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Mortgage fraud alleging vicarious liability of broker for its dishonest agent's acts to go to trial

*Donald, Phyllis & Janine Frederick and Sharnay
Redmond v. Positive Financial Solutions (Financial
Services) Limited
[2016] EWHC 2030 (Ch)*

Article by David Bowden

Master Bowles sitting in the Chancery Division of the High Court has determined preliminary issues in a mortgage fraud case. He has struck out all claims except for one relating to vicarious liability. A long established reputable financial advisory business ('the broker') had taken on an agent who then made fraudulent mortgage applications. Those applications falsified income, employment and loan purpose details. The agent was also running a property development business with another man. The purpose of the mortgage applications was to raise money for that business. The business failed and the family who were duped lost over £400,000. The agent is worthless and the family sought to bring a claim against the broker claiming it was vicariously liable for its agent's acts. All mortgage applications were made using the broker's systems to which its agent had access and it received commission from the lender for arranging all loans.

Donald, Phyllis & Janine Frederick and Sharnay Redmond v. Positive Financial Solutions (Financial Services) Limited
[2016] EWHC 2030 (Ch) 5 August 2016
High Court of Justice, Chancery Division (Master Bowles)

What is the nature of the business of Positive Financial Solutions ('the broker')?

Positive Financial Solutions www.thinkpositive.com is a long-established business which is now one of the UK's largest national financial adviser firms. It has over 650,000 clients. It is authorized (number: 184591) by the Financial Conduct Authority ('FCA'). Included within that is an authorisation is to advise on regulated mortgage contracts.

Who are Mr Qureshi and Mr Warren?

Mr Qureshi and Mr Warren were directors in a business called HGQ Limited (Company number 06333801). This company was formed in August 2007, dissolved in May 2012 and the stated nature of this business was 'development of building projects'. HGQ was meant to have been undertaking a property development in Wembley for which it required additional funding.

At companies house, Mr Luke Harrison Warren ('the agent') gave 'independent financial adviser' as his occupation. The FCA had previously authorized Mr Warren (number: LHW00003).

What connection did the agent have with the broker?

The Agent was appointed as an agent of the broker by a written agreement dated 29 November 2005. Under this agreement Mr Warren was appointed a '*registered Individual for the purpose only of introducing Applications by Clients for new Contracts for submission to Institutions specified by the Registered Individual and approved by*' the broker. This agreement included applications for mortgages or re-mortgages.

The other relevant terms of this agreement were:

- **Clause 2.4** – The broker was not to be bound by acts of the agent which exceeded the authority granted by the agreement or by fraudulent actions on his part,
- The agent was not an employee of the broker,
- **Clause 10** - the agent should make reasonable enquiries as to any client's ability to pay for any products contracted for,
- The agent should not act prejudicially towards the interests of the broker or its customers,
- The agent should not effect any transaction which would place the agent in a position of conflict of interest with any client,
- **Clause 10.7** - any act or omission of the Registered Individual was to be treated as an act or omission of the broker, and
- **Clause 14.3** - provided that the '*Registered Individual shall indemnify (Positive Solutions) against any liability arising out of or otherwise connected with any misrepresentation, negligence, dishonesty or fraud by the Registered Individual*'

What connection did the agent have with the Fredericks and Redmond ('the family')?

Mr Qureshi was a friend of Janine Frederick. Mr Qureshi and Mr Warren were in business together. Mr Qureshi used Mr Warren to obtain the remortgage finance for their business from Janine Frederick and her family. The purpose of this was to raise finance for HGQ Limited's property development in Wembley. Mr Warren had no personal dealings with the family.

All 4 claimants are members of the same family. Donald and Phyllis Frederick are husband and wife. Janine is their daughter. Sharnay Redmond is Phyllis' sister.

What properties did the family own?

The 3 properties owned were as follows:

- Old Oak Road, Acton – Donald & Phyllis Frederick – a 'buy to let' property,
- Oakleigh Avenue, Surbiton – Janine Frederick – again a 'buy to let' property, and
- Elmbridge Avenue, Surbiton - Sharnay Redmond – her main home.

What remortgage applications were made by the family with the lender?

The agent submitted remortgage applications for these 3 properties through the broker. The lender in each case was to be Abbey PLC ('the lender'). The details of the 3 deals were:

- Acton – **£500,000** advance of which £217,500 was paid to HGQ Limited and £39,00 to Mr Warren personally,
- Oakleigh Avenue – **£430,00** advance of which £246,00 was paid to HGQ Limited and the rest to redeem the existing mortgage, and
- Elmbridge Avenue - **£386,000** advance of which £53,000 was paid to Mr Warren personally and the rest to redeem the existing mortgage.

In what ways were the mortgage applications false?

The 3 mortgage applications were false in the following ways:

- **Acton:**
 - Donald's income was stated to be £80,000 a year when he earned £47,000,
 - It stated it was a replacement of existing borrowing when it was capital raising.
- **Oakleigh Avenue:**
 - Janine's income was stated to be £92,000 a year with £25,000 overtime when she earned £58,000 a year,
 - Her job was stated to be 'manager at an investment bank' when she was an associate,
 - Janine said she lived there when it was a 'buy to let' property.
- **Elmbridge Avenue:**
 - Sharnay's income was stated to be £83,750 a year when she earned £26,000 a year,
 - Her job was stated to be 'human resources manager' when she was a personal assistant.

Did either the broker or the family know about the falsity?

The entire family claim in their witness statements and the pleadings that they did not know about these falsities in their re-mortgage applications at the time they were submitted. It should be noted that this was a hearing on an application for strike out or summary judgment, and so there has been no cross-examination of any witness yet.

The broker also said it did not know about the falsity. Mr Warren as one of its authorised agents had access to its mortgage portal and made these remortgage applications without the need to involve (or have a counter authorization) from anyone else at the broker.

Are there any other relevant facts?

The monies that the family paid to HGQ Limited or Mr Warren have been lost because the property development failed. They put their losses at £400,000. Janine Frederick says she found Mr Warren's entry in the FSA Register and '*derived comfort*' from that. All 3 mortgage offers from the lender stated '*Positive Solutions recommended that you take out this mortgage*'.

The family had no personal dealings at all with the agent – they dealt with their friend Mr Qureshi. Mr Qureshi had no connection with the broker and did not deal with it. The family did not have any direct dealings with the broker. The agent had access to the systems of the broker as one its appointed agents.

The broker received commissions from the lender on all 3 re-mortgages but the judgement does not record quite how lucrative this was for the broker. Initially it said it could not match the commission payments and they were put in a suspense account but then the agent submitted 'false documentation... purporting to show that the transactions had taken place in 2009 (rather than 2008) and that a proper advice process had been undertaken' and the commission was then allocated. Again disappointingly the judgement does not record what happened to the commission and whether the agent received all of it or whether the broker took a cut too.

What is vicarious liability?

Vicarious liability is a doctrine which imposes responsibility upon one entity for the failure of another, with whom the entity has a special relationship to exercise such care as a reasonably prudent person would use under similar circumstances. It is a legal doctrine that assigns liability to an entity who did not cause the damage but who has a particular legal relationship to the person who did. It is derived from the Roman law concept of *respondere superior* ('let the master answer').

What has the Supreme Court ruled recently on vicarious liability?

The Supreme Court has handed down 2 judgements this year on vicarious liability in cases it heard together. One of these (*Mohamud*) has involved it over-ruling a long-standing ruling from the Privy Council (*Keppel Bus Company* [1974] 1 WLR 1082) on this issue which English courts had followed. As vicarious liability is at the heart of the claims in this case, the Master allowed both sides to make further written submissions after the hearing because these judgements were handed down after the February 2016 hearing.

Mohamud v. Wm Morrison Supermarkets PLC [2016] UKSC 11 (Lord Neuberger PSC, Lady Hale DPSC and Lords Dyson, Reed and Toulson JJSC)

The close connection test has been followed at the highest level and there is nothing wrong with it as such. What function or field of activities has been entrusted by the employer to the employee? This is to be viewed broadly. Is there a sufficient connection between the position in which he was employed and his wrongful conduct to make it right for the employer to be held liable?

Applying those tests it was Mr Khan's job to attend to customers and respond to their inquiries. His interacting with customers was within the field of activities assigned to him by his employer. What happened thereafter was an unbroken sequence of events. The connection between the field of activities assigned to Mr Khan and his employment did not cease at the moment when he came out from behind the counter and followed the Claimant onto the forecourt.

It is not correct to regard Mr Khan as having metaphorically taken off his uniform the moment he stepped out from behind the counter. When Mr Khan followed the Claimant to his car and told him not to come back to the petrol station. That was not something personal between them but an order to keep away from his employer's premises. In giving the order he was purporting to act about his employer's business. Mr Khan's motive in the attack is irrelevant.

Cox v. Ministry of Justice [2016] UKSC 10 (Lord Neuberger PSC, Lady Hale DPSC and Lords Dyson, Reed and Toulson JJSC)

Lord Reed gave guidance on the sort of relationship which may give rise to vicarious liability. In *Various Claimants v Catholic Child Welfare Society* [2012] UKSC 56, Lord Phillips mentioned five factors which make it 'fair, just and reasonable' to impose vicarious liability on a defendant, where the defendant and the tortfeasor are not bound by a contract of employment. Lord Reed explains that these five factors are not equally significant.

The first factor, that the defendant is more likely to have the means to compensate the victim and can be expected to have insured against vicarious liability, is unlikely to be of independent significance in most cases. The fifth factor, that the tortfeasor will have been under the control of the defendant, no longer has the significance it was sometimes considered to have. In modern life, it is not realistic to look for a right to direct how an employee should perform his duties as a necessary element in the employment relationship.

The remaining three factors are inter-related. These are:

- the tort will have been committed as a result of activity being taken by the tortfeasor on behalf of the defendant,
- the tortfeasor's activity is likely to be part of the business activity of the defendant, and
- the defendant by employing the tortfeasor to carry on the activity will have created the risk of the tort committed by the tortfeasor.

A relationship other than one of employment is in principle capable of giving rise to vicarious liability where harm is wrongfully done by an individual who carries on activities as an integral part of the defendant's business and for its benefit (rather than his activities being entirely attributable to the conduct of a recognisably independent business of his own or of a third party), and where the commission of the wrongful act is a risk created by the defendant by assigning those activities to that individual.

On what basis is the claim brought against the broker?

The family brought their claim on these 4 grounds:

- The broker is vicariously liable for the agent's acts,
- The agent acted with the ostensible authority of the broker,
- The broker owed a common law duty of care to the Fredericks and Redmond to render it liable for the agent's actions, and

- The broker is in breach of statutory duty under:
 - S150 of the Financial Services and Markets Act 2000, and
 - the FCA's Mortgage Conduct of Business Rules.

How do the family say the broker is liable to them?

They put their claimed vicarious liability of the broker on these 4 bases:

- Mr Warren was their agent and fiduciary. Had he acted properly he would have refused to act on the re-mortgages because of a clear conflict of interest. If so, there would have been no re-mortgages made and they would not have suffered any losses.
- The agent should have given full disclosure of the content of the falsified mortgage applications. If he had, at the point they would have withdrawn them and no re-mortgage would have been made.
- The agent assumed a responsibility and duty of care to them to advise them of the suitability of the re-mortgage applications. If he had complied with that duty, they would not have proceeded with the re-mortgages.
- Any application made on their behalf should have been made truthfully in which case the lender would either have refused the re-mortgage applications or would have lent less.

What was the application before the Master?

The broker made 2 interlinked applications:

- to strike out the claim as disclosing no reasonable grounds for making a claim, or
- in the alternative for judgment on the claim in its favour on the basis that it has no realistic prospects of success.

On what basis did the family seek to resist the application?

It says that the broker is vicariously liable for the acts of the agent. The agent submitted falsified mortgage applications using the broker's system to which it granted him access. It also received commission from the lender. It has assumed responsibility in the legal sense for the agent's actions. The claim discloses both reasonable grounds and has realistic prospects of success.

What does the broker say in response?

There was a complete lack of contact between the family and both the broker and Mr Warren. The conduct complained of was entirely attributable to the property business or opportunity with which Mr Warren and Mr Qureshi were concerned. The loss for this cannot be laid at their door. The family went ahead because they wanted to 'secure a fixed return' on the deal that had been promised.

What did the Master rule on the application?

The Master refused both applications and neither struck it out nor gave judgement for the broker. The Master ruled that the vicarious liability claim could proceed but the other 3 claims could not as they had no prospects of success. He said that:

'62. In this case, I am satisfied, for the reasons already given, that there is a sufficiently close connection between the wrongful conduct alleged against Mr Warren and the class of acts that he was authorised to carry out under and in respect of his agency as to warrant liability for the loss, or harm, arising from that conduct being borne by Positive Solutions.'

Are there prior authorities of relevance?

These authorities are relevant in this case.

Hamlyn v. John Houston & Co [1903] 1 KB 81 Court of Appeal

The fact that there are no dealings, as between a claimant and a defendant said to be vicariously liable for the conduct of his agent, is no bar to liability.

Lloyd v. Grace Smith & Co [1912] AC 716 House of Lords

An employee was put in a position whereby he procured possession of documents of title enabling him to defraud his employer's client. The connection between that wrong doing and the class of acts that he had been authorised to conduct so as to give rise to vicarious liability on his employer, was that the employer had put the employee in the position in which, by reason of the class of acts he had been authorised by his employer to carry out, he was enabled to secure a dishonest gain.

Kooragang Pty v. Richardson & Wrench [1982] AC 462 House of Lords

Making negligent mortgage valuations was carried on without any connection with the business of the defendant upon whom vicarious liability was sought to be imposed. Where the employee (even while

performing acts of the class that he was authorised to do) so clearly departed from the scope of his employment, his employer would not be vicariously liable.

Caparo Industries PLC v. Dickman [1990] 2 AC 605 House of Lords

Courts apply a 3-stage test to decide whether to impose a duty of care: (1) foreseeability, (2) an appropriate relationship of proximity, and (3) whether it is fair, just and reasonable that a duty be imposed.

Lister v. Heselby Hall Ltd [2002] 1 AC 215 House of Lords

It is no answer to a vicarious liability claim that the agent or employee was acting exclusively for his own benefit. In determining whether a particular principal may bear vicarious responsibility, the decision rests not upon the presence (or absence) of benefit to the principal from the act complained of. Instead it rests upon an intense focus on the connection between the nature of the agency of the wrongdoer and the wrong of which complaint is made.

Dubai Aluminium Co Ltd v. Salaam [2003] AC 366 House of Lords

Those who carry on business through the agency of others create a risk that harm will be caused to others by the agents who carry on that business, such that, when those risks ripen into loss, it is just that the business should be responsible for compensating the person wronged.

The Catholic Child Welfare Society v. The Institute of the Brothers of the Christian Schools
[2012] UKSC 56

The law of vicarious liability had developed recently to establish that it is possible to be vicariously liable even if the wrongdoer's act is in breach of the duty he owes to the person liable and even if the act was a criminal offence. The criteria to be demonstrated to establish vicarious liability involved a synthesis of two stages:

- whether the relationship was one which was capable of giving rise to vicarious liability, and
- examination of the connection that linked the relationship between them with the wrongful act or omission

Stage 2 is usually satisfied when a wrongdoer does something he has been required or requested to do pursuant to his relationship with the defendant in a manner that is negligent.

Is there anything else of note in the judgement on vicarious liability?

The Master goes through all the authorities including the 2 this year from the Supreme Court and decides that the vicarious liability claim can go to trial. He says this:

'40...Looked at more widely, it seems clear to me that the modern approach to vicarious liability...is not determined by the application of a "badge" of agency ... but by the determination as to whether the circumstances of the wrong doing are such as to enable the court to say that the risk of the loss caused by that wrong doing should fairly and properly be regarded as arising in the course of the relevant agency... such that liability should fall upon the business, or other entity, which placed the wrongdoer in the position whereby he could cause the loss of which complaint is made.'

The Master drew support for this from Clause 14.3 of the Agency Agreement in which the agent provided an indemnity and that commission income was paid to the broker. This the Master said was

'demonstrative of the closeness of connection between the conduct complained of and the operation of the agency'. He said *'the connection between his agency and his wrongdoing could scarcely be closer'*.

As the broker sought an indemnity from Mr Warren this *'seems to me to further demonstrate'* that it *'acknowledged the possibility of its own liability for the dishonesty of an agent in the position of Mr Warren'*.

As to the lack of contact between the family and the broker, the Master said *'I am not persuaded that the want of communication or contact...is determinative'*. Concluding he said:

'This seems to me to be the classic case where a person is placed, unsupervised, in a position where, acting...in what can be properly regarded as the course of his agency, he is enabled to take advantage of the incidents of his agency to act in a way that causes loss, or harm, to others. It is Positive Solutions which has put him in that position and, accordingly, it is Positive Solutions that should take legal responsibility for the consequences arising from that fact.'

Finally he said:

'Mr Warren's agency provided him both with the status and the means to make the applications complained of and without that status and that means the applications could not have been made. The applications complained of are integrally related to his agency and, for that reason, sufficiently connected to give rise to vicarious liability.'

What did the Master rule on ostensible authority?

He dismissed a claim under this head quite briefly ruling:

'I do not think that any case of ostensible authority can be made out. For ostensible authority to arise, there must be some holding out of the wrongdoer by the alleged principal as being authorised to carry out the particular acts complained of. The fact that Positive Solutions may have published Mr Warren's name, as its agent, in the Financial Services Register, is wholly insufficient to establish that he was held out by Positive Solutions as authorised to make the applications complained of.'

He noted that the mortgage offers from the lender with a statement that the broker had recommended that take out this mortgage came into existence after the mortgage applications had been made and therefore could not have amounted to a holding out.

What was the Master's ruling on breach of a common law duty of care?

He said this failed the proximity test in *Caparo*. He said: *'It seems to me that such a wide duty, if it existed, would extend the potential liability of entities, such as Positive Solutions well beyond the range of those to whom they should be regarded as being in a proximate relationship'* and that *'there does not seem to me to be any good reason, or any requirement of justice, to impose the direct duty of care upon Positive Solutions which has been contended for.'*

What was the Master's ruling on breach of statutory duty?

This was dismissed quite brusquely with the Master simply ruling:

'69. In particular, the claim advanced, now only on behalf of the Fourth Claimant, for so-called statutory damages under and by reason of section 150 of the Financial Services and Markets Act 2000, cannot be made out and should be struck out.'

What will happen next with this case?

The Claimants will need to amend their statement of case so that it makes a claim only in relation to the broker being vicariously liable for the acts of its agent Mr Warren. The claims in relation to ostensible authority, breach of common law duty of care and breach of statutory duty against the broker will have to be removed. In the absence of settlement, this will have to be set down for trial where the family's evidence can be tested in due course.

19th August 2016