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Sir John Chadwick
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Dear Sir John,

Apportionment and Other Matters

1. There are some notable points outstanding from your letter of 1st October which I would like to follow up. For convenience I use the original paragraph numbering as in your response. [I have already commented on matters related to Comparators in my letter of 12th October.]

2. [5.B] We are much encouraged by your comments about "even-handedness" and by the flexibility that the Administrative Court imputes to your role. Nevertheless we remain concerned that some of the constraints in your terms of reference are unsound, either by reason of being contrary to any informed reading of the history of the matter, or by an unjustifiably skewed interpretation of the Ombudsman's findings.

3. **In particular:**

3.a **The interpretation to be placed on the Term "Full and Fair Distribution" as it was explained by sales representatives and understood by policyholders. [Largely covered by my letter of 12th October]**

3.b **The issue of notional *Apportionment* of liability to third parties. [Discussed extensively below]**

3.c **The way in which in setting out your remit the Government has sought to 'rewrite' the Ombudsman's carefully circumscribed findings. *However, we note that this aspect is particularly affected by the decision of the Divisional Court and is still under review there. We think it sensible to defer further comment until the revised Instructions are available in writing.***

4. [5.E] You did not comment on this issue which we consider rather important: *"Are you able.. to offer any assurances regarding the disclosure of the detailed statistics that underlie your own proposals? Such disclosure would*

seem to accord with the principles of natural justice." **As I said in my original letter:** ***"I ask this question because we know from hard experience how difficult it is to advocate changes to such proposals when the underlying figures are withheld, and we may need to subject such figures to an independent actuarial review."***

Could you please let us know your intentions in this respect?

Deliberate Courting of Risk [5.J1]

5. **I may not have been sufficiently explicit in rebutting the claim that Equitable policyholders deliberately courted risk, although all the ground was covered in my previous letter of 12th October. You kindly provided many references to the policy of "Full and Fair Distribution" which the Society claimed to be following. We would agree that customers were told that the Society retained 'no unnecessary estate'. Lord Penrose also quoted from Annual Reports in which a senior Director extolled such approaches in similar terms. None of these statements implied any deliberate assumption of risk. The risks were concealed by the means subsequently described here. [see 28 below]**

6. **In effect the President's statements were fraudulent (whether he knew it or not) and the Regulators must have known that they were fraudulent. Policyholders and sales representatives were told that Policy Values (including Final Bonus) represented smoothed asset shares, when there was in fact a large and continuing realistic asset deficiency. The assertion that policyholders deliberately courted risk is unfounded, and arises from conflating the ignorance of policyholders with the expert knowledge of those who set out to deceive them.**

Apportionment and Related Issues [J2,3]

7. **May I make a general point about the parts of your Terms of Reference which refer to apportionment. Their purpose is clear: - to create reasons for reducing any actual payouts to policyholders. But the reasoning is completely opaque. Two passages are referred to from *Penrose,* of which one conflicts with the authoritative findings of the PO, and is therefore illegitimate, while the other makes the somewhat oracular point that "The Society was the author of its own misfortunes". Strictly speaking it was of course the <u>management of the Society</u> that Penrose was referring to, not the totality including the policyholders and similar.**

8. **The latter is both a teleology and a tautology, because there could not have been any injustice caused by the Public Bodies without prior failure by the management of the Society, the primary statutory role of those bodies being to regulate the actions of the Society in order to protect its policyholders. In any case, the issue in question is not the Society's misfortunes but injustices inflicted on policyholders with the participation of the regulators. They are related outcomes but they are by no means identical.**

9. There are many more passages from *Penrose* which support the policyholder case for injustice and remedy, and Mr Scawen of ELTA has already drawn your attention to some of them. To that we would add that Lord Penrose's Report is long, written in separate sections and inconsistent in some important aspects. Most importantly, in passages not subject to Maxwellisation, he attributed knowledge and attitudes to policyholders based on hearsay and casual inference, which were remarkably similar to criticisms which emanated from the Treasury in 2000 when it sought to deflect blame for Equitable's collapse. (There were references to 'fat cats', 'windfall gamblers' and 'demutualisation carpet baggers'.)

10. Part 3 of the Interim Report addresses the question of Apportionment and you open with these words:

> 3.1 I turn now to the second matter on which I am required by my Terms of Reference to advise:
>
> *10.a.i.1. "the proportion of [the relative losses suffered by different classes of policyholder in relation* to *the accepted cases of maladministration] which it would be appropriate* to *apportion* to *the public bodies investigated by the Ombudsman, as opposed* to *the actions of Equitable Life and other parties"*

11. You go on to construe this term to require apportionments wherever shared liabilities can be demonstrated. But surely, 'even-handedness' requires that you first consider in more depth whether Apportionment is applicable at all, because the wording of your Terms of Reference is otherwise gravely prejudicial to the redress that should be due to policyholders.

12. You have made reference to the Law Commission's Consultation Paper on Redress, which contains both a review of the present state of law and ministerial practice, and suggestions for future improvements. We found that paper enlightening but troubling in some of its thinking. But, it is clear from it that existing practice for remedies of Injustice identified by the Ombudsman is to apply the principle of Joint and Several Liability. Apportionment therefore is not normal practice under existing conventions. (see 3.45-3.50 in the Consultation: 3.50 is quoted in full –

12.a "3.50 Ex gratia schemes may provide for compensation to be paid out for personal injury and property damage and also extends to any sort of injustice or hardship including both financial and non-financial loss. As to the level of compensation, HM Treasury's guidance states that a department should provide such compensation as it considers "fair, reasonable and proportionate". **This will normally mean sufficient compensation to restore claimants to their position prior to the maladministration or service failure**."

13. Clearly, if there is discounting for apportionment the ex gratia scheme being developed will not accord with these <u>current Treasury</u> guidelines.

14. Furthermore, the effective acceptance of full liability by Public Bodies is well established and was the relevant practice <u>when the injustices occurred.</u> It was also the relevant practice both when the Ombudsman began and when she finished her Investigation. Surely, established conventions require that

Apportionment be excluded as a basis for this scheme of payments? Moreover, to introduce novel ideas about apportionment based on the Law Commission's Paper is effectively to introduce the equivalent of prospective legislation, which must surely be as unacceptable and unjust as the introduction of retrospective legislation is acknowledged to be?

15. **We submit that the Government, not being bound by the principles of civil law in these dealings with its subjects, should nevertheless seek to follow principles of fairness and natural justice, and this too militates against Proportional Liability.**

16. **However, if for some reason there are grounds for giving greater weight to the Law Commissions draft proposals than to established practice, we would ask you to take note that those proposals are far from being settled law or administrative practice. In the words of the Commission** ***"These are difficult issues. The proposals we present are tentative and provisional. Others will prefer to see the balances between public and private interests struck in different ways." and "We will be undertaking a wide consultation process in order to gather as many different views and information as possible." (Law Commission Paper 1.12).*** **Our criticism of their preference for Proportional Liability for "Truly Public" activities is that it is not justified on principle, merely by the inadequacies of the existing systems for which it indeed poses other remedies.**

17. **More significantly in our view, it is clearly driven by the desire of officials to reduce the budgetary impact on their departments arising from maladministration in general, and gives almost no weight to the need for redress for those victims that matches the scale of the injustice inflicted. We construe this to imply that, provided serious fault is established and losses are not partitionable between Government and third parties, then Government should be responsible for full redress and liabilities due from third parties should be pursued by the Government in tandem. We reject the casual application of Proportional Liability as being a pure money-saving doctrine, divorced from concepts of fairness between Government and Subject.**

18. **We could expand on this analysis at some length, but to do so would surely be out of place. Suffice it to say that in our view and in the view of a majority of Equitable's 1.5 million policyholders, the Commission's proposals on redress remain highly controversial.**

19. **In using the term 'full redress' we refer not to 100% of claims, but to accepted losses reduced by public purse and self-insurance considerations as set out in my paper of 12th October.**

Hypothetical Discussion

20. **If, for the sake of argument, it were to be established that Apportionment was a proper option for a responsible Minister prior to any enactment of relevant statutes, then we would propose further detailed arguments against it as set out in the following paragraphs.**

20.a The Law Commission *Consultation Paper* does not propose the use of Apportionment in any and every trial of the Government's liabilities, but suggests it as a reserve power for a Court in those cases where the failings of a Public Body are more notional than real. But this is not such a case. The failings of the Public Bodies were not incidental or accidental. They were the products of neglect and negligence and ultimately arrogant denial of the proper rule of law.[See the evidence submitted to PASC by Nicolas Bellord of EMAG and based on the Ombudsman's detailed Chronology under : - http://www.publications.parliament.uk/pa/cm200809/cmselect/cmpubadm/41/41we11.htm]

20.b Nor were these failings legalistic nitpickings which some inexperienced judge was persuaded to accept. They were the conclusions of the Parliamentary Ombudsman after an investigation based on expert understanding of the various processes involved and of the challenges facing regulatory bodies in practice. The Public Bodies were given a great deal of time to develop detailed rebuttals to the charges against them so that the ultimate findings of Maladministration were 'rock solid'.

20.c The Parliamentary Ombudsman asserted in the Preface to her Report that the bar for findings against the Public Bodies was set very high indeed. Indeed, in our judgement, a 'near-criminal' standard of proof was demanded, not the lesser standard that might apply in a Civil Court action. Indeed, from the perspective of many policyholders and other commentators, the Findings were too conservative by far.

20.d It therefore follows that apportionment away from the Public Bodies is not relevant to this case which relates to chronic, serious and negligent maladministration and the injustices flowing from that maladministration, and ultimately a government inspired cover-up. In such cases, the only proper approach is that of "Joint and Several Liability", and that fits in not only with the law of the land but with ordinary public concepts of justice.

20.e But this does not mean that the Public Purse should carry the burden of the whole cost of redress if there are other parties who share responsibility, and who can still be pursued cost effectively for their share of the liability. But this pursuit should be carried out by Government, in whose hands it can be completed much more expeditiously than by ad-hoc groups of policyholders going to law on their own account. [I speak from direct experience of the latter ventures which are extraordinarily difficult to organise and to finance.]

20.f We are far from arguing that, given a smidgeon of government maladministration, then all losses fall to its account. That must depend

on the seriousness of the failure and how that failure related (or did not relate) to the underlying causes of the losses.

20.g Your Terms of Reference also require you to consider apportionment to the Society as such. With respect, this leads to logical and legal nonsense. Even if the actions of the Society were 100% responsible for policyholders' losses this could not reduce the liability of the public bodies. They were never accused of originating the losses and the Ombudsman never implied that they had done so. Where they failed was in exercising their supervisory duties negligently and ineffectively for over a decade, and they thereby facilitated the losses in question. [I exclude here the post closure period when regulators, following policy set by Government, were intimately involved in the day to day management of the Society and participated in conduct which many believe to have been unlawful.]

20.h In effect, the Ombudsman found that, under the legislation then current, the public bodies shared *Joint and Several Liability with the Society* for the injustices visited on the victims. Any apportionment back to the Society in such circumstances would be a scandal.

20.i There remains a question whether there could have been types of loss not accounted for by the regulatory failures, which we have referred to above as *'partitionable* losses'. This raises a basic issue which is not addressed in detail in the Interim Report: – *Under what conditions can Apportionment be carried out fairly?* This is discussed in the following section.

Apportionment Requires Concrete Causation

21. The case in hand exemplifies the type of 'claim' where the victims of injustice can broadly say what they have lost, but cannot readily divide responsibility for same on any robust basis. In our view it is not acceptable to apportion such losses by dubious inferences or casting of lots. It first needs to be demonstrated that the parties in question were acting independently. There needs to be a robust and concrete basis of allocation if the Minister concerned is not to find himself back at Judicial Review. Where such a basis of allocation does not exist, then it would seem that Apportionment must be ruled out. What must be comprised in such a basis of allocation?

22. <u>Quantifiable Contribution:</u> We would suggest, again on grounds of natural justice, *that there should only be such apportionment when there is good evidence that the third party contributed to the injustice of which the Public Body has been held responsible, and there is a sound basis for saying that the harm would have been quantifiably less in the absence of the third party's failure.* For example, in the case in question, would it have made any significant difference if the rating agency had not misunderstood the

minutiae of the Society's Insurance Returns? If not, apportionment should be ruled out.

23. <u>Separable and Actionable Contribution:</u> ***Furthermore, we argue that any apportionment of liability to third parties should also be separable and actionable on its own, with practical prospects for victims or groups of victims to gain redress by proceeding in court or elsewhere against those third parties.*** **If such a case could only succeed by bringing the Public Body back into court to admit to its failings in exquisite detail (which it would not do), then such apportionment would amount to a legal fiction which would compound the original injustice and fan the flames of 'outrage'.**

24. <u>Concrete Causation:</u> We do not see how a Minister could put forward a scheme of apportionment ***without establishing a concrete chain of causation linking the failures of the various parties to the injustices inflicted on the victims, and in sufficient detail to assign liability for a given quantum of the losses to each of the parties.*** **Where, as in the present case, the Public Bodies have spent nearly ten years in bitter denial of their share of responsibility, the trail of causation to third parties will almost certainly have run cold making assignment of quantum effectively impossible.**

25. In 3.15 of the IR you state that you have already made a decision regarding losses caused by Headdon's withholding of the 'side letter'. This is surprising and seems premature for these reasons:

25.a Your conclusion conflicts with that of the Parliamentary Ombudsman.
25.b You have adduced no new evidence.
25.c The conclusion has been reached prior to the submission of our views and those of other policyholders. [see Appendix A 3.15]
25.d No reasoning is given.
Is this perhaps a drafting error?

26. You stated in the IR that you could see no practical way of proceeding with an EGP scheme based purely on the PO's Report. She could neither quantify the losses, nor could she analyse their causes outside the Public Bodies, due to the statutory limitations under which she was required to work. Your remedy was to introduce a "Comparator" to determine relative loss and thereby sidestep the causation question. There is then a danger that by introducing apportionment, causation will be introduced via a back door and make the whole scheme open to challenge again.

The Need for a Finding of Fact

27. Rather than leave a vacuum in the area of causation we suggest that you should consider making a 'finding of fact' that is unlikely to be challenged by policyholders and which also <u>explains and reconciles with all the known losses.</u> Many such causes have been put forward, but once circular explanations and non-sequiturs are eliminated the number of basic causes becomes manageably few. [Again I exclude the further compounding of

losses after the Society's closure which raises grave issues regarding the behaviour of public officials and Government.]

28. <u>Suggested 'Finding of Fact':</u> There were <u>four</u> fundamental errors made by the management of the Society which the Public Bodies actively underwrote, and these errors in themselves were sufficient to generate all of policyholders' generic losses. These 'errors' are described in the following paragraphs. They were all visible to trained Life Actuaries in GAD via information contained in the Annual Accounts and Annual Insurance Returns. The 'errors' in question are central myths which were all deliberately put in place by 1988 and on which Equitable relied in order to operate with assets that were grossly inadequate to meet the commitments made to WP policyholders:

28.a That an Estate, i.e. a substantial surplus over the minimum solvency requirement, was purely a matter of choice and that there was no definite need of such for the business being written.

28.b That newer policies taken out after 1988 were part of the same continuum of policies written prior to that date and could expect to earn comparable inflation adjusted returns.

28.c That, as evidenced by the general availability of 'no-charge surrender', policy values as notified to holders represented their up-to-date "*smoothed asset share*".

28.d That their failure to make proper provision for guarantees clearly set out in older GAR policies was due to excusable oversights and technical failures in Actuarial guidance.

29. None of the Public Bodies (GAD, the DTI, the FSA or the Treasury) sought to challenge these central myths throughout the 1990s up to the 'Policy Cuts' of July 2001, except for d) where modest provisions were first insisted on in 1998 to be immediately countered by inappropriate concessions.

30. If it could be proved by new evidence that other organisations set out to support these myths then it could be argued that they too should bear some share of liability. But, as advocates of the policyholder cause, if there were to be any possibility of losses being apportioned away from the Public Bodies to third parties for policyholders to recover directly, we could not in good faith advance any grounds for such apportionment.

Conclusion

31. It is most relevant here to note that the Parliamentary Ombudsman has written to you to emphasise that she used the title "*A Decade of Regulatory Failure*" advisedly. We submit that <u>in this case and on the facts as they have emerged</u>, it is appropriate to apply the concept of Joint and Several Liability to the Public Bodies concerned and to make no apportionment against other notional sharers of responsibility (if such exist). However, it follows directly that a condition of any EGP or similar payment should be that the recipient

assigns to the Treasury all rights to proceed against third parties who might be considered to share legal liability for the losses in question.

32. This device is particularly appropriate where experience has demonstrated that the legal system does not provide effective means for the mass of policyholders to pursue such actions on their own account.

33. <u>Aggravating Factors:</u> There may also be aggravating factors which affect the possible apportionment of liabilities. The Parliamentary Ombudsman has listed an extensive catalogue of forms and varieties of Maladministration, while emphasising that her catalogue is by no means complete. It seems an obvious proposition that the more serious the Maladministration, the stronger needs to be the proof that one or more other organisations shared responsibility for it.

34. In this case it is manifest that the Government has adopted a policy of *delay, denial and deceit*. As a consequence of this policy around one hundred thousand[1] policyholders have borne their losses to the grave. More immediately, the withholding of full information to which Members of the Society should have been entitled has made it effectively impossible to pursue other organisations who may share responsibility. [The Society has still not published any proper accounting of its lost assets or who benefited from their loss, something that was called for in court more than seven years ago!] The Treasury, acting in concert with the FSA, has held the Society in thrall for the last nine years and could have remedied these deficiencies at any time. It has chosen not to do so and must, we submit, bear the inevitable consequences.

35. We submit that whatever apportionment might have been appropriate had the Treasury followed a policy of openness and timely action, <u>that apportionment (if any) has now been negated by the aggravating factors mentioned above.</u>

Yours sincerely

Michael Josephs

[1] Estimate based on 1,500,000 insured lives and an average age of 55 at the end of 2000

Appendix A: Detailed responses on Apportionment [Part 3 of the Interim Report]

(Responses are in this 'Times Font', coloured dark blue. Numerical references included are to the main body of this letter)

3.3 I understand that at law the rule that would apply as between joint wrongdoers is that of "joint and several liability": that is to say, where two or more persons are jointly liable for the same wrong, each of them is separately liable to pay the victim of the wrongdoing the whole amount of any damages awarded by the court. But a wrongdoer who makes a payment to the victim is entitled to seek a "contribution" from the other wrongdoers; so as to bear only whatever proportion of his payment the court considers appropriate.

(We argue in 7 to 15 that this is the only appropriate approach)

3.4 ……..The fact that I have been asked to consider apportionment is indication enough that I am not expected to apply legal concepts; save, perhaps, by analogy.

(The mere fact that you have been requested to consider apportionment does not make it either right or proper.)

3.5 ……..I have been asked to advise on what apportionment is "appropriate". I take that to confer a wide discretion as to what matters I may take into account.

(This would imply that mere plausibility would be sufficient to sustain an apportionment. We argue to the contrary in Apportionment Requires Concrete Causation**21-24.)**

3.6 …. The Law Commission recommended that "responsibility" in such context should be assessed according to both the degree of the public body's fault and the extent to which it contributed to the damage."

(As we point out, this is merely a proposal, and contentious at that. In a case with such a major impact on claimants it would be wrong to introduce new methodology at this point.)

Whose conduct should give rise to a notional apportionment?

3.8 My starting point is the Penrose Report. In its Response ", the Government referred to Lord Penrose's observations that the Society was the author of its own misfortunes. Lord Pen rose had said this (Penrose 20/83-84):

> *"83. As for the regulatory system, I do believe that it has failed policyholders in this case. This is not, in general, because of individual failures. I do not pin that blame on individuals, who in the main have operated in good faith and* to *the best of their abilities within the system as they found it. But I do take the view that the system itself was not overseen, and in particular was not kept up-to-date, and operated in an ineffective manner.*
> *84. The deficiencies are not so obvious as some are inclined (or wish)* to *believe. And, it is seldom enough, and it is not enough in this case,* to *infer from the coincidence of systems deficiencies and loss that one caused or contributed* to *the other. Principally, the Society was author of its own misfortunes. Regulatory system failures were secondary factors. The jurisdiction* to *adjudicate on regulatory failure in duty is not mine. Even less is it for* me to *comment on how government should*

respond if it were to *acknowledge that there had been regulatory failure. But it may be appropriate* to *comment that the practices of the Society's management could not have been sustained over a material part of the 1990s had there been in place an appropriate regulatory structure adapted* to *the requirements of a changing industry that happened* to *manifest themselves in an extreme form in the case of Equitable Life."* [Emphasis added]

(*Penrose 83 and 84* have been superseded by the Ombudsman's Investigation and findings and it is not legitimate to resurrect them at this stage. Even the authors of your Terms of Reference should have been aware of the impropriety of so doing.

As we have argued, in relation to the Society the only acceptable model is Joint and Several Liability with the Regulators: see 8 and 20.g. Therefore the questions under 3.11 below are not relevant.)

3.11 In deciding whether it would be appropriate, in the present case, to make a notional apportionment of loss between the public bodies and regulators and Equitable Life's former management, it seems to me that I need to give weight to the following matters.

(i) ……

3.15 ……This informed her view that GAD committed maladministration even on the basis of the limited and uncandid disclosure made by Equitable Life: a view which, of course, the Government has accepted. But that finding does not dislodge the conclusion that Equitable Life (in the person of Mr Headdon) causally contributed to the losses suffered by Equitable Life's policyholders.

(This suggestion exemplifies the dangers that we have pointed out of seeking to make quasi-judicial decisions without clearly established chains of causality and quantification of the different components of losses (See the Hypothetical Discussion 21-24). Moreover, on the facts of the case, no loss flowed from Headdon's 'side-letter' because it added nothing to what was already known, the regulators being fully aware that the policy in question provided no substantive insurance.)

3.20 My present intention, therefore, is to wait until the findings in the disciplinary proceedings against Ernst & Young are published (following appeal) before expressing a view as to whether those findings provide a basis for a notional apportionment of some policyholders' losses on the basis of the auditors' conduct. If they do not do so, I am not, at present, minded to make a minded to make a notional apportionment of loss on the basis of any alleged failings by the auditors.

(On our analysis of established practice and the sources of the Injustices visited on policyholders, you should only consider such apportionment where a) the losses might be directly recoverable by Policyholders and b) the losses in question do not lie against the Public Bodies to any significant degree; i.e that the losses are partitionable. At the moment we know of no such losses under either head.)

Conclusions

3.21 At paragraph 3.8(ii) of the Proposals, I expressed the view that I should seek, so far as possible, to avoid the need for any form of "maxwellisation", on the ground that that could result in substantial delay in giving advice under my Terms of Reference, which would be inconsistent

with the need for expedition. There was no substantial objection to this approach, and I intend to adopt it.

(It is not in any way obvious what is implied by this exclusion. It might well impose crippling restrictions on your ultimate 'advice'. Could you please supply some examples?)