The Liability of Financial Institutions for the Unauthorized Acts of Employees

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THE LIABILITY OF FINANCIAL INSTITUTIONS FOR THE UNAUTHORIZED ACTS OF EMPLOYEES

1. The law in relation to the liability of a principal for the unauthorized acts of his employee or agent is fairly well settled. The Courts have held for centuries that an employer will be liable, not only for acts which his employee had actual authority to do, but for acts which the employee had "ostensible" authority to do. It was thought at one time that the employer would only be liable if the act in question was done for his benefit, or to borrow language more commonly used in motor vehicle accident cases, the employer would not be liable if the employee was "on a frolic of his own". In ***Lloyd v Grace,Smith & Co. [1912] A.C. 716***, however, the House of Lords established that there was no such principle, and that the employer (a firm of Solicitors) was liable, although its employee (its managing clerk) had committed a fraud for his own benefit.

2. Subsequent cases further clarified the rule. In ***Uxbridge Permanent Benefit Building Society v Pickard [1939] 2 AER 344,*** England's Court of Appeal disapproved of dicta in earlier cases which suggested that an act of forgery was outside any actual or specific authority, and held that once the employee (another solicitor's clerk!) was doing something that a person in his position would normally do, his employee would be liable notwithstanding the fact that a forgery was involved.

3. The employee's apparent or "ostensible" authority will usually arise in one of two ways. He may hold a position which is generally regarded as carrying with it authority to do certain acts or there may be a course of dealing between the parties which led the

person dealing with the employee to believe that he had the authority to do the relevant acts. It is important to note that in either case, it is the act of the employer that must create the appearance that the agent had the authority.

4. In ***Armagas Ltd. v Mundogas S.A., The Ocean Frost [1986] 2 AER 385*** (another decision of the House of Lords) the court held that an employer would not be liable if the third party's belief that the agent had authority resulted from the third party's "own misguided reliance on the employee" and the employer himself did nothing to encourage that reliance. At page 393, Lord Keith said:

> *"The essential feature 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."*

5. The authorities seem to place a further qualification on that principle. In effect, the third party must "reasonably" believe that the employee had authority to act as he did. If the transaction was on its face irregular or if circumstances were such that the third party ought to have been put on an enquiry, the third party will not be able to rely on the apparent authority of the agent and the employer will not be liable.

6. An interesting example of this principle is the decision of England's Court of Appeal in ***A. L. Underwood Limited v Bank of Liverpool & Martins {1924} 1 KB 775***. Mr. A. L. Underwood had an account at the Bank of Liverpool for many years. He then formed A. L. Underwood Limited in which he held all the shares but one (which was held by his wife), and he was the sole director. He transferred his business to the company and he continued to keep his accounts at the Bank. The Company had a separate account at another Bank, but the Bank of Liverpool had no knowledge of that fact.

7. Mr. Underwood received a number of cheques payable to the company. He endorsed them on the company's behalf and deposited them into his account. He used the funds for his own purposes. A Debenture holder put the company into receivership and the Receiver sued the Bank of Liverpool in the company's name for the proceeds of the cheques.

8. The Bank argued that since Mr. Underwood was the sole director of the Bank, he probably had actual authority and certainly had the apparent authority to endorse the cheques over to himself, and that they were therefore not bound to enquire further before allowing them to be deposited to his account. Both the trial judge and the Court of Appeal ruled against the Bank, however, on the ground (among others) that the act of an agent paying his principal's cheques into his own account was so unusual that the Bank should have been put on enquiry. The Bank should have asked, for example, whether the company had a separate banking account and if it had, why the cheques were not being lodged to that account. The court held that their failure to make that enquiry amounted to

negligence. Lord Justice Bankes said at page 788:

> *"I entirely accept the view of the learned judge with regard to the conduct of the cashiers, and I think his conclusion establishes not only negligence on their part, but such an absence of ordinary enquiry as to disentitle (the Bank) from relying on a defence founded on the ostensible authority of Underwood."*

9. Lord Justice Atkins added at page 797:

> *"...the whole facts of the case appear to demonstrate that in disposing of the cheques as he did Underwood was not acting within the ordinary scope of his authority, but was doing something unusual which ought to have attracted the attention of the Bank's servants."*

10. While the principle relied on by the court in the Underwood case is fairly straight-forward, there will obviously be much room for debate as to what circumstances will be enough to put the third party "on enquiry". In fact, what is unusual in one country or decade may not be unusual in another.

11. The same principle was recently summarized in ***Bodden & Bodden Dev. Co. Ltd. v Real Time Invs. Inc., Kirby and Great Cayman Dev. [1992-93] CILR, n2.***

> "Except in the case of persons who have or ought to have notice of any excess of authority or have had notice of an irregularity placing them on enquiry as to whether the agent's authority is being exceeded, the principal cannot escape liability for acts done by the agent which fall within the apparent scope of his authority by seeking to rely on any particular instructions limiting that authority"

12. ***Ebeed v Soplex Wholesale Supplies Limited [1985] BCLC 404*** is another interesting decision. In that case, a guarantee was signed on behalf of a Bank by the Manager of its "Documentary Credits Department" above the stamp of the Bank. The Manager had no authority to sign the guarantee and in fact, he concealed from his superiors the fact that the guarantee had been given and when it was discovered, he was dismissed. The recipient sued upon the guarantee. The Bank argued that it was not within the apparent authority of the Manager to sign such a guarantee because, among other reasons, guarantees of that sort usually required the signature of more than one person.

13. Both the trial judge and the Court of Appeal found that the Bank was liable and that the Manager did have apparent authority to sign the Guarantee. The Court of Appeal ruled that the court should not restrict its enquiries only to an assessment of what was the usual authority of a person holding that position. It should consider all the evidence and all the acts of the Bank. They relied expressly on the following facts:

a. The recipient of the guarantee was taken to the office of the Manager, at the Bank's premises, during working hours by a customer of the Bank;

b. The Manager knew all about the transaction and about the affairs of the company being guaranteed;

c. The transaction involved separate visits on three days to the Bank's premises;

d. The guarantee was typed at the Bank and signed in the recipient's presence; and

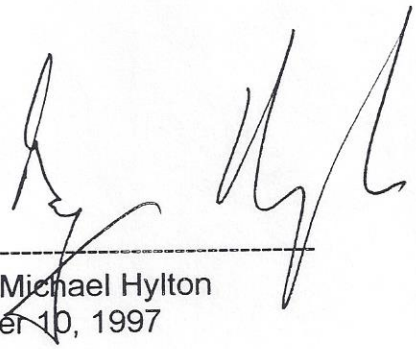
e. The person relying on the guarantee did not know and could not find out what the Bank's signing requirements were, and they had been told by the Manager that only one signature was necessary.

14. The same court made a similar ruling much more recently in ***First Energy (U.K.) Limited v Hungarian International Bank Limited [1993] BCLC 1 409.*** In that case, a Bank Manager told a third party that he had no authority to approve a credit facility. Some time later, he wrote to the third party sending him certain loan documents and stating that on receipt of the documents, the Bank would be "in a position to release" the proceeds of the loan. The recipient completed and returned the documents but the Bank refused to provide the loan. The Court again held the Bank liable.

15. The Court ruled firstly that any reasonable businessman receiving the letter would read it as communicating an unconditional and firm offer which was capable of becoming a binding contract upon acceptance. More importantly, the court held that the

Manager's position gave him the ostensible authority to communicate that head office approval had been given for the facility. The fact that the recipient knew that the Manager had no authority to himself approve the loan did not mean that it knew that he was not communicating head office's approval. The judgment begins:

> "A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected."



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