant facts of that case;
  - (2) Give an overview of the relevant law;
  - (3) Indicate what Moore-Bick LJ held; and
  - (4) Suggest a different analysis from that of the Judge.

### The facts

5. The following is a very condensed summary of the underlying facts.
6. The parent company of a wholly owned subsidiary (“ERF”) wished to sell it. It entered into negotiations with the eventual purchaser.
7. In the course of negotiations it became apparent that the representatives of the vendor did not have sufficient detailed knowledge to explain ERF’s accounts to the purchaser. So Mr Ellis, the Financial Controller of ERF and the most senior member of ERF’s finance department, was invited to, and did, attend certain meetings with a view to explaining the figures. Everyone at the relevant meetings knew that Mr Ellis was ERF’s employee and that he had acquired his knowledge of the accounts in his capacity as ERF’s Financial Controller.
8. The vendor did not know that ERF’s accounts had been fraudulently prepared by Mr Ellis, so that they showed net assets far in excess of the true figure (despite having been audited). Since the accounts themselves were known by Mr Ellis to be false, it followed that most of Mr Ellis’s explanations of them to the purchaser were tainted by fraud.
9. The judge held that the purchaser relied on Mr Ellis’s implicit fraudulent representations that the accounts had been honestly drawn. The purchaser did not discover the truth, however, for some 15 months after the purchase. When the fraud was uncovered, the purchaser claimed that the vendor was vicariously liable for the deceitful implicit misrepresentations made by Mr Ellis. The judge agreed and held Freightliner potentially liable for the very substantial sums lost by the purchaser (not only the purchase price, but also the huge sums of money pumped into ERF after the purchase but before the fraud was discovered).
10. A curiosity about the judge’s findings, however, was that he based liability on implicit representations made in two negotiation meetings, at which he regarded Mr Ellis as representing the vendor. The purchaser alleged that Mr Ellis was also representing the vendor during a lengthy due diligence exercise which was conducted off-site with Mr Ellis as virtually the only ERF employee available to answer questions. The judge held that Mr Ellis was not representing the vendor at the due diligence, although he was making the implicit representations whenever he discussed the accounts. It is to be noted that ERF itself could in no sense be regarded as acting for, or representing, the vendor.

## The law

11. Five strands of authority are potentially relevant:-
- (1) Authorities dealing with the rationale for the imposition of vicarious liability;
  - (2) Authorities dealing with the “transfer” of an employee to another “temporary” employer;
  - (3) Recent authorities dealing with the possibility of joint vicarious liability;
  - (4) Authorities dealing with goods vehicle licensing; and
  - (5) Authorities dealing with vicarious liability for misrepresentations.

### (1) The rationale for the imposition of vicarious liability

12. In Dubai Aluminium Co v Salaam [2003] 2 AC 366 Lord Millett said that the underlying rationale of vicarious liability was to impose liability where “...it is just that the loss resulting from the servant’s acts should be considered as one of the normal risks to be borne by the business in which the servant is employed”.<sup>1</sup>
13. This rationale helps to explain the test for vicarious liability as formulated, for example, by Lord Steyn in Lister v Hesley Hall Ltd [2002] 1 AC 215: the employee’s tort must be “so closely connected with his employment that it would be fair and just to hold the employers vicariously liable”.

### (2) Transfer of employment

14. There has been a series of cases dealing with the situation where an employee of one employer has been temporarily lent to another. The leading authority is Mersey Docks and Harbour Board v Coggins & Griffith (Liverpool) Ltd [1947] AC 1. That case decided that it was a central requirement of establishing that someone other than the “general” employer (meaning the person by whom the tortfeasor is

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<sup>1</sup> Lord Millett was quoting from the *American Law Institute, Restatement of the Law, Agency*, 2d (1958), section 229.

actually employed) was vicariously liable for the employee that sufficient control over the manner in which the employee carried out his work, as opposed to control over what work the employee did, had passed to the “temporary” employer.

15. Other important cases include:-

- (1) Denham v Midland Employers Mutual Assurance Ltd [1955] 2 QB 437;
- (2) O’Reilly v ICI [1955] 1 WLR 1155;
- (3) Ready Mixed Concrete v Yorkshire Traffic Area Licensing Authority [1970] 2 QB 397; and
- (4) Karruppan Bhoomidas v Port of Singapore Authority [1978] 1 WLR 189.

16. These cases make clear that a party will have a heavy burden, which can only be discharged in exceptional circumstances, to show that vicarious liability for the acts of an employee of “x” should be imposed on “y”, on the basis that the employee was, at the time of the act in question, the “temporary servant” of “y”.

(3) Joint vicarious liability

17. The Court of Appeal has recently held in Viasystems (Tyneside) Ltd v Thermal Transfer (Northern) Ltd [2005] EWCA Civ 1151<sup>2</sup> that it is legally possible for two parties to be vicariously liable for the same acts of an individual. This decision ran contrary to the received wisdom that only one employer could be vicariously liable for a particular act of an employee. The Court of Appeal held that it had never been decided (at least in any decision binding on the Court of Appeal) that this was correct. The reason for the finding of dual vicarious liability in Viasystems was that both defendants had equal control over the tortfeasor in the Mersey Docks sense (or something very like it).

18. Rix LJ said (in paragraph 79) that he would:

*“hazard ... the view that what one is looking for is a situation where the employee in question, at any rate for relevant*

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<sup>2</sup> Judgment in Viasystems was handed down on 10<sup>th</sup> October 2005, shortly before the judgment in Freightliner.

*purposes, is so much a part of the work, business or organisation of both employers that it is just to make both employers answer for his negligence. What has to be recalled is that the vicarious liability in question is one which involves no fault on the part of the employer. It is a doctrine designed for the sake of the claimant imposing a liability incurred without fault because the employer is treated by the law as picking up the burden of an organisational or business relationship which he has undertaken for his own benefit.”* (emphasis added)

19. The Court of Appeal has even more recently approved and amplified the Viasystems reasoning in Hawley v Luminar Leisure [2006] EWCA Civ 18.

*(4) Goods vehicle licensing cases*

20. In Sykes v Millington [1953] 1 QB 770 the Queen’s Bench Divisional Court considered whether an offence had been committed under section 2 of the Road and Rail Traffic Act 1933, which prohibited the use of goods vehicles otherwise than in accordance with an appropriate licence. The argument turned on whether the respondent haulage contractor was to be treated as the “user” of the relevant vehicles, which had, at the relevant time, been on hire to a company with a licence. Section 1(3) of the Act provided:

*“When a goods vehicle is being used on a road for the carriage of goods ... the person whose agent or servant the driver is, shall, for the purposes of this Part of this Act, be deemed to be the person by whom the vehicle is being used.”*

21. The justices had held that no offence had been committed on the basis that, whether or not the drivers were the servants of the respondent, they were at all material times the agents of the hiring company so that it, rather than the respondent, was the user of the vehicles. On a case stated by the justices, the Divisional Court held that the justices had been wrong, because the drivers were at all times the servants of the respondent and they could not, at the same time, be the agents of the hiring company.
22. Lord Goddard reached this conclusion by applying the test in the Mersey Docks case. He said (at page 775):

*“The only question is, therefore: were the persons who were driving these vehicles the agents or servants of the respondent? The justices would not decide whose servants they were, but*

decided that they were the agents of the company. With all respect to the justices, **a man cannot be the servant of A and the agent of B in performing the same piece of work. He is either the servant of A or the servant of B.** If my servant is driving my car as my servant, the mere fact that I have lent the car to a friend and told my driver to drive him, does not make the driver an agent. He remains my servant all the time. There might be certain circumstances in which a person driving the car would not be the servant because the relationship of master and servant had changed, but there was no evidence here on which the justices could find that the drivers were the servants of any person except the respondent. Therefore, they could not find that they were the agents of the company.” (emphasis added)

23. In Interlink v. Night Trunkers [2001] EWCA CIV 360 Arden LJ tentatively agreed with Lord Goddard’s analysis, but expressly without deciding the issue.

(5) Vicarious liability for representations

24. In Lloyd v Grace, Smith & Co [1912] AC 716 the defendant firm had employed Mr Sandles as their conveyancing manager and managing clerk. Sandles had fraudulently induced the plaintiff, who instructed the firm to carry out certain transactions for her, to enter into conveyances in his favour. The principle which the House of Lords held to be applicable was stated by Lord Loreburn (at page 725) to be:-

*“If the agent commits the fraud purporting to act in the course of business such as he was authorised, or held out as authorised, to transact on account of his principal, then the latter may be held liable for it”.*

25. Whilst the House of Lords framed this principle in the language of agency and actual or ostensible authority, Mr Sandles was, in fact, the employee of the firm and there was no issue as to which of two employers or principals were vicariously liable. There is no suggestion in the speeches that normal principles of vicarious liability were disappplied in the case of fraud.
26. In Armagas v Mundogas (the “Ocean Frost”) [1986] 1 AC 717 the House of Lords considered the position where the claimant knew that Mr Magelssen, the defendant’s “vice president (transportation) and chartering manager”, did not have any general authority to enter into a three year charterparty. Mr Magelssen had represented that he did have specific authority to enter into the transaction in question.

27. Once again, Mr Magelssen was the defendant's employee. There was no question as to whether he had a temporary employer or was an agent of someone else. The claimant argued that the question of whether Mr Magelssen had actual or ostensible authority to enter into the charterparty was irrelevant because the defendant was vicariously liable for the acts of its employee whether or not he had such authority. The House of Lords rejected that contention. Lord Keith said (at page 781):

*“It was argued for Armagas that in Lloyd v. Grace, Smith & Co the fraudulent clerk was not acting within the scope of his actual or ostensible authority but was acting in the course of his employment, and that it was the latter which made the employer liable. In the present case, so it was maintained, Mr. Magelssen was acting in the course of his employment though not within the scope of his actual or ostensible authority, so Mundogas was liable. In my opinion the attempted distinction has no validity in this category of case. Lord Macnaghten, in Lloyd v. Grace, Smith & Co. [1912] A.C. 716, 736, regarded the two expressions as meaning one and the same thing. The essential ingredient for creating liability **in the employer** is that the party contracting with the fraudulent servant should have altered his position to his detriment in reliance on the belief that the servant's activities were within his authority, or, to put it another way, were part of his job, this belief having been induced by the master's representations by way of words or conduct” (emphasis added).*

28. In other words, the House of Lords held that the test applicable to the imposition of vicarious liability for fraud was narrower than whether or not the fraudster was an employee, but it did not hold that the fact of employment was irrelevant to the imposition of liability. On the contrary, the fact of employment was the starting point. For example, at page 782-3, Lord Keith said:

*“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” (emphasis added).*

29. Bowstead & Reynolds on Agency suggest (at 8-183) that this reasoning, based on concepts of agency and authority, not only limits the scope of the normal ‘course of employment’ test, but also “*may be used to create liability in one person for another who is not his servant, and for whom there is no liability under the principles relating to independent contractors*”.<sup>3</sup>
30. The authorities cited in support of this suggestion relate to a limited range of factual situations, such as liability for fraudulent representations by an estate agent. The way in which vicarious liability for an agent’s deceit arises (as opposed to the contractual consequences of fraud by an agent) has not been explored in any detail in these authorities. There does not appear to be any case in which an agent, who was not an employee of the party found to be liable, was employed by a third party, or at least where that third party was not a company which was itself the agent of the party found to be vicariously liable.

#### Moore-Bick LJ’s decision

31. There is a potential tension between the transfer of employment cases and the cases about representations because:-
  - (1) The latter cases have tended to speak in the language of agency;
  - (2) That language is particularly apposite to contractual authority;
  - (3) There is no problem where there is no alternative employer who can be alleged to be liable because a test of authority is probably narrower than one of acting in the course of employment;
  - (4) But the test of whether or not someone has authority to negotiate a contract does not coincide with the enquiry as to change of control which is relevant to the imposition of vicarious liability on a party who is not the general employer of the tortfeasor;

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<sup>3</sup> The context shows that the liability for independent contractors being referred to arises where the “employer” owes a non-delegable duty of care directly to the claimant. This was not alleged in MAN v Freightliner.

- (5) Where the alleged agent, who made the fraudulent representations, is employed by someone other than the principal (and especially where the employer is not itself the agent of the principal), how is the Mersey Docks doctrine to be applied?
32. Before MAN v Freightliner, there had never been a case which addressed this question. The judge's answer was simply that the Mersey Docks doctrine does not apply to cases of vicarious liability for fraud.
33. The vendor submitted that:-
- (1) Mr Ellis remained at all times an employee of ERF and was involved in the sale negotiations in that capacity;
  - (2) Before the vendor could be vicariously liable for Mr Ellis's implicit fraudulent representations, it was necessary to show a transfer of control over Mr Ellis, in a Mersey Docks sense, from ERF to the vendor;
  - (3) The purchaser had never alleged that such a transfer of control had occurred, nor had the evidence established such a transfer;
  - (4) Mr Ellis could not have been the agent of the vendor at the same time, and in respect of the same acts, as he was acting as an employee of ERF;
  - (5) Consequently, it was not fair or just that the vendor should be vicariously liable for Mr Ellis's fraud.
34. The judge held:

*“Given the nature and incidents of a contract of employment, as well as the likelihood in many cases that the general employer will have given the workman the training and instructions necessary to enable him to perform his task (both matters that were adverted to by Lord Porter [in Mersey Docks] at pages 15-17), one can understand why it will often be difficult to show that there has been a temporary transfer of employment. In a case such as the present, however, **where all that is alleged is that the employee of one person was authorised to speak about certain matters on behalf of another, the same difficulties do not arise.** There is in my view **no obvious reason why [the Vendor] should not have authorised Mr. Ellis to speak on its behalf despite the fact that he remained an employee of ERF at the time.** If that was indeed the case, it would be right to regard him as speaking*

*only for [the Vendor] at the meetings in question and to that extent it could be said that there was a transfer of functions (albeit not of employment), but that is simply another way of saying that in those meetings he was speaking in his capacity as agent of [the Vendor] rather than in his capacity as an employee of ERF. One comes back, therefore, to the question whether Mr. Ellis purported to speak for [the Vendor] at the meetings in question and was authorised (or at least was held out by [the Vendor] as being authorised) to do so.” (emphasis added)*

A different analysis?

35. Moore-Bick LJ overlooked the underlying rationale of vicarious liability, which is that it is fair and just to render a business liable for wrongs committed by people who are truly to be regarded as engaged in carrying out that business (whether as employees or as a result of some analogous relationship).
36. In Karruppan Bhoomidas v Port of Singapore Authority [1978] 1 WLR 189 Lord Salmon pointed out (on page 192) that, although Mersey Docks was concerned with the situation where a crane was lent with a driver, making the task of showing that control remained with the owners of the crane easier, the principles applied in that case were of “*general application*” and not confined to their particular facts. Yet Moore-Bick LJ held that these principles did not apply in the case of fraud.
37. He accepted that Mr Ellis could not be regarded as carrying out the vendor’s business when he attended the off-site due diligence investigations. But, when Mr Ellis answered exactly the same sort of questions at two negotiation meetings, the judge said the vendor was vicariously liable for his fraud. Nothing was done or said by the vendor to indicate that it regarded Mr Ellis as fulfilling a different role in the due diligence from these meetings (one of which took place before due diligence and one after).
38. Mr Ellis did not have any kind of contractual authority from the vendor. He was not authorised to conclude a deal, or even to negotiate.<sup>4</sup> His role, as everybody knew, was to supply information in his role as ERF’s financial controller. No one contemplated that the

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<sup>4</sup> Although it was alleged that, up to a point, he did argue the vendor’s corner at one of the meetings.

vendor would tell Mr Ellis how to answer the purchaser's questions.<sup>5</sup> How can it fairly be said that Mr Ellis was truly engaged in carrying out the vendor's business?

39. Moore-Bick LJ's decision is under appeal. It will be instructive to see how the Court of Appeal grapple with the difficulties involved in imposing vicarious liability for wrongs committed by an employee of a third party.

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<sup>5</sup> Although the purchaser unsuccessfully tried to establish that the vendor had done so.