IN THE MATTER OF THE EQUITABLE LIFE ASSURANCE SOCIETY
AND IN THE MATTER OF GUARANTEED ANNUITY RATE POLICIES

JOINT OPINION

Introduction

1. We are instructed by the Equitable Life Assurance Society ("the Society") following the decision of the House of Lords in *Equitable Life Assurance Society v Hyman*[1]. We are asked a number of specific questions which we answer in paragraph 100. We express our conclusions very briefly in paragraph 101.

2. Our Instructions arise out of pressure on the Society from one of the action groups which have been formed as a result of the litigation - the Equitable Members Action Group ("EMAG"). We have received, in addition to our Instructions and their enclosures, together with additional material requested from our Instructing Solicitors[2], papers and submissions on behalf of EMAG. It is accepted by the Society that the purpose of our Instructions is really to see if there is any way in which the consequences of the House of Lords' decision can be ameliorated from the point of view of those who are adversely affected by it and that we should, in doing so, not be constrained by the narrow scope of the questions expressly asked. But equally, it has to be accepted by EMAG that we do not have a free-ranging brief to examine all the avenues which may be open for those adversely affected to obtain redress. We do not, for instance, proffer detailed advice about claims which may arise against the Society relating to the conduct of its business including the sale of policies or any advice at all about alleged negligence on the part of professionals, such as accountants, involved in the management of the Society's business; nor should we be read as expressing any concluded view on any of those aspects.

3. We should draw attention to our own personal positions. We are both members of the

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[1] [2000] 3 WLR 529.

[2] We have been provided with all the information for which we have asked.

Society. Mr Warren is a GAR policyholder as well as having unit-linked policies. Mr Lowe is a non-GAR policyholder. Needless to say, we have not consciously allowed those interests to affect the opinions we express. We do not believe that we have, subconsciously, allowed those interests to affect our views. Indeed, our personal financial interests are opposed but we have nonetheless reached a view which we both share. Further, whilst we have attempted to give an entirely independent view on the questions we address, it is the Society which is our client; we do not undertake any direct duty to members of the Society whose interests, in any event, conflict.

Structure

4. With that introduction, we now set out how this Opinion proceeds to deal with the issues. We consider the following questions:

   a. What did the House of Lords actually decide? In considering this question, we will identify some of the arguments which were raised in the House of Lords in order to address concerns, expressed in the papers before us, that they were not raised.

   b. Who is bound by that decision and in what way? In considering these questions, we will look at the scope of the representation order, whether the Society could properly represent the non-GAR policyholders and whether the fact that Lord Hoffmann was a policyholder causes any problems notwithstanding that he was careful to disclose his interest as such and that the Society waived any objection to his sitting on the panel.

   c. Do certain arguments ("the Arguments"), identified by EMAG and set out in paragraphs 44 to 48 below, afford any basis for re-opening the decision of the House of Lords?

   d. Do the non-GAR policyholders have rights in relation to bonuses under their policies which are inconsistent with those of the GAR policyholders and, if so, can those competing rights be asserted in the light of the House of Lords'

decision?

What the House of Lords decided

5. The leading speech is that of Lord Steyn. Putting matters very briefly for the moment, he decided three matters:

a. First, in the context of differential bonuses allotted to a GAR policyholder depending on whether or not he exercised his option to take a contractual annuity at the GAR or alternative benefits, Lord Steyn decided that the larger terminal bonus awarded to a policyholder who waived the GAR option and elected for alternative benefits was nonetheless a Related Bonus. Accordingly, it would have made no difference to Lord Steyn whether a terminal bonus was declared as an additional annuity or as an increase in the nominal amount from which the annuity is to be calculated since there is a precise correlation between the two *ie* the GAR itself[3].

b. Second, in that same context, he decided that the declaration of a different terminal bonus in respect of a GAR policy according to whether or not the option to take an annuity at the GAR was exercised was not permissible. In the light of paragraph a. above, it was not possible for the Society to justify (as it had argued it could) the differential as a "top-up" bonus which was not a Related Bonus.

c. Third, on the ring-fencing issue, he decided that his reasoning on the main issue (*ie* his decision as in paragraph b. above) led to the conclusion that it was not permissible to ring-fence the GAR policies so as, in effect, to throw the cost of the GARs onto the GAR policies themselves: instead, there has to be a non-differential bonus. In our view, this part of the decision effectively entails that it is impermissible to take account of the existence of the GAR in differentiating the level of bonus declaration as between GAR and non-GAR

[3] Mr Hyman's policy appears to operate by providing for Related Bonuses to be declared as additions to the annuity; other GAR policies add the bonus to a guaranteed capital amount.

policies[4].

6. We set out in Addendum 1 to this Opinion a detailed analysis of Lord Steyn's decision and his reasoning, at the same time noting certain observations of Lord Cooke. In the light of that, we conclude that

a. The House of Lords decision is concerned with the effect of the bonus policy. Although certain parts of the speeches of both Lord Steyn and Lord Cooke might appear to be considering the purpose of the Society when declaring bonuses, and thus not prohibit differences based on the different costs attributable to GAR and non-GAR policies, or based on considerations of fairness, we do not consider that the decision as a whole can be read in that way. Indeed, Lord Steyn considers the question to be entirely constructional in nature and considers that one never reaches the question whether the power under Article 65 was exercised for an improper or collateral purpose. Accordingly, any bonus policy the effect of which is to erode the GAR is impermissible[5].

b. That is not to say that there is, in principle, an absolute prohibition on the Society drawing a distinction between GAR and non-GAR policies for the purposes of bonus declaration: it could do so - at least, the House of Lords decision does not entail that it could not do so - provided that that differential is not based on the presence of a GAR. We know, however, of no factors which would, in fact, justify such a differential treatment. We address later the important issue of whether consideration of the economic differences between GAR and non-GAR policies, and the consequences for the management of the with-profits fund of the existence of GARs, might have led to a different decision from the House of Lords; those differences stem,

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[4] The actual level of bonus applicable to all with-profits policies generally must, of course, take account of the GAR since that will impact on (a) the available profit for distribution and (b) the cost of any particular level of bonus.

[5] Note however the discussion of limited ring-fencing in Addendum 1.

however, from the GARs themselves and cannot be prayed in aid, according to the actual decision of the House of Lords, to justify a differential bonus treatment.

c. In this last context, differentiation between different classes of business for bonus purposes is in practice made. For instance, many with-profits policies outside the class of pensions business are operated outside the tax-free environment available for approved pensions policies: the two classes are treated differently for bonus treatment. Certain businesses out of the UK are treated in a differential way: in these cases, we understand that there are assets within the with profits fund as a whole hypothecated to, and matched with, those businesses. The differences in bonus treatment prior to the House of Lords' decision had, we understand, nothing to do with the presence or absence of GARs in any of the policies of either class. The House of Lords has not expressly decided that such differential treatment is not permissible; and we express no view on the matter which is clearly outside our remit[6].

7. We are acutely aware that there is a large body of opinion which considers that the House of Lords' decision is one which it should not have reached[7] or, at least, that the reasoning leading to that decision was at best opaque. Many objections and arguments have been raised by commentators and in the papers before us. Other than the additional arguments raised by EMAG, which we consider in detail later, we see little point in considering, in this already long Opinion, those many objections and arguments. In substance, they formed the backbone of the case presented to the Courts by the Society, but were rejected by the House of Lords: there is no possibility at all of re-opening the case on the basis of those arguments.

8. There is some suggestion in the papers before us that certain arguments may not have

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[6] The Society will need to consider - it may already have done so - whether these discrete businesses can in effect be ring-fenced against the cost of GARs even in the light of the House of Lords' decision.

[7] It is difficult to describe it as "wrong" when it represents the final word.

been put to the House of Lords. These, insofar of any significance, are:

a. Arguments based on the existence of a guaranteed investment return ("GIR") in certain of the GAR policies. It is quite clear that the existence and effect of the GIRs was brought to the attention of the House of Lords. The Society's printed Case set out its contention that its long-standing practice of adjusting final bonuses so as to take account of different levels of GIR was on all fours with its practice in relation to GARs, noting that the Vice-Chancellor had accepted that in paragraphs 76 and 96 of his judgment. The same point was made in oral submission[8]. It has been suggested that the decision of the House of Lords entails that it is no longer possible to differentiate between policies on the basis of a GIR in a policy any more than on the basis of GAR in a policy. We do not express any view on that question at all; not only is this not a question on which we are asked to advise, but its determination is not relevant to the task in hand. The only point which needs to be made is that the Society did argue the point before the House of Lords as it had done before the Courts below.

b. One correspondent has questioned why those acting for the Society did not cite well-known authorities on the scope of trustees' and directors' discretions, listing a number of cases. In fact, several cases were cited under the headings, in the Society's printed Case, "Judicial review of business decisions" and "The Respondent's first argument: alleged collateral purpose": these cases included *Howard Smith Ltd v Ampol*[9]*, Edge v Pensions Ombudsman*[10] and *Scott v National Trust*[11] (one of the cases mentioned by the correspondent); in addition, US academic writing and authority was cited. The point was fully made, and supported by authority, that the Courts should not readily interfere

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8 Transcript Day 1 p 29 ll11ff.

9 [1974] AC 821.

10 [1998] Ch 512.

with the discretions conferred on directors. On the question of collateral purpose, there was, simply, no disagreement between the parties about the issue; it was accepted, as it had to be, that the power under Article 65 could not be used for a purpose going beyond the scope of the power, and relevant authority[12] was cited. In the event, the House of Lords decided the matter on the basis of a term to be implied into Article 65 as a matter of strict legal necessity. We do not consider that any more could have been expected of the Society in relation to this point.

c. It was absolutely clear to the House of Lords that the effect of a decision against the Society on both the main arguments (*ie* differential bonus within the GAR policies) and on the ring-fencing issue would have consequences perceived to be unfair by the Society. There is not a shadow of doubt that the House of Lords was fully aware that its actual decision would mean that the non-GAR policyholders would not receive their asset share and that GAR policyholders who exercise their option to take their contractual annuities would receive more than their asset share[13]. But matters went much further even than that. During the first day of the hearing, Miss Gloster referred to the evidence sworn by Mr Nash on behalf of the Society, taking the judges to paragraphs 76 to 80 of his affidavit and, in particular, to a section dealing with "Consequences if the relief sought in the Originating Summons is not granted". In those paragraphs the following points are made:

   i. In paragraph 77, Mr Nash makes the point that there is only one cake to be divided up and that if the Society has to allot the same proportionate bonus to all GAR with-profits policyholders irrespective of whether or not the benefits are taken in guaranteed form, the level of final bonus will need adjusting downwards. The directors would need

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11 [1998] 2 All ER 705.

12 *O'Neill v Phillips: in re A Company (No 00709 of 1992)* [1999] 1 WLR 1092.

13 See *eg* Lord Steyn @ p 532B-C.

to decide whether the cost of any final bonus for GAR policyholders electing to take their contractual annuities should be borne by all with-profits policyholders or simply GAR policyholders alone. Mr Nash's assumption, at this stage, is of course that ring-fencing is at least possible.

ii. In paragraph 78 he observes that a decision in Mr Hyman's favour would force the Society to abandon, at least in relation to GAR policies, the "asset share" concept: again Mr Nash is proceeding on the basis that ring-fencing is possible. He also notes that past allotments of bonuses by the Board to its with-profits policies (not just to policies providing for guaranteed annuities) would have proceeded on the mistaken assumption that adjustment would be possible at the final bonus stage and that, had the Board appreciated that it did not enjoy the flexibility in relation to guaranteed annuities, it could not have announced final and annual bonuses at the rates at which they were announced in fact, but would have been obliged to take account of the fact that a high proportion of policyholders were likely to take their benefits in guaranteed annuity form because benefits would be more valuable in that form. This result would have been regarded as inequitable by the Society

iii. We should then quote the whole of paragraph 78.4:

> "Such an obligation would also require a more substantial part of the fund to be more conservatively invested, so - to that extent - potentially diminishing bonuses in the future. Broadly, the Society holds part of its assets in fixed interest securities to match liabilities, for example in relation to declared bonuses. When the Board comes to determine the level of declared bonuses, its approach is to have regard to the level of investment return which might have been earned if all the Society's with-profits fund had been invested in such fixed interest securities. The final bonus broadly represents additional earnings of the Society achieved by widening its portfolio of investments to include equities and property. Since

> GARs began to outstrip current annuity rates in October 1993, the Society has reflected the Board's decision to determine final bonuses according to whether a given policyholder takes his benefit in guaranteed annuity or fund form by continuing to invest a larger proportion of its with-profits funds in historically higher-performing equities and property than would have been required if the Society had taken the approach of adding the same proportionate level of final bonus irrespective of whether benefits were taken in guaranteed annuity form. Had the Board not taken such a decision, the Society would have been obliged to have held a more significant proportion of its assets in the form of fixed interest securities in order to hedge against the potential additional liabilities now being asserted, rather than to adopt the more equity based investment policy which has enabled all members of the Society to benefit from the more substantial investment returns which equity holdings made possible, and hence the generation of greater surpluses from which bonuses could be paid. All with-profits policyholders (including those holding policies containing provision for GARs) have benefited from the consistently high bonus rates declared by the Society over the years as a result of its freedom to invest more broadly, on the assumption that it had the ability to adjust final bonuses so as to ensure (so far as possible) irrespective of the form of benefits chosen, that individual policyholders did not receive more than their "*asset shares*" in practice."
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> That passage is important since it makes clear that the House of Lords knew about the added freedom and flexibility to invest inherent in a composit with-profits fund and the economic justification for the "asset share" approach to bonus declaration. Of course, we appreciate that EMAG suggests that this investment policy was irrational, a vital aspect with which we will deal with in due course.

Who is bound by the House of Lords decision and in what way?

9. A judicial decision *in personam*[14] operates by way of estoppel in favour of and against parties and their "privies" only and not against third persons or strangers. Although nominally only Mr Hyman and the Society were parties to the litigation, the GAR and non-GAR policyholders were represented as a result of the order of deputy Master

[14] We do not consider that the decision on construction can be properly be characterised as a decision *in rem*.

Weir. Had they not been specifically represented at all by an order of the Court they would not have been deemed to have been represented by the Society[15]. *The principle in the case of a representative proceeding is that the judicial decision in the action operates so as to bind not merely the nominal parties but all members of the class whom the party purported to represent*[16].

10. *There are, however, a number of potential difficulties in the way of a simple application of the principles of res judicata* which need to be addressed. These may be broadly summarised as follows:

a. The question arises whether the non-GAR policyholders have a legitimate challenge to their representation by the Society in the House of Lords in the light of the "*Pinochet* objection" to Lord Hoffmann's conflict of interest. The question arises whether the Society had authority to waive this objection.

b. The Order of deputy Master Weir appointed the Society to represent the non-GAR policyholders only for the purposes of the questions asked on the Originating Summons. These did not include the ring-fencing issue. The representation was not amended at any stage of the proceedings. The formal position, therefore, is that there is no order that the Society represent the non-GAR policyholders on the ring-fencing issue.

c. In the absence of a representation order binding the non-GAR policyholders, the question arises whether they are nonetheless bound by the decision on the ring-fencing issue as the result of an issue estoppel or the doctrine of *stare decisis* arise.

d. The question also arises whether the Society's representation of the non-GAR

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[15] Presumptive representation applies only to trustees (as reflected by RSC Order 15 r14) and because, even if it could be extended to the Society, the trustee could not rely on the presumptive representation to represent one class of beneficiaries against another *Hamond v Walker* (1857) 3 Jur N.S. 686, *Re Burton* [1901] WN 202 and *Re Richards* (1912) 50 WR 90.

[16] See Spencer Bower *Res Judicata* 2nd ed, para 231 p202, *Sewers Commissioners v Gellatly* (1876) 3 Ch 610, 616 *Carnie v Esanda Finance* (1995) 182 CLR 398 per Toohey and Gaudron JJ para 36.

policyholders could somehow be challenged on the grounds that the Society could not itself run certain arguments on which it might have had a conflict of interest. Principally, it is suggested, the Society could not have put forward a construction of the GAR policies which might have highlighted an allegedly "irrational" investment strategy.

e. As we explain below, we consider that there may be certain aspects of ring-fencing which remain unresolved and which are pertinent to the debate about how the benefits and burdens of the with-profits fund are to be shared between members. To the extent that the decision of the House of Lords leaves such questions unresolved, it is open to the members of the Society to raise them in new proceedings.

Taking those in turn.

Was there an effective waiver of the "*Pinochet* objection"?

11. When a person has been appointed to represent a class of persons for the purposes of litigation so as to bind those deemed to be represented to the outcome, it is obvious that certain tactical decisions will be made during the litigation. So long as these are taken *bona fide* and not so as to overreach the interests of the represented class, we cannot see that members of that class are able to object, after the event, to the tactical decisions which had to be taken. Indeed it has been said that the represented party will be bound by the decision unless he can show "fraud or collusion or anything of that sort or show that the Court was cheated into believing that the case was fairly fought or fairly represented when in point of fact it was not"[17].

12. It is, of course, undeniable that Lord Hoffmann had an interest in the proceedings of the very sort contemplated in R v Bow Street Magistrates ex parte Pinochet[18]*. However, it is equally plain that such an objection can be waived by the parties*[19]. Lord Hoffmann very properly made his interest known in advance of the hearing and

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17 See *Sewers Commissioners v Gellatly supra per* Jessel MR @p616.

18 See [2000] AC 119.

both the Society and Mr Hyman waived any objection. The House of Lords plainly accepted this to be a legitimate waiver not only on behalf of the nominal parties but also on behalf of the large classes of policyholders being represented.

13. We note that throughout the proceedings it was extremely difficult to find judges who were not members of the Society and it was no less difficult to constitute a disinterested panel of Law Lords. In those circumstances it would have been an entirely conventional tactical decision to have waived any objection having regard to the advantage of having such a highly respected judge on the panel and the improbability that his self-interest would affect his judgment or make any difference to his deliberations. There is nothing which would suggest to us the remotest prospect of showing that the Society took anything other than the most conventional of strategic decisions. Accordingly we see no basis upon which any of the non-GAR policyholders could claim they were not fairly represented when the decision was taken to waive the "*Pinochet* objection". It follows that we do not consider that the "*Pinochet* objection" affords any basis for challenge to the decision on the first question (*ie* differential bonuses with the GAR policies).

14. It is true that the non-GAR policyholders were not represented on the ring-fencing question so that it might be said that, if they were entitled to be heard on that question, then they would then be entitled to take the *Pinochet* objection to the decision on ring-fencing - or perhaps even, on that basis, to the whole of the judgment. In the latter situation, so it is maintained, the whole case would have to be reopened.

15. We do not consider this argument to be correct for a number of reasons.

    a. The waiver of the objection having been made at the hearing, we do not consider it to have been restricted to the questions on which the non-GAR policyholders were properly represented. The objection based on a judge's self-interest is rooted in the principle that justice must be seen to be done fairly. Once it is accepted that the non-GAR policyholders waived any

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[19] *Locabail* v *Bayfield Properties* [2000] QB 451 @475.

objection to Lord Hoffmann's involvement on the first issue, we do not see that anybody would have regarded his participation in the decision on ring-fencing as giving rise to any additional or greater risk of injustice than that which had already been waived. We do not believe that the waiver would be taken to have distinguished between issues.

b. Even if it were possible to persuade the House of Lords to hear representations from the non-GAR policyholders (on the basis that the Arguments had some prospect of success), it does not follow that the position is exactly the same as it would have been had the non-GAR policyholders been joined in the first place and been present at the hearing. If the non-GAR policyholders had been present, no doubt they could have objected to Lord Hoffmann's presence on the panel: that may have led to an adjournment to find a replacement judge. But, unfortunately for the non-GAR policyholders, that was not the case. It does not follow from *Pinochet*, in every case where there has been some inappropriateness of procedure leading to a judge in a position of conflict hearing a case, that the decision will be set aside and the case heard again. The House of Lords must, we consider, retain an element of discretion and will not automatically be forced to accept that, because there is (making the assumption for the moment that this is so) a new argument which the non-GAR policyholders wish to put and which the House of Lords is willing to hear, the case on ring-fencing must be heard by a new panel. If the House of Lords is willing to listen to the Arguments at all, we consider that the same panel of Law Lords would do so, and would consider the Arguments on their merits. If, as we think is the case for reasons given at length below, the House of Lords considers (i) that its decision on the first point leads necessarily to its decision on ring-fencing and (ii) that the Arguments afford no realistic basis for suggesting that the decision should be different give the arguments which actually <u>were</u> presented to the House of Lords, then that panel would, we consider, reject the Arguments, determine that the non-GAR policyholders were properly represented by the Society and hold that the waiver extended to the ring-fencing issue.

Extent of the representation order made by deputy Master Weir

16. As we have said, there is no formal order appointing the Society to represent the non-GAR policyholders on the ring-fencing issue. However, in agreeing to extend the scope of the case in the House of Lords - both in the printed Case on behalf of the Society and at the actual hearing - it is clear that the Society regarded itself as representing the non-GAR policyholders. The House of Lords itself clearly proceeded on that basis. Had a formal representation order been sought at the hearing, there is no doubt that it would have been made. But the fact remains that such an order was not made. It is, in our view, either now too late for the House of Lords (or any other court) to extend the order, or, if that is wrong and if the Society or Mr Hyman sought to have the order extended, the non-GAR policyholders ought to be allowed to be heard to object to that course with a view to raising, in new proceedings, some of the issues discussed in this Opinion[20].

Is the answer to the questions actually raised in the Originating Summons itself determinative of all ring-fencing questions?

17. *On the first question (ie* whether there could be differential bonuses within the GAR policies) the non-GAR policyholders are clearly bound in the light of the representation order made. They are also bound <u>as parties</u> by an issue estoppel in relation to any issue encompassed by the answer to the first question even if not expressly addressed. Accordingly, if the answer to the ring-fencing issue was necessarily determined, as sure as night follows day, by an issue decided in answering the first question, then the non-GAR policyholders will be bound by the answer to that issue. Lord Steyn, as will be apparent from our analysis in Addendum 1, stated that his conclusion on ring-fencing (*ie* that it was not permissible) must follow from his reasoning concerning the construction of the GAR policies and the Articles. It has to be asked, therefore, whether Lord Steyn's reasoning was in fact determinative of the ring-fencing issue. He clearly thought and said that it was; but his decision on that aspect (*ie* whether it was determinative) is not binding on the non-GAR policyholders, so it needs to be examined whether there is any argument that he was wrong on this -

the question is not, it is to be noted, whether he was wrong in his conclusion on the first question.

18. It is easiest, we think, to address this question by postulating a situation in which the ring-fencing issue had not been addressed or argued at all in front of the House of Lords and in which Mr Hyman, having won on the first question, then brought new proceedings to prevent the Society from ring-fencing the GAR policies. Could the Society argue that ring-fencing was permissible, or would Mr Hyman be able to say that the House of Lords had already supplied the answer in its judgment on the first question and that the Society was bound by an issue estoppel?

19. To answer the hypothetical question we have posed necessitates an analysis of Lord Steyn's reasoning - a task which we have undertaken in Addendum 1. For present purposes let it be assumed, according to the analysis we have undertaken, that his decision on the first question (*ie* differential bonuses within the GAR policies) involves determinations that (i) the GAR policyholders' contractual rights were to have the GAR applied to all bonuses and not to have the level of bonuses adjusted by reason of the existence of the GAR and (ii) it is an implied term of the Articles that the discretion in Article 65 is not to be used to diminish the contractual rights of members so as to undermine the guarantees in the GAR policies. Pausing there, we can see that ring-fencing the GAR policies would be inconsistent with the contractual rights which the House of Lords has held that the GAR policyholders in fact have. Viewed in isolation, Article 65 could not be deployed to enable ring-fencing to be effected. If there is nothing more in the analysis, the non-GAR policyholders are bound by an issue estoppel arising on the first question which is determinative of the ring-fencing issue with the result that they are bound by the decision on ring-fencing.

20. However, it seems to us that this cannot be the end of the matter. If it is also assumed for the sake of argument that the Society had granted directly contradictory rights[21] *to the non-GAR policyholders (in the sense that it had expressly promised that delivery*

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[20] Although if we are right in the views we subsequently express, the non-GAR policyholders are already bound in much the same way as if a representation order had been made.

[21] See the parallel argument in relation to the "balloon" policy in Addendum 1.

of their asset share would not be adversely affected, or that the exercise of its powers under Article 65 would not be affected, by the existence of the GARs) the Society would have assumed obligations which it could not perform. The term implied by Lord Steyn into the Articles - assuming we have analysed it correctly - does not help to determine how these contractual obligations could be reconciled[22]*. It seems to us inevitable that the way in which the with-profits fund would then fall to be apportioned between policyholders with competing rights would diminish the value of the GAR and benefit the non-GAR policyholders. This question could arise not only in relation to pension policies but in relation to all other categories of the Society's business. It is another question entirely (which we address further below) whether there are, in fact, inconsistent contractual or indeed other rights. However, whilst we consider that the House of Lords' reasoning necessarily means that ring-fencing is impermissible in circumstances where the only rights in issue are those of the GAR policyholders, we do not see that the same conclusion inexorably follows if other competing rights have to be considered in the context of Article 65.*

21. *In our view, therefore, if contractual rights in non-GAR policies can be established which compete with the GAR policies, we do not consider that any issue estoppel arises which would prevent the non-GAR policyholders from asserting those rights. The Society might then be faced with competing contractual claims, both of which dictate specific restrictions on the exercise of the discretion under Article 65 but which restrictions are inconsistent. We do not think that the House of Lords decision can be read as telling the Society how to resolve that conflict.*

22. *If we are right in what we have said about ring-fencing, then it is strictly unnecessary to consider the other questions of issue estoppel and stare decisis* set out below; we do so for completeness and to cover the case should we be wrong in our main conclusion.

To what extent are the non-GAR policyholders (including non-pension policyholders)

[22] If it is suggested that the GAR policies take priority because they were issued before the non-GAR policies, then the same argument would apply to earlier non-GAR policies *eg* with-profits endowment policies issued before GAR policies first started to be issued.

otherwise bound?

23. We have already expressed the view that, by virtue of the representation order, the non-GAR policyholders were bound[23] *by the decision on ring-fencing (following the decision on the first question, to which they were parties) even though they were not expressly represented by Society on that question. If we are wrong in thinking that the non-GAR policyholders are bound by the ring-fencing decision, then the question presents itself whether they were nevertheless affected by the decision. There are a number of issued to address:*

(a) Was there privity between the Society and the non-GAR/non-pension policyholders?

24. Although it has long been recognised that "privity of interest" is sufficient to bind a stranger to the estoppel created by a judgment there is still only limited authority[24] *on what constitutes privity of interest. It has been said that there must be a "community of interest"*[25] *or a "sufficient identity of interest" to make it just*[26] *to hold that the decision should be binding on the non-party. Certain relationships such as suretyship or probate disputes are deemed to give rise to privity whereas others such as principal and agent, landlord and tenant are understood not to do so.*

25. *It is generally considered, in cases concerning the construction of trusts or articles of association of a company, that privity of interest does not exist between beneficiaries or shareholders. It is perhaps for that very reason that shareholder or trust disputes are frequently turned into representative actions to ensure that non-parties are properly bound. Spencer Bower on Res Judicata*[27] expressed the view that a decision on the construction between, say, a trustee and one beneficiary whose interest is as one of a class will not affect another beneficiary-member of that class. This view was

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23 Subject to paras 19 and 20.

24 A common lament: see *Carl Zeiss Stiftung v Rayner & Keeler* [1967] AC @936 per Lord Guest, @p913 per Lord Reid; *House of Spring Garden v Waite* [1991] 1 QB 241 @252 per Stuart-Smith LJ.

25 See *Carl Zeiss* supra per Lord Guest @ p936.

26 See *Gleeson v Whippell* [1977] 1 WLR 510 @515.

27 See p212.

in turn said to be based on the first instance decision in *Re Waring*[28] *in which the Court of Appeal had previously been called upon to construe a trust. We see no obvious reason to question this analysis.*

26. Accordingly, all things being equal, we would not consider there to be privity of interest between the Society and the non-GAR policyholders, particularly in a battle with the GAR policyholders on questions of construction of the articles of association. Still less could there be privity between the Society and non-pension with-profits investors in respect of any of the questions.

(b) Did the non-GAR/non-pension policyholders acquiesce in the proceedings?

27. During the litigation, the Society members received a number of communications from the Society and other information was available to members directly or via the financial press. In those circumstances it might be said that they stood by allowing the Society to resolve the matter knowing that they would be affected by the outcome.

28. Recently, a species of acquiescence appears to have become established as a form of privity for the purposes of the estoppel rule. The principle is most neatly encapsulated by the following:

> "If a person, knowing what was passing was content to stand by and see his battle fought by someone else in the same interest, he should be bound by the result and not allowed to re-open the case"[29]

Spencer Bower considered this acquiescence principle to be limited to probate cases[30] *but in House of Spring Garden v Waite*[31] *it was applied to the case of joint tortfeasors and said to have general application. It should be noted that for a person to be bound by acquiescence he cannot be a mere bystander but must have the same interest or an*

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[28] See [1948] Ch 22; see also *Cox v Dublin City Distillery* [1915] 1 Ir R 345 @367, 372. 378; compare with *Cox v Dublin City Distillery* [1917] 1 Ir R 203 where it was held that the trustee had represented the beneficiaries in earlier proceedings and thereby caused them to be estopped.

[29] See Lord Penzance in *Witcherley v Andrews* (1871) LR 2 P&M 327 @ 328 adopted by the Privy Council in *Nana Ofori Atta II v Nana Abu Bonsra II* [1958] AC 95 @102-3 and in *House of Spring Garden* @ p253.

[30] See Spencer Bower *Res Judicata* p203-204 pa 232.

[31] [1991] QB 241.

opportunity to intervene[32].

29. *We do not, on balance, consider that the non-GAR policyholders acquiesced in a decision on the ring-fencing issue. The non-GAR pension policyholders received periodic notices of the progress of the litigation from the Society but in none of the correspondence, so far as we are aware, did the Society mention the fact that it was proposing to allow the House of Lords to resolve the question of ring-fencing. Had the non-GAR policyholders asked to see the representation order and originating summons they would not have known that this question was to be determined. In fact the representation order would have been positively misleading in that respect. In those circumstances we do not consider that the broader acquiescence principle would have any application.*

30. *The position of the non-pension policyholders appears to us to be an a fortiori* case. We do not know whether other members interested in the with-profits fund received communications similar to the non-GAR policyholders or whether they were informed that their interests could be affected by the litigation. The issue in the Originating Summons did not obviously concern them and if they had acquainted themselves with the issues in the litigation they might well have concluded that they were of no immediate relevance to them.

(c) Would it be an abuse for the non-GAR policyholders to raise the ring-fencing question?

31. To the extent that ring-fencing is the only question on which the representation order failed to ensure that the non-GAR policyholders were bound by the judgments given in the proceedings, it needs to be asked whether they would be bound by the broader form of issue estoppel normally described as the rule in *Henderson v Henderson* given the extent to which the representation was effective.

32. Broadly, the rule in *Henderson v Henderson*[33] *holds that the parties to litigation must*

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[32] That said, *House of Spring Garden* appears to have envisaged a broader form of "interest"

bring forward their whole case and the Court will not (except under special circumstances) permit the parties to open the same subject of litigation in respect of matters which might have been brought forward as part of the subject in contest but which was not brought forward only because of negligence, inadvertence or even accident. The consequence is that issue estoppel applies not only to issues upon which the Court pronounced judgment but "to every point which properly belonged to the subject of litigation and which the parties with reasonable diligence might have brought forward."[34] *This rule has been applied to representative proceedings in the context of the Lloyd's litigation*[35] *and to other non-parties*[36].

33. *The application of Henderson v Henderson* to the present facts is in a sense artificial because the issue of ring-fencing was in fact raised and decided. As far as the Society is concerned the rule is irrelevant because this is self-evidently not a case where the party has failed to argue an obvious point. However, if, as we believe, the ring-fencing issue was not raised representatively on behalf of the non-GAR policyholders the question is more difficult. They were properly represented in the proceedings on the first issue and are in a position where it might be said that the Society as representative should have raised the ring-fencing issue on their behalf when arguing the first issue. The question can therefore legitimately be asked whether the non-GAR policyholders could have started fresh proceedings on the assumption that the ring-fencing issue had never been raised and argued at all. If not, then *a fortiori* it would not be possible to do so where the issue had in fact been raised in the proceedings.

34. Looking at the matter in this way (*ie* on the hypothesis that ring-fencing was never raised or argued) we have some serious doubts as to whether the Society or the non-GAR policyholders would have been prevented from raising the ring-fencing issue in new proceedings. These were proceedings for declaratory relief. It is not immediately obvious why other questions on which declaratory relief might be sensible must be

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than that under discussion in the earlier cases.

[33] (1843) 3 Hare 100, 114-115.

[34] See *supra* per Wigram VC .

[35] See *eg Barrow v Bankside Members Agency* [1996] 1 Ll R 278.

[36] See *e.g.* Mr Johnson in *Johnson v Gore Wood* [2001] 2 WLR 72 whose company had brought earlier proceedings.

raised in a single proceeding. Indeed, to take an analogy, in most cases where trustees are seeking directions that would be a surprising conclusion. These proceedings were not clearly geared to deciding causes of action, although we can see that Mr Hyman might have contended otherwise. Unless the form of the originating summons on which the non-GAR policyholders were represented *itself* dictated that the ring-fencing question ought to have been brought forward, it seems to us that it would have been difficult for the GAR policyholders to prevent any fresh proceedings on the ring-fencing question by the Society or the non-GAR policyholders. It does not seem clear to us that Mr Hyman's right not to be discriminated against or have the benefit of the GAR removed through differential bonuses required the question of ring-fencing to be raised. Ring-fencing raises much larger and thornier questions in relation to the allocation of parts of the with-profit fund.

35. In the final analysis it also has to be remembered that the underlying principle of *Henderson v Henderson* is one of preventing parties from improper abuse of process[37]. *It has always been understood that special circumstances will excuse a party from not having brought forward an argument in earlier proceedings. Given the form of the representation order and the limited content of the communications sent to members, it might be considered unjust to hold that the non-GAR policyholders could not now raise ring-fencing in new proceedings simply because the Society had not argued it. In summary, it seems to us doubtful that it would be an abuse of process for the non-GAR policyholders to argue ring-fencing if they were otherwise not estopped by the decision of the House of Lords (ie* by virtue of privity with the Society or on the grounds of acquiescence) on that question.

(d) Stare decisis: to what extent does the decision of the House of Lords represent precedent binding on all the members?

36. The significance of the doctrine of precedent in this context can be illustrated by taking the example of a case involving the construction of articles of association. Contrary perhaps to the instinctive view, a decision on the construction of articles of association is not a decision *in rem* binding on all the world, so that the same question

of construction can be raised again between different parties provided there is no estoppel *in personam* (*eg* because of the absence of privity). In those circumstances, the only reason why a Court could feel bound to follow the earlier decision would be if the doctrine of *stare decisis* applied.

37. It is a commonplace assumption amongst lawyers to regard the construction of a formal document such as a contract, settlement or articles of association as a question of law. Accordingly, the doctrine of *stare decisis* theoretically should mean that any inferior court would be bound by the point of construction decided and any coordinate court should follow the decision. If theory held, we would expect, for example, a decided point of construction on the articles of association of a limited company to be conclusive as to the construction of identical articles of association of a different company. It is therefore a matter of surprise to see that numerous courts have expressed the view that the *stare decisis* doctrine has no real application in this field.

38. The notion that the construction of documents is a question of law is an historical fiction said to be a legacy of trials by juries who might not all be literate so that the judge took from them the direction as to the meaning of documents. Although it has been said that it is now too late to alter the technical classification resulting from this practice[38]*, the rule is fast becoming irrelevant in the light of decisions such as Prenn v Simmonds*[39] *and Investor Compensation Scheme v West Bromwich Building Society*[40]*. Since ascertaining the meaning of particular words may entail investigation of the factual context in which they were used, it would normally be relatively easy in any event for a litigant to distinguish a decision on the construction of a form of contract made against a different factual background. Hence the scope for the application of the doctrine of stare decisis* is in any event limited.

39. Moreover, even when the factual context (so far as admissible in evidence) is common to identically worded provisions, a decision does not have the status of

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[37] See *Bradford Bingley BS v Seddon* [1999] 1 WLR 1482; *Johnson v Gore Wood* [2001] 2 WLR 72.

[38] *Pioneer Shipping Ltd v B.T.P. Tioxide Ltd* [1982] AC 724.

[39] [1971] 1 WLR 1381.

precedent. Before the days of cases such *Investor Compensation Scheme* it seems it has never been the case that Courts felt bound to follow previously decided points of construction. It was said by Jessel MR that:

> "...nothing is better settled than that the construction put upon an instrument by a Court of law or equity is not binding on another Court of law or equity, even of inferior jurisdiction, as regards the construction of an instrument couched in somewhat similar language."[41]

and:

> *"...nothing is better known than that on a question of mere construction even the decision of the Appeal Court on similar grounds is not binding on another Court, and much less on a Court of equal jurisdiction. As regards the construction of the instrument, even if there are the identical words, although we follow them, they are not strictly binding; but on similar words they are not binding."*[42]

Warrington J had these observations in mind in Pedlar v Road Block Gold Mines of India[43] *when he considered that he was entitled to disregard a construction of identical articles of association reached by a court of coordinate jurisdiction.*

40. A more modern expression of the inapplicability of the doctrine of precedent appears in Ashville Investments Ltd v Elmer Contractors Ltd[44]

> "However, I do not think that there is any principle of law to the effect that the meaning of certain specific words in one arbitration clause in one contract is immutable and that those same specific words in another arbitration clause in other circumstances in another contract must be construed in the same way. This is not to say that the earlier decision on a given form of words will not be persuasive, to a degree dependent on the extent of the similarity between the contracts and surrounding circumstances in the two cases. In the interests of certainty and clarity a court may well think it right to construe words

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40 [1998] 1 WLR 896.

41 See *per* Jessel MR in *New Callao Ltd* (1882) 22 Ch D 484 @488.

42 *Hack v London Provincial Building Soc* (1883) 23 Ch D 103 at 111.

43 [1905] 2 Ch 427.

44 [1989] 1 QB 488, @ 495.

> in an arbitration agreement, or indeed in a particular type of contract, in the same way as those same words have earlier been construed in another case involving an arbitration clause by another court. But in my opinion the subsequent court is not bound by the doctrine of *stare decisis* to do so."

41. No part of the decision of the House of Lords on Article 65 and the interpretation to be placed on the GAR policies can therefore be invested with the authority of precedent. It is nevertheless advisable to recognise that a Court of inferior or coordinate jurisdiction is likely to find the judgment persuasive even if not binding by the doctrine of precedent. If another Court chooses to depart from the reasoning of the House of Lords on ring-fencing it will have to be given a powerful reason for doing so.

Challenge to Representation on the Grounds of the Society's Conflict of Interest

42. We consider the economic arguments at length below. However, we think it is misconceived to suggest that the effect of the representation will be in some way diminished just because the non-GAR policyholders are able to identify arguments which the Society could not have been expected to run. Unless the representation can be challenged on the grounds of fraud or collusion, we do not see that merely pointing to a conflict of interest (of which those representing the Society were in any event unconscious) is sufficient for any Court to relieve the non-GAR policyholders of the consequences of representation[45]. *Even if that were not so, it would be necessary that the additional arguments which it was sought to present were ones which were not only new (and not simply a different way of presenting arguments already actually presented) but also ones which can be seen to be compelling. For reasons which we now develop, we do not think those arguments form a realistic basis for seeking to bring the case back before the House of Lords.*

The additional arguments suggested by EMAG ("the Arguments"): Summary of the Arguments

43. EMAG's arguments set out to establish the propositions that the Society was not able to represent non-GAR policyholders, that the House of Lords should now hear further

argument and that the decision, especially in the light of the Arguments, should be overturned. Although the Arguments are directed principally at the ring-fencing issue, we prefer to take it on a wider basis, treating the ring-fencing issue as a special case. This is because, if there is anything in the Arguments in relation to the ring-fencing issue, they undermine not only Lord Steyn's decision on that issue but inevitably also his rationale in relation to the first issue before the House of Lords. There are several strands to EMAG's arguments, but we think they are all summarised sufficiently in the following paragraphs 44-48; we set out the arguments (which include, it seems to us, aspects which go to the correctness of the House of Lords' decision rather than to the appropriateness of the Society representing the non-GAR policyholders) before addressing them.

44. Contrary to the Society's apparent approach, GAR policies, it is said, are not simply non-GAR policies with icing on: they are fundamentally different types of policy with different economic characteristics. That the House of Lords may not have appreciated that is because the point was not made, adequately or at all, by the Society. GAR policies ensured that, however badly the Society's investment performance turned out to be, the policyholder was guaranteed a minimum return; and however low interest rates fell, he was guaranteed a minimum annuity rate which would be applied to his guaranteed investment. It was an inevitable consequence of this that a more conservative investment approach should have been adopted in relation to GAR policies to ensure, so far as possible, that the guarantees could be met. And this is so even if the Society had been correct in believing that it could allocate differential bonuses within the GAR in accordance with the policy it adopted.

45. The Board does not appear, says EMAG, to have pursued a different investment strategy in relation to the funds supporting GAR policies as it should have done. Its investment approach was "economically irrational". As a corollary of that, there could and should have been separate treatment by the Society of the allocation of terminal bonuses to GAR and non-GAR policyholders from the moment the non-GAR policies first began to be issued and GAR policies ceased to be issued.

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[45] See footnotes 16 and 17 above and the text to them.

Although not expressly stated, we think the argument must then be that the Society should not be obliged to allot terminal bonuses in a manner which would undermine the non-GAR policyholders' rights or expectations had the Society acted as it should have done from the beginning.

46. Because the Board could not be expected to instruct the Society's lawyers to put forward a case that depended on highlighting the Board's fault in relation to investment of policyholders' funds, the Board could not represent the non-GAR policy in the House of Lords, at least on the ring-fencing issue.

47. The arguments in paragraphs 44 to 46 above are put more fully in the letter dated 6th December 2000 from Jeremy Lever QC to Mr Nash the relevant parts of which are set out in our Instructions. In order to make this Opinion self-contained, we set out the relevant text in Addendum 2 to this Opinion.

48. In relation to the implied term under Article 65, it is suggested by EMAG that, because non-GAR policyholders were not separately represented, nobody addressed the question whether a term should be implied into post-1989 non-GAR policies to the effect that other persons with pre-existing GAR policies were entitled to the same terminal bonus as a non-GAR policyholder, however disadvantageous that might be to the non-GAR policyholder. The implication of such a term would have rendered such a non-GAR policy virtually unmarketable.

49. On ring-fencing, it is accepted that a member with a GAR policy has a contractual right to invoke the GAR; but there is, it is said, no reason why such a member should be able to share in the profit in the same way as a non-GAR policyholder once the contractual obligation has been met (any more than a person with a GIR should be entitled to share in the profits in the same way as a member without a GIR once the contractual obligation has been met). If that is right, there is no reason why a member with a GAR policy should receive the same share of the terminal bonus as a non-GAR policyholder.

Consideration of the Arguments

50. It may well be correct that, viewed in isolation, a fund supporting solely GAR policies would need to be invested more cautiously than a fund supporting solely non-GAR policies. We assume for the purposes of the following discussion that the Board ought to have pursued a different investment approach, as suggested by EMAG, even in the context of a single with-profits fund[46]. *We do not thereby intend to accept that EMAG is in fact correct in saying that the Society was acting in an "economically irrational" manner (as suggested in paragraph 45 above) in investing the with-profits fund as it did at a time before it knew what the House of Lords was going to say about differential bonuses within the GAR policies.*

51. Had that been known, the question of investment would we suspect, be beside the point since it is hard to think that the Society would have ever commenced issuing GAR policies in the form it did; or, if it had done, that it would have continued to issue non-GAR policies (eg with-profit endowments) or started to issue non-GAR pension policies in 1989 without either creating separate funds under recital (F) and Article 57 of its Memorandum and Articles of Association or taking some other steps to protect such policyholders. We have in mind here that the Society could have issued the GAR policies with an express terms permitting the award of differential bonuses (i) as between those who do and do not elect to take the contractual annuity and (ii) as between GAR policies and non-GAR policies[47]. *There would have been a de facto* separation of assets and the adoption of appropriate investment policies in relation to separate funds. The House of Lords' decision means that the Society has done something which, had it foreseen the consequences of what it was doing, it would most likely not have done *ie* to issue GAR policies with the right to participate in bonuses which the House of Lords has decided is attached to those policies.

52. However, if it is correct that the Society was acting in an economically irrational way in investing as it did in the light of its assumed belief that it could allocate different

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[46] We consider at paras 73-74 below the merits of the argument that the Society's investment approach was in fact open to criticism

[47] As explained in Addendum 1, we do not consider that the term which Lord Steyn implied into the GAR policies would prevent the inclusion of such an express term. *Cf* paras 3(i) to (iii) of Mr Lever's letter.

terminal bonuses depending on the election made by the policyholder, then, *a fortiori*, it would have been acting in an economically irrational way in following its investment approach in the context of GAR policies which do not permit that sort of differential allocation. In other words, it makes no difference to EMAG's argument whether or not the GAR policies in fact permit differentiation because, in either case, the criticism of the Society is that it did not act in a manner which was economically consistent with its belief.

53. It is suggested (again see paragraph 45 above) by EMAG that it is a necessary corollary of the allegedly irrational investment approach (*ie* irrational for the Society even if it believed that it could allot a differential bonus within the GAR policies) that there should have been separate treatment of allocation of terminal bonuses to GAR and non-GAR policyholders from the beginning. If that is correct then, again, *a fortiori*, the same should be true in relation to the GAR policies which in fact do preclude such a differential approach being taken[48].

54. EMAG's argument depends critically on the corollary which is said to flow from an investment policy which reflects the different economic characteristics of the different types of policy ie the corollary that a different bonus policy should have been adopted from the beginning. As to that, if what is being said is that, in order to deliver to each policyholder the returns on his investment, then of course it follows that lower investment returns (for GAR policyholders in comparison with non-GAR policyholders) means smaller bonuses. If it is implicitly being asserted that such delivery is the only fair way of proceeding, we understand what is being said. And if it is said that the economic purpose of all policies is that they are simply investment vehicles - a particular type of "wrapper" round the underlying investments designed to take advantage of tax breaks and of the smoothing which can be achieved through a with-profits fund - we also understand what is being said. We understand, too, the argument that the different economic characteristics of the GAR and non-GAR policies means that the different policyholders should expect different returns. But if

[48] Although as we have said in para 50, we think the question of investment would have been beside the point: rather the Society would have issued a different sort of GAR policy or had separate with-profits funds.

what is being said means more than all that, we do not understand what, or why. There is no necessary reason[49] *why the cost of the GARs should be deducted solely from the asset share of the GAR policyholders since that cost is, on the face of it, a cost to the Society as a whole.*

55. *It seems to us that the only basis on which the corollary can be said to flow from the EMAG investment approach is if each policy is properly to be regarded as an investment vehicle intended to deliver, in value terms, to the policyholder smoothed returns in respect of his investment reflecting his asset share (together with a share of profits or bearing a proportion of the loss of the Society's other (without-profits) business); if the different economic characteristics of different types of policy dictate different investment policies, then the return - delivered in practice through guarantees and bonus allocations - should reflect the performance of the distinct investments. It is implicit in this approach that the bonus declared in relation to the notional fund supporting the GAR policies would need to be such that the terminal bonus should bring the value of the benefits up to the value of the notional fund.*

56. *If that analysis is correct, we do not see why it should make any difference to the arguments about the Society's power to award bonuses which differ as between GAR and non-GAR policies that, in fact, investments have not been selected in line with EMAG's approach or that the assets selected have not been notionally allocated to the different classes of policy. It does not make any difference to the principle of delivery of benefits reflecting asset share whether the share derives from notional funds derived from an investment approach such as EMAG suggests or from a share of a larger fund in which all participants share, and to which the GAR policyholders have made contributions. Whatever way one looks at it, the gravamen of EMAG's argument always comes back to the contention that the delivery of the GAR policyholder's asset share should recognise the cost of the GAR. The same arguments which point to the need for different bonus treatments for GAR and non-GAR policies apply whichever investment approach has been adopted.*

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[49] Certainly if the GAR policies had had the meaning for which the Society contended, and

57. *To put this point a different way, in whatever the with-profits fund was invested, it was still one fund*[50]. *Although the EMAG investment approach might result in a different mix of investments, there would still be a single fund the profits of which had to be divided under Article 65. The overall profit of that fund might be smaller than under the approach actually adopted; that would result in smaller bonuses across the board but should not have any effect on the central question whether asset share delivery was an appropriate basis for the bonus policy actually adopted.*

58. *The House of Lords, however, rejected the detailed arguments which were put to it on the basis of delivery of asset share. We have no doubt, as we have already said, that the House of Lords was fully aware that its decision would result in a larger share of profit being allocated to the GAR policyholders and that in consequence the non-GAR policyholders would receive less than their asset share. It was, therefore, fully aware of the facts which it is said give rise to the very unfairness which supports the corollary (ie* the need for a different bonus approach for GAR and non-GAR policies from the beginning) but rejected those facts as giving rise to an unfairness or as justification for the Society's bonus policy.

59. We accept, of course, that the Society might not have felt able to put the point that it was behaving in an economically irrational manner in adopting the investment policy it in fact adopted on the assumption that its contentions about the construction of the GAR policies were correct. It could, however, have put the point that decisions, not only that differential bonuses within the GAR policies were prohibited, but also that ring-fencing of the GAR liability through bonus allotment could not be achieved, would result in compelling the Society to adopt an approach which is certainly economically unfair and very possible economically irrational. Why, it would be asked, would any investor ever purchase a non-GAR policy knowing that the GAR policyholders would be entitled to share disproportionately in profits without regard to the cost of the GARs? Such an investor could probably never be better off with the Society's with-profits fund than in some other form of safe investment, and might

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possibly even on the meaning which the House of Lords held them to have.

[50] We consider below the possibility of having separate funds pursuant to Recital (F) and Article 57 of the Memorandum and Articles of Association of the Society: but that was not done.

well lose. The Society may not have used words such as "economically irrational": but we have no doubt that the real points were made over and over again *ie* that fairness and the reasonable expectations of non-GAR policyholders dictated delivery of asset share and that that necessarily required allotment of different bonuses to GAR and non-GAR policyholders. In this context, we refer in particular to paragraph 6c above.

60. As we have already said, EMAG's argument depends on the proposition that the Society could have adopted a policy of allotting different bonuses to GAR and non-GAR policyholders from the beginning if it had invested in accordance with EMAG's approach, a corollary based on the factors we have already discussed. Suppose, then, that it were possible to get the matter back before the House of Lords (in an attempt to get the same panel to reverse its determination). Mr Sumption is assumed to be there, representing Mr Hyman as before. What would Mr Sumption say? He would certainly make two main points:

    a. The first is the substantial point that, even had the Society adopted such an investment approach, a differential bonus based on the different investment would have been invalid.

    b. The second is the perhaps more forensic point that the Society had not in fact adopted the EMAG approach and that what it could have done in relation to investment should not trouble their Lordships in relation to what it actually did with respect to bonuses or what it might do in the future.

61. In the context of the first of those points, we note the statement in the letter referred to at 47 above that there was general agreement (at an earlier meeting between the Society and EMAG) that when the Society ceased to issue new GAR policies the Board could have differentiated between terminal bonuses allocated to different policies according to whether or not they contained a GAR. We understand that this was agreed to be so whatever the investments actually effected. Certainly it was agreed to be the case in the context of the investment approach which EMAG

suggests should have been adopted. But is this correct? Or is the point we hypothetically attribute to Mr Sumption correct? We have identified the following possible ways in which the Society might have proceeded:

a. By the creation of a separate fund for the new with-profits business pursuant to Recital (F) and Article 57 of the Society's Memorandum and Articles of Association. Recital (F) provides for the creation or setting aside of a special fund or funds and for the giving to any class of policyholder or annuitant special rights over the fund so created. That power can only be exercised, by virtue of Article 57, with the sanction of a Special Resolution of the Society.

b. Following the hypothecation of assets to the GAR and non-GAR policies *ie* an earmarking or notional allocation to the GAR policies of the more conservative investments needed to reflect the guarantees and to the non-GAR policies of less conservative investments reflecting the greater flexibility available in respect of those policies. We shall refer to this possibility as "earmarking". In particular, if the Society had adopted an investment policy of the sort which EMAG suggests it should have adopted, there would in effect be separate earmarked funds representing the appropriate asset mix for the different classes of policy.

c. Simply as an exercise of the power under Article 65 but in the light of the make- up of the fund the composition of which, on EMAG's approach, would reflect the nature of the underlying liabilities under all with-profits policies participating in the fund. In other words, the investment approach suggested by EMAG would have resulted in a different spread of investments within the with-profits fund reflecting the different economic characteristics of the underlying policies and would have justified an exercise of the powers under Article 65 to allocate different terminal bonus to different classes of policy.

62. As to the first suggestion, we have no doubt that it would have been possible to create a separate fund out of the contributions of the new non-GAR policyholders and for the

rights of participators in that fund to be defined in such a way that the profits derived from that fund could be dealt with, so far as concerned terminal bonus, in such a way to give effect to the bonus policy actually adopted by the Society once the annuity which could be purchased with a given sum of money applying the current annuity rate ("CAR") fell below the annuity which could be purchased with that sum applying the GAR. It is absolutely clear that the Society did not do this. Whether or not the Society can be criticised for not doing this is not within the scope of the advice which we give; the fact that it did not do so cannot help the non-GAR policyholders. Indeed the fact that it could have been done - and thus have insulated the non-GAR policyholders from exposure to the cost of the GARs - is, if anything, a factor in favour of the GAR policyholders.

63. As to the second suggestion, it appears an attractive possibility at first sight, but on analysis we do not consider that it leads anywhere. Either such earmarking is intended to create a separate fund (for one or other or both of the GAR and non-GAR policies) or it is not. If it is so intended then that can only be done pursuant to a special resolution as required by Article 57 (which was not in fact done by the Society). If it is not so intended, then the entirety of the assets remain comprised in a single with-profits fund, albeit one which represents the assets of distinct classes of business; and bonuses still need to be declared pursuant to the power conferred on the Board by Article 65 in respect of that single fund.

64. It is not then easy to describe precisely what earmarking could amount to. We should, however, clear out of the way an analogous concept - that of <u>appropriation</u>. The appropriation of assets is a well-understood concept in the context of a trust fund: for instance, where shares of a trust fund are held for different classes of beneficiary, trustees may have an express power (and, indeed, have limited implied powers) to appropriate assets of the correct proportionate value to one or more of those shares so that distinct assets become held, in effect, on distinct trusts (whilst remaining part of a single composite trust fund for many purposes *eg* the trustees' implied right of indemnity for expenses properly incurred). But an appropriation of that sort would, we think, be the creation or setting aside of a separate fund for the purposes of Recital

(F) and could not be done without a special resolution.

65. It seems to us, then, that earmarking would, and could, amount to no more than a notional allocation of certain assets to different classes of policy reflecting the different economic characteristics of the different classes coupled perhaps with administration (*eg* future investment policy) of those notionally allocated assets in a way appropriate the policies to which they are notionally allocated. It does not seem to us that such notional allocation could have any real consequence. It certainly does not follow that, because such an allocation is made, the allocation is relevant to, let alone determinative of, bonus declaration policy as between the different classes of policy concerned.

66. At this stage of the analysis, we refer back to paragraph 6c above to note that differential bonuses are, in fact, declared in relation to certain classes of business. Indeed, so far as concerns the non-UK business, we understand that certain assets are regarded as earmarked to the relevant policies[51]. *As we have said, we do not express any view on whether that process is valid or not: it may be that the different economic characteristics of those policies justify this sort of earmarking and consequential differentiation in bonus treatment. A related, but conceptually separate, question is whether it may also be possible to ring-fence those policies against the cost of the GARs, but again we express no view on that*[52].

67. Let us now suppose that the Society had adopted the sort of investment policy which EMAG suggests it should have adopted, in contrast with the policy which it did adopt and which EMAG suggests was "economically irrational". There would then be asset pools earmarked to the GAR policies and the non-GAR policies just as there would be asset pools earmarked to the non-UK business. The asset pools for these different classes would differ to reflect the different economic characteristics of the policies concerned. However, the only reason for an asset pool for GAR policies in contrast with non-GAR pension policies would be the presence of the GARs since it is

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51 There has been no creation of separate funds pursuant to recital (F) and Article 65.

52 We are, however, bound to say that there may be difficulties in maintaining any distinction between different classes of non-GAR with-profits policies for the purposes of ring-fencing.

from the presence of the GARs alone that the different economic characteristics spring. In contrast, the different asset pool for eg non-UK business as compared with non-GAR pension policies might arise from differing economic characteristics which had nothing whatsoever to do with the GARs: it might then be permissible[53] *to have differential bonuses for these types of policy and thus to ring-fence such policies from the GAR policies.*

68. *Since the different earmarking of assets to the GAR policies would arise simply because of the presence of the GAR, it follows that any differential bonus which is based on the asset share represented by the earmarked assets would also arise simply because of the presence of the GARs. Just as Lord Steyn applied his reasoning on the principal issue (ie* whether there can be differential bonuses within the GAR policies) to the ring-fencing issue, we think it as certain as things can be in litigation that, even assuming it were possible to get before the House of Lords again (by which we mean before the same panel of the House), he would apply that reasoning, too, to the suggestion that a differential bonus would be permissible if based on a different asset allocation itself where that resulted solely from the presence of the GAR. He would not, we consider, view EMAG's argument as in any sense new: it would reflect simply another way of putting the argument which had been so fully put already *viz* that terminal bonuses should be used to deliver asset share to the policyholders. Instead, he would, we feel confident, have dismissed the argument: he clearly not only regarded the policyholder as entitled to a capital sum to which the GAR would apply <u>but also</u> considered that the allocation of capital sums to each policyholder should not depend on whether or not his policy contained a GAR otherwise the benefit of the GAR would be undermined. Now, one can agree or disagree with his reasoning - many would disagree - but what one cannot do is distinguish it even if one starts with an investment approach of the sort advocated by EMAG.

69. We should, for completeness, add at this stage that we see no difference in principle between reversionary (or interim) bonuses and terminal bonuses. We have no doubt that, had the Board sought to allot different reversionary bonuses depending on

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53 See para 6c. above.

whether or not the policy contained a GAR, Lord Steyn's reasoning would have led to the conclusion that this could not be done. Accordingly, one could not have reached a point where the guaranteed nominal amounts of GAR and non-GAR policies differed at the moment when terminal bonuses came to be allotted.

70. We have just considered the position were it now possible to get the matter back to the House of Lords. One can only speculate about how the House of Lords would have reacted at the actual hearing if different advocates had also appeared for non-GAR policyholders, putting different arguments, or the same arguments in a different way. That is beside the point: the fact of the matter is - and nothing can happen to change this - that if the same panel of the House of Lords were to entertain any further hearing, it would do so against the background of the decision which it has already made.

71. It should also be borne in mind that all of the courts which heard the case had available to them a mass of evidence. In particular, there were expert actuarial reports from Mr BJ Brindley (on behalf of Mr Hyman) and Mr M Shelley (on behalf of the Society). Those reports, as well as the evidence of Mr Nash (a passage from which we have already quoted) and Mr Headdon, give a full picture of the nature of a with-profits fund and contain full discussions of the nature of policyholders' reasonable expectations ("PREs"). No-one reading that evidence could fail to have a basic understanding of how a with-profits fund is intended to work from an economic viewpoint[54]. *One might be forgiven for thinking that the totality of that evidence clearly established the fairness of the Society's terminal bonus policy of delivery of asset share and that the PREs of both GAR and non-GAR policyholders could not have included an expectation on the part of GAR policyholders that their terminal bonuses should provide them with more than their asset share and deprive the non-GAR policyholders of theirs. However, it seems to us that a Court which, in the face of that evidence, was nonetheless able to imply, as a matter of strict necessity, the term which was in fact held to be implied, would not have seen the position any differently even if there had been expert evidence stating in express terms that the*

Society's investment policy was economically irrational.

72. *As to paragraph 61(b) above, the fact that there was no earmarking of funds would make it doubly difficult to persuade the House of Lords to reopen the case. Even if it were correct that the Society should have adopted a different investment policy and that even if, had it done so, it should have operated a bonus policy which distinguished between GAR and non-GAR policies, it does not follow from that that the decision of the House of Lords was wrong. The basis of the decision is that a term was to be implied into Article 65 the effect of which was that the guarantees in the GAR policies should not be undermined since the powers under that Article should not be exercised so as to conflict with the GAR policyholders' contractual rights. If it is assumed that the Society could have done what EMAG suggests, and had done so, then to operate a bonus policy which distinguished between GAR and non-GAR policyholders would not, on that assumption, have undermined the guarantee or infringed contractual rights. But the Society did not do so; and the House of Lords has held, in that factual context, that the Society's bonus policy did infringe the contractual rights of the GAR holders.*

73. *In the light of the above, it is not strictly necessary to address whether it might be possible to establish EMAG's suggestion of economic irrationality on the part of the Society even if the Society's contentions on construction of the GAR policies had been correct. Two things are clear:*

    a. *It is not self-evident or obvious that EMAG is correct. Indeed, the Society considers that it is wrong and that its investment policy was economically rational.*

    b. *Even if it is correct, there is not before us at the present time us any expert evidence which supports EMAG.*

74. *But if EMAG is correct, then a significant part of the with-profits business of UK*

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[54] Although a deep and sophisticated financial thinker might be troubled with all the

insurance companies may have been carried out on an incorrect basis for many years; and that would be so notwithstanding the wide-ranging regulation to which the industry was subject. We do not say that that is not a possible result: it would all depend on expert evidence. But it would be a very surprising result. Further, even if this matter could be brought back before the House of Lords, it could only be done if the expert evidence adduced as justification for reopening the case were compelling. We have not suggested that any attempt be made to obtain such evidence. This is partly because we do not think that it would have any impact on the House of Lords' decision for the reasons given; partly because it would occasion even further delay in the production of this Opinion were we to await the result of such an attempt; and partly because the Society, which is our client, considers that there its policy was sound and on this issue could not, we think, reasonably be asked to fund an attack on itself.

75. *Our conclusions on this part of the case, therefore is that EMAG's arguments based on the suggested economic irrationality of the Society's investment approach afford no realistic prospect of persuading the House of Lords that its decision on ring-fencing was incorrect, even assuming (a) that the matter could somehow be brought before the House again and (b) that it could in principle, reverse or somehow circumvent its decision.*

76. *Nor, for the reasons and in the light of the analysis set out in Addendum 1, do we think there is anything in the argument set out in paragraph 49 above.*

Rights of non-GAR policyholders

Introduction

77. *We have already discussed the scope and effect of the House of Lords' decision. There remains the question whether the non-GAR policyholders might nonetheless have claims that their own contracts with the Society prevent the Society from throwing the costs of meeting the GARs onto the non-GAR policyholders in determining own bonus allocation and, if so, whether the House of Lords decision*

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implications.

(assuming that it is otherwise conclusive) precludes that argument being taken. The issue is whether the non-GAR policies create rights which are irreconcilable with the rights created by the GAR policies. Our formal Instructions raise only the question set out in paragraph 100(e) below, but as will become apparent, the issues which need to be addressed go wider.

78. *If irreconcilable rights can be identified, that might be significant in one of two ways. First, it might be suggested that the existence of competing rights arising out of non-GAR policies ought to have been put forward on the construction argument and were only ignored because non-GAR holders were not separately represented. Secondly, it might be suggested that the Board is now faced with two sets of competing rights which it has to accommodate in a way which would require a reduction of the benefit that can in fact be delivered to the GAR policyholders. These are rather separate forms of approach. The first suggestion is concerned to impugn the judgment whereas the alternative suggestion is designed to live with the House of Lords' decision but to modify its consequences for allocating some sort of compensation or damages to the non-GAR policies before ascertaining the profit available for distribution.*

79. *We do not think that there is anything at all in a suggestion that the House of Lords' decision would have been influenced by considerations of the rights which the non-GAR policies conferred contractually even assuming that competing contractual rights could be established:*

    a. *It has to be accepted that the Society did not argue that the non-GAR policyholders had legally enforceable rights inconsistent with those of the GAR policyholders. This is hardly surprising since the Society did not believe that the non-GAR policyholders enjoyed legally enforceable rights to asset share or any particular level of bonus any more than it believed the GAR policyholders to be able to insist on the same terminal bonuses as non-GAR policyholders.*

b. *Accordingly, no non-GAR policies were included in the voluminous exhibits before any of the Courts. The Society adduced no evidence to explain the selling practices in respect of non-GAR products. None of the argument before the House of Lords was directed to the construction of non-GAR contracts. The regulatory background was not explained. However, we do not believe that the House of Lords would have considered such material of any assistance on the question before it viz.* construction of the GAR policies, anymore than it found evidence about industry practice bonus allocation in relation to with-profits funds of assistance[55].

c. *The House of Lords was only concerned with the construction of the GAR policies and Article 65, and in particular with the basis upon which the Board had purported to exercise its powers under Article 65. Looked at from the point of competing rights and obligations the House of Lords could have justifiably considered the implied term (viz* that the Art 65 discretion would not be used to undermine the rights of policyholders) as being entirely neutral as between GAR and non-GAR policyholders

d. In any event, the PREs of non-GAR policyholders were considered by the Society as being directly relevant to the question of the proper exercise of the Article 65 discretion; and that is why a great deal of evidence was put before the courts directed to PREs. It is those same PREs which need to be relied on to assert any contractual right which would assist the non-GAR policyholders. But those PREs were rejected as a basis on which to justify the Society's bonus policy. Once that rejection is accepted - as it has to be - we have difficulty in seeing how the possibility that there might be competing contractual rights could have affected Lord Steyn's analysis of the implied term.

e. It may well be - and for the purposes of discussion we assume - that, had the market known of the meaning of the GAR policies as held by the House of

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55 *Cf* the remarks of Lord Woolf @ [2000] 1 WLR 815 para (f) in relation to expert evidence.

Lords, non-GAR policies would have been rendered virtually unmarketable irrespective of whether the non-GAR policyholders themselves had contractual rights. As we have said more than once, there can be no doubt that the evidence before the courts left no room for any doubt that the effect of a decision preventing ring-fencing would be to throw at least some of the cost of the GARs onto the non-GAR policyholders in an economic sense. That adverse effect was well-appreciated by the House of Lords. Effectively, the non-GAR policyholders are therefore left with policies which could never have been marketed to them had the true position been known[56]. While it is hard not to sympathise with the view that these considerations should have prevented a term from being implied in the GAR policies, the House of Lords has held to the contrary and has done so in the face of sustained argument to the contrary.

f. We are firmly of the view that, even if consideration of the contractual rights of non-GAR policyholders, and the material needed to establish those rights, could now be put before the House of Lords and the ring-fencing issue be re-argued, there would be no prospect at all of persuading the same panel to alter its decision.

80. Before turning to the contractual issue, we point out that such an implied term would be merely one means by which rights competing with those of the GAR policyholders might be asserted. We have already said that we are not advising in any detail on claims which may arise against the Society relating to the conduct of its business including the sale of policies. We nevertheless feel that the arguments as to the contractual rights of the non-GAR policyholders will have to be addressed by reference to the selling practices of the Society so that there is an inevitable overlap with the wider issue of potential claims against the Society. An analysis of those practices suggests that the non-GAR policyholders may have certain alternative causes of action enabling them to set up rights against the Society with the result that

[56] The question whether the Society could properly have issued such GAR policies in the light of the existing non-GAR policies is one the House of Lords does not address.

the bonus allocation may have to be revisited to an extent which diminishes the presently assumed entitlement of the GAR policyholders

81. We turn then to competing contractual rights. It has to be recognised there is no express contractual term in any of the non-GAR policies which entitles the policyholder to delivery of his asset share without any reduction to reflect the contractual rights of any other person (*eg* those of Mr Hyman) sharing in the bonus declaration[57]. *It is therefore necessary to address whether there might be some implied term*

82. The non-GAR policies must be construed against the factual background in which they were issued. For policies issued after the commencement of the Financial Services Act 1986, that background includes the regulatory framework within which the Society operated. Further, the construction of the non-GAR policies may be influenced by the product particulars and other sales literature which the Society issued to potential purchasers.

The LAUTRO Rules

83. The Society was a member of LAUTRO[58] and obliged to comply with its rules. We set out in Addendum 3 what we perceive to be the relevant LAUTRO rules and make some comments on them. The most important rules required the Society to provide information about its investment products sufficient to enable investors to make fully informed decisions and, in particular, to disclose its policy on the allocation of bonuses from its with-profits fund as between different policyholders. Contravention of such rules gives rise to a claim for breach of statutory duty by virtue of section 62 Financial Services Act 1986. Moreover, as will be further explored below, many of these rules can have contractual consequences or result in statements or omissions being characterised as misrepresentations.

The Sales Literature

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[57] We have not seen any actual non-GAR policies but we have been provided with copies of some standard policy documentation.

[58] The Life Assurance and Unit Trust Regulatory Authority.

84. *We have seen certain of the post July 1989*[59] *sales literature which was used to market non-GAR pension policies and various editions of the with-profits policies. What we have seen shows remarkably few details about the with-profits fund included in the product particulars, in contrast with the information about unit linked funds. The descriptions of the bonus policy do not specify the contracts which participate in the with-profits fund; the risk to the with-profits fund inherent in the GARs (even on the Society's view of what it could achieve through differential bonus allotment) is not mentioned. The potential risk of having to meet the GARs does not form part of any explanation about how the charges and expenses will affect the return on the policy. No mention is made of the substantial risk represented by the GARs in the events which have happened (ie* prohibition on ring-fencing); but this is not, of course, surprising given that the Society did not appreciate that the GAR policies carried that risk to the with-profits fund.

85. We do not consider that the Society's literature contains any real warning that the bonuses of policyholders could be reduced by the rights of <u>other</u> policyholders participating in the with-profits fund (in particular, those arising out the GARs in the GAR policies established by the House of Lords' decision). There is - unsurprisingly since the Society did not appreciate that its GAR policies had the meaning attributed to them by that decision - nothing to indicate the risks which have materialised as a result of that decision. Further, we consider that there is real doubt about whether the risks of the GAR policies were sufficiently identified even if the policies had meant what the Society contended:

a. Successive editions of the "With-Profits Guide"[60] *describe the effect of guarantees with the statement "With every contract a certain minimum level of benefit is guaranteed. The exact nature of that guarantee depends on the precise terms of the contract. Earnings on the assets …are smoothed and passed on to the policyholders by way of guarantees and bonuses of various*

[59] Non-GAR pension policies first started being issued from about that date. We have not seen, not having asked to see, the material before that date on the basis which non-GAR policies (*eg* with-profits endowments) were sold.

[60] CIML1 File F p1865

kinds". That suggests that guarantees form one way of delivering the earnings attributable to each policy.

b. The effect of any warning about the effect of guarantees in general is diminished when taken in the context of the emphasis throughout the literature[61] *that the policyholder would obtain an investment return from his contributions. The sales literature seems to us to have repeatedly conveyed the message to investors that their contributions were being invested in a range of assets to generate an investment return.*

c. *Under the heading "Recent Bonus Policy" in the With-Profits Guide investors were told that "it is a fundamental principle underlying the way the Society operates its business that the Society attempts to be fair to policyholders with contracts for all different types and duration"*. We think that there is a real question whether this statement is sufficient compliance with the requirement in LAUTRO Rules Sched 8 para F1[62]. *More important, since the effect of the GARs on the asset-shares of non-GAR policyholders is, in the light of the House of Lords' decision, not "fair" to them, the statement may even be misleading.*

d. *Under the heading "Other Factors" in the With-Profits Guides, investors are told that*

> *"There are miscellaneous sources of profit and loss which contribute to the overall bonus picture but they are not significant because of the Society's approach to guaranteed and unit linked business. Those parts of the business are run so as to provide an adequate return on the capital employed and to avoid making losses rather than so as to make profits. Since, however, some degree of margin is allowed for in the premium basis as part of the prudent running of the business, some profits are normally made."*

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61 See *eg* in the "With-Profits Guide" under the heading "Factors Influencing Bonus Rates" or in the documents entitled "Equitable Pension Plans – Investment Details": see CIML 1 File 6 p1950.

62 See para i.i in Addendum 1.

This might be taken to suggest that the "guaranteed and unit linked business" are essentially ring-fenced.

86. One argument is that the cost of the GAR is one aspect of the business participating in the with-profits fund of the Society brought into account in ascertaining the profits and losses in which participants of the with-profits fund share, and that any member must be taken to understand that he must share in losses as well as profits. No doubt the profits referred to in Article 65 do reflect the cost of the GAR in relation to guaranteed funds. But that is neutral in the context of the issue whether or not to imply a term which requires the delivery of a fair investment return through the exercise of the power conferred by that Article. We do not therefore find this argument terribly convincing when considered by reference to the sales literature. We do not here attempt to identify all the relevant material but the following statements seem to us worth highlighting:

a. The With Profits Guides contain a brief description of the investments in the with-profits funds. None of those investments would enable the Society to claim the cost of the GAR as a natural by-product of the investment.

b. In fact the statement quoted from the With-Profits Guide quoted in paragraphs 85a and c above suggests that "earnings" are ascertained before the cost of guarantees has to be met and that guarantees and bonuses together are designed to distribute those earnings in a fair way.

c. The literature repeatedly suggests that members will have to share the fortunes of the Society to the extent that the "investments" may go up or down:

i. In successive versions of the Pension Product Particulars[63] *under "the with-profits approach" the policyholders is told that "the major part*

[63] Tab 1 of File containing non-GAR sales literature

of bonuses arises from the activity associated with the investment of the contributions on with-profits contracts ."

ii. But it will be pointed out, against the non-GAR policyholders, that this statement continues with this: *"However since the Society has no shareholders the with-profits policyholders effectively stand in the position of proprietors sharing in any profits made or losses incurred in running the business"*. The words which we have underlined might be relied on in this way; any loss of the Society would fall on the with-profits fund and this would include a loss arising by virtue of the GARs *ie* the shortfall in the asset share over the cost of the GARs applied to the GAR policyholders' nominal capital amounts. There are two points to make in relation to that:

(1) first, it would not provide an answer to how profit, once ascertained, is to be shared between the "proprietors"; and

(2) second, it is not natural to describe as a loss an expense which arises as a result of the allocation of a profit - in other words, it is odd to describe the cost of the GAR in relation to a terminal bonus as, or as contributing to, a loss.

iii. In the "Key Features" documents between 1994 and 1998[64] *relating to with-profits annuity contracts, the policyholder is told that "there is no guarantee that projected*[65] *benefits will be borne out in practice – the actual benefits will depend largely on future investment returns which cannot be known in advance"*.

iv. In a brochure entitled "The Equitable 2000 Pension Funds" the "with-profits approach" is described as a more conservative form of

64 CIML Vol 6 Tab 14 eg @p1992 under the heading "What are the Projected Payments?"

65 Projected benefits are based, as they must be, on the basis of assumptions prescribed by LAUTRO.

investment where *"most of the bonuses come directly from the investment of the contributions into the with-profits fund"*. One finds similar statements in other material relating to pension policies.

v. In the brochures issued between 1996 and 1998 entitled "Equitable Pension Plans - Investment Details"[66] *it is said that "earnings on the assets ... are averaged out and after deduction of currently ½% pa of the fund as a further allowance to expenses are added to the guaranteed benefits by way of bonuses…"*

87. Furthermore, we question whether a non-GAR policyholder would expect the Society to say that he was sharing in what we would describe as the Society's "loss experience" when disproportionate bonuses (*ie* which diminish the non-GAR policyholder's asset share) are allotted to fellow members of the mutual society. The only reason why the GAR policyholder has the ability to receive benefits which exceed those payable on an asset share basis is because of the contributions made by the non-GAR policyholders. Moreover, investors were given a description of the investments and the sales literature went to great lengths to ensure that members were alerted to the effect of expenses and mortality rates. The introduction to the With-Profits Guide drew attention to the importance to the policyholders of understanding the factors which affect bonuses; some factors are mentioned, but nothing at all is said about the effect of GARs in policies which participate in the with-profits fund. If the additional benefits allotted to the GAR policyholder can be described as, or as giving rise to, "losses" we anticipate that it could be countered that such a loss is different in kind to the type of loss which the non-GAR policyholder could reasonably anticipate as a risk to his investment (*eg* a loss on the without-profits annuity business). He would not expect his contributions to be used to enhance the bonuses of fellow members participating in the with-profits fund. We view with some scepticism a suggestion that the Society had made effective disclosure of the GAR liability by virtue of general statements that investors were alerted to their exposure to potential

66 See CIML 1 Vol 6 p 1950ff

losses of the Society, particularly when the risk was not one which the Society itself appreciated - not being aware of the true meaning of the GAR policies - and could not therefore have disclosed .

Analysis

88. Having regard to LAUTRO rules and the content of the sales literature we make the following preliminary observations:

a. We believe it is arguable that the LAUTRO rules required the effect of the GARs on non-GAR policyholders to be disclosed in the contexts of (i) the provision of an explanation of the features of the with-profits fund and (ii) the description the bonus policy and the means by which fairness was achieved.

b. We do not consider that the existence of the GARs can be said to have been disclosed to non-GAR policyholders in the With-Profits Guides, product particulars or other documentation. To assert merely that the bonus policy was "fair" and to draw attention to the fact that members share in "losses" as well as "profits" is arguably short of what was required by LAUTRO rules[67]. *In any event, what the Society thought was fair is something which the House of Lords has said it cannot implement consistently with the terms of the GAR policies.*

c. It is arguable that the literature overall contained certain representations to non-GAR policyholders. Without claiming to have encapsulated these in the most elegant terms we suggest they might be expressed as follows:

i. That their contributions would be used to generate investment returns which would be affected only by mortality rates and the expenses associated with the policy.

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67 It is important when considering the Society to remember that this is a criticism that can be levelled at the with-profits industry as a whole. The failure to explain how with-profits funds operate and the opaque use of language in declaring bonuses was recently highlighted by Sir Howard Davies in a lecture entitled *"Future Regulation of With-Profits Business"* to The Institute of Welsh Affairs to be found on the FSA website at www.fsa.gov.uk/pubs/speeches.

ii. That they would not be treated unfairly as investors.

iii. That the Society had exercised reasonable care and skill in describing the rights of the non-GAR policyholders in the with-profits fund.

d. We think it is arguable that the representations in i and ii were false[68]*, although not, of course, known to be so*[69]*. We do not speculate whether the Society acted negligently*[70] *in making the representations in i and ii or whether the representation in iii was false. Those are much larger questions beyond the scope of this Opinion.*

89. Given those observations, the post 1988 non-GAR policyholders may potentially have claims for (a) breach of statutory duty under section 62 Financial Services Act 1986 by reason of its contravention of LAUTRO rules (b) claims for misrepresentation under section 2(1) Misrepresentation Act 1967 (c) claims for breach of warranty either in a collateral contract or in the primary contract. Whilst we consider these briefly we point out that we cannot be taken to have given more than preliminary and tentative views on these because we have not been presented with all the arguments for and against such claims. We do emphasise what we have just said: it is important that persons reading this Opinion who would wish to see the decision of the House of Lords neutralised should not regard the possible claims which we have identified as being claims with a good chance of success, let alone as claims which are almost certain to succeed. To assess the real strength of such claims will entail considerably more work. In any event, our instructions are only to explore these as possibilities.

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[68] But we should observe that if a court is willing to ignore or view restrictively the PREs of the non-GAR policyholders in construing the GAR policies (as the House of Lords has done), then it may also take a great deal of convincing that the Society would be acting unfairly in selling non-GAR policies in the way that it did.

[69] Indeed, there was no cause for concern at all about ring-fencing until the litigation was under way.

[70] If there were negligence, the Society might also be liable for contravention of the LAUTRO rules requiring it to use due care.

Section 62 Financial Services Act 1986

a. *The statutory duty embodied in section 62 imposes strict liability which only requires proof of negligence when that it is inherent in the conduct of business rule which is said to have been contravened. Assuming that contravention of the rules could be identified it seems to us therefore that it would be no defence for the Society to say that it misunderstood the terms of the GAR policy and therefore failed to declare the extent to which the GAR rights would undermine the expectations or rights of the non-GAR policyholders.*

b. *However, there may well be an issue of construction of the LAUTRO rules ie* whether the rule which required the Society to set out how it would ensure fairness between its members merely obliged the Society to state the basis upon which bonuses would be calculated (*ie* given the Society's belief) or the basis upon which they <u>should</u> be calculated (given the Society's obligations to other policyholders). In considering such an issue of construction a Court would have regard to the fact that the rules are designed to ensure that members are fairly and fully informed about the nature of the investment so that an informed decision can be reached and that the rule is not self-evidently satisfied merely by showing a *bona fide* disclosure.

c. Once a claim for breach of statutory duty is established it would of course be another question entirely how damages would be calculated[71].

Misrepresentation

d. *We have already suggested that the statement in the With-Profits Guide that the bonus policy would be "fair" to the non-GARs might be taken to amount to a misrepresentation because the obligations of the Society assumed under the GAR policies forced the Society to be unfair to the non-GAR policyholders. We have also pointed out that we do not speculate whether or not the Society acted negligently in making such statements.*

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71 See further at paras 95-99 below.

e. *It then needs to be asked whether representations could be implied by virtue of the Society's duties of disclosure under LAUTRO rules and whether liability could be imposed on the grounds of non-disclosure in the context of the positive representations that were made. It might be said that investors were entitled to assume that the Society would disclose negative information about the with-profits fund such as the existence of the GARs in some policies. Instead the Society emphasised at every opportunity that the investor's contributions would entitle him to delivery of benefits based on the return on his investment. In those circumstances we consider that it might be possible to imply a representation from the failure to disclose the GARs that the contracts of other policyholders did not require the Society to deprive the non-GAR policyholders of part of the investment return which they would otherwise receive.*

f. *Damages for misrepresentation may be available under section 2(1) Misrepresentation Act 1967 with the consequence that the Society would have to prove that it had reasonable grounds to believe and did believe the representations to be true. Pure non-disclosure or silence is not, it seems, actionable under section 2(1) but misrepresentation based on partial non-disclosure is so actionable*[72]*. Accordingly, the non-GAR policyholder may be entitled to compensation for the lost opportunity of investing his funds in some other form of comparable fund in which his contributions were reflected as an asset-share*[73]*. This would not necessarily be the same as the bonus allocations that could have been made by the Society in the absence of the GARs. Damages on this basis are not the same as damages for breach of warranty.*

g. *A claim for negligent misstatement at common law, for example, under Hedley Byrne v Heller* principles would require proof by the non-GAR policyholders of negligence on the part of the Society. The measure of damages may not in fact be very different.

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72 *Banque Keyser Ullman v Skandia* [1990] 1 QB 665 and Chitty on Contracts 28th ed Vol 1 pa 6-16.

Breach of Warranty

h. Given that a claim for misrepresentation is arguable, it also seems to us arguable that the Courts would elevate such representation into a warranty - either collateral or as a term of the non-GAR policy itself. The representation, essentially to the effect that the contracts of other policyholders did not require the Board to exercise its discretionary powers in relation to bonuses so as deprive the non-GAR policyholders of part of the returns on their investments, could easily be converted into a warranty to like effect. The test for determining whether a representation should be elevated into a warranty is whether, having regard to the parties' conduct, the reasonable bystander would infer that the representation was intended to be treated as a promise. It has been said that:

> *"...if a representation is made in the course of dealings for a contract for the very purpose of inducing the other party to act upon it, and actually inducing him to act upon it, by entering into the contract, that is prima facie ground for inferring that it was intended as a warranty. It is not necessary to speak of it as being collateral. Suffice it that it was intended to be acted upon and was in fact acted on. But the maker of the representation can rebut this inference if he can show that it really was an innocent misrepresentation, in that he was in fact innocent of fault in making it, and that it would not be reasonable in the circumstances for him to be bound by it."* [74]

If a pre-contractual statement is made of facts which are clearly within the exclusive knowledge of the maker and such statement would be considered to be an important inducement by a reasonable bystander then the statement could amount to more than a mere misrepresentation.

i. The bystander is only concerned which facts which could reasonably be taken as known by both parties. He would not take into account the existence of the terms of the GAR policies because this information could only be within the

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[73] See Chitty Vol 1 para 6-054.

Society's knowledge. It is, therefore, no answer to a claim for breach of warranty that the Court would be implying a term which would compete with the rights of the GAR policyholders.

j. Damages for breach of warranty would have to be calculated on the footing that the warranty was true. In other words, the non-GAR holders would be entitled to be compensated on the footing that bonuses would have reflected their asset-shares[75] *without reduction because of the presence of GARs in other policies.*

The position of other non-GAR policyholders

90. *Many of the non-GARs will have acquired their with-profits policies in circumstances when LAUTRO rules had no application eg* for UK business before the commencement of the Financial Service Act 1986 and for non-UK business at any time. We have not seen sales literature concerned with non-pension products but prior to 1986, the Society's brochures contained only the briefest explanations of the with-profits business. Nor was there any obligation of disclosure prior to that time.

91. We have therefore considered whether, in the absence of the LAUTRO rules and the sales literature generated as a result, the non-GAR policyholders would ever have been able to argue for some form of implied term, the effect of which would be to prevent the Society from using the asset-share of such a policyholder to meet the cost of the GARs[76]. *Such a term would have to be implied by the test of strict necessity adopted by Lord Steyn himself or by reference to the test of obviousness.*

92. *There are, we think, formidable difficulties with any argument which relies on implication. For instance:*

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[74] *Dick Bentley v Harold Smith* [1965] 1 WLR 623 *per* Lord Denning MR and see also *Esso Petroleum v Mardon* [1976] QB 801.

[75] This is not to say that they would necessarily have received their asset shares: the Society has, on any view, a discretion under Article 65 which cannot be read as requiring delivery of asset share even in the context of a bonus policy which is required to be "fair".

a. *It would be said that a with-profits fund inevitably involves elements of cross-subsidy, for example, by virtue of the effects of smoothing and as a result of mortality experience differing from assumptions. Moreover, policyholders should be taken to realise that members often have different forms of policy which makes uniform and strict application of an asset share principle unlikely. In the absence of any duty of disclosure and in the absence of any actual misrepresentation, it is not easy to see how any claim could be sustained. In any event, the process of implication would have to be undertaken by reference to the relevant factual matrix and we are not at present in a position to undertake that task.*

b. *Moreover, it would no doubt be suggested that it is simply not possible at all to imply into the non-GAR policies issued after GAR policies first came to be sold a term which is inconsistent with the GAR policies, especially as the relevant implied term is, according to Lord Steyn, implied into the Articles. However, if our analysis of the implied term is correct, we do not think that there is anything in this suggestion. The implied term is a general provision preventing interference with contractual rights or reasonable expectations. The rights and expectations of a GAR policyholder do not derive from the Articles but from the GAR policy itself. The (correct) proposition that it is not possible to imply into a contract a term which is inconsistent with an express term of that same contract has, we think, no scope for application.*

93. *An alternative argument may be that the selling of GAR policies without the approval or knowledge of prior non-GAR policyholders was itself "oppressive" or "unfair" to those non-GAR policyholders because it diminished the bonus allocation which they were entitled to expect. Section 75 Companies Act 1980 (now section 459 Companies Act 1985) created a broadly based jurisdiction by which members of a "company" can petition a Court on the grounds that the company's affairs have been conducted in a manner unfairly prejudicial manner to members. The predecessor to this jurisdiction, section 210 Companies Act 1948, provided a more limited remedy for*

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[76] It should be noted additionally that the non-UK businesses may be unaffected by the existence

"oppressive" conduct but that was available only when that conduct was continuing at the time of the petition. There would be a number of issues to consider with any such statutory claim:

a. *The first is whether the Society is a "company" for the purposes of the section. Although we do not know whether it is in fact the case, the Society, having been incorporated under the Companies Act 1862-1890, also appears to have been registered either under the Companies (Consolidation) Act 1908 or the Companies Act 1948. The Articles are expressed as if the 1948 Act has application (see e.g. Article 67). If so, the Society would also be a "company" for the purposes of Companies Act 1985 (see sections735 and 676).*

b. *The next is whether section 459 can be invoked in respect of conduct which occurred prior to its enactment in 1985. The remedy has been available since the coming into force of section 75 Companies Act 1980 so it must at least be available in respect of the period between 1980 and 1985. If the right to petition for "unfair prejudice" under Companies Act 1985 is restricted to events occurring after the commencement of section 75, holders of older non-GAR policies (which preceded the GAR policies) could only have claimed under section 210 and it is unlikely that they would be able to establish "oppressive" and continuing conduct. However, section 75 replaced section 210 and our preliminary researches have not shown that claims thereafter relating to events prior to 1980 had to be fitted into section 210. It does not seem that the point has been considered. It may well be that the holders of older non-GAR policies can now invoke section 459 in respect of matters which occurred in the 1960s or 1970s without their knowledge.*

c. *However, the Society would no doubt be entitled to raise limitation defences, although the non-GARs may have an answer to these under section 32 Limitation Act 1980.*

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of the UK GARs if ring-fencing in respect of those businesses has occurred and is effective.

If these hurdles are overcome it seems to us well arguable that the PREs of the non-GAR policyholders would qualify as the stricter type of legitimate expectation recognized in O'Neill v Phillips[77]*. It would not be appropriate for us to debate such claims further without investigating the circumstances in much greater detail.*

94. *Whilst we do not wish to prejudge their position, it seems to us self-evident that non-GAR policyholders whose contracts pre-date the commencement of the Financial Services Act 1986 have different causes of action, if they indeed have any claims at all, from those whose contracts post-date that time (and who are able to rely on the regulatory background and LAUTRO rules in formulating their claims). The claims in relation to the older non-GAR policies, if they exist at all, are inevitably weaker.*

How Would the Society Accommodate the Potential Claims of the Non-GAR Policyholders?

95. *The tentative position therefore is that non-GAR policyholders who purchased policies after the commencement of the Financial Services Act 1986 have arguable claims but that other non-GAR policy holders, if they have claims at all, have ones which face formidable hurdles. The extent to which these claims have the potential for neutralising the GARs depends on how potential claims could or should be met by the Society.*

96. *On the face of it, claims for damages (other than for breach of the terms of the non-GAR policy itself - which we consider in a moment) against the Society are claims against its assets and therefore have to be met by the Society from what it would otherwise make available to members out of the "with-profits fund". This gives rise to difficult questions about the correct measure of damage, particularly since recovery of damages by a non-GAR policyholder on this basis may in turn give rise to parallel claims by the GAR policyholders. We do not attempt to resolve those difficulties in this Opinion.*

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77 [1999] 1 WLR 1092.

97. On the other hand, if the non-GAR policyholders advance contractual claims under their policies (including claims for breach of contractual terms), the position seems to us to be rather different. Such claims would present the Board with the need to reconcile inconsistent rights. In simple terms the Society would have made promises to both sets of policyholders about how it would exercise its powers under Article 65, which promises it could not deliver. Clause 4 of the Articles of Association limits the Society's liabilities under policies to its assets and property: indeed, there is no other source of funds to meet the promises. In normal circumstances one would suppose that the fair way of reconciling such claims is to share the net assets in proportion to the size of the valid claims with a view to paying a dividend.

98. The question is whether the House of Lords decision in those circumstances requires the Board to resolve the conflict by delivering unreduced benefits to the GAR policyholders and not to the non-GAR holders.

a. We consider that, in these different circumstances which were not addressed, the House of Lords cannot have been taken to have determined that the Board would be acting for an improper purpose in using its powers under Article 65 to deal with these competing claims. If we have interpreted the House of Lords' decision correctly, the term which we consider to have been implied by the House of Lords does not resolve the competing rights[78].

b. However, it is also far from clear to us that the discretion under Article 65 is engaged at all at the point when these claims have to be reconciled. The Society, realising it could not meet valid claims fully, would in effect be meeting contractual claims for damages capped by Clause 4 of the Articles. In doing so it would be making provision out of the with-profits fund for the

[78] The GAR policyholders would win on competing rights if both (a) Lord Steyn's *ratio* is stricter than we consider in our analysis in Addendum 1 and (b) we are wrong in our analysis of the way in which the non-GAR policyholders could be bound in the absence of a formal representation order. As to (a), contrary to the general term which we understand him to say is implied, we have in mind that the implied term envisaged by him is one which prevents any diminution in the entitlement of GAR policyholders in any circumstances when the powers in Article 65 are exercised.

competing claims and it is by no means clear to us that the Board would be exercising the discretion under Article 65 at all.

99. *It should be apparent from the above that, if the non-GAR policyholders can establish rights such as we have discussed, such rights are capable of neutralising, to a greater or lesser extent, the rights of the GAR policyholders thereby achieving, in economic effect, an element of ring-fencing. Curiously, the potential for neutralising the effect of the GARs appears to us to be greater if the claims are made, not under the non GAR policies themselves, but as claims for damages arising outside the policy. This is so because:*

a. *Claims which operate outside the policies - and which are effectively claims that the policies were not properly sold - would, it seems to us, result in the payment of damages*[79] *to the relevant policyholders which would be a liability of the Society to be met out of the with-profits fund before declaration of any further bonuses. This would achieve much the same economic result as ring-fencing but (a) not through the exercise of Article 65 and (b) not in a way which undermines the GARs since, on this approach, the compensation payable is a charge on the with-profits fund before the allocation of bonus.*

b. *Claims by non-GAR policyholders which arise under their policies and which are inconsistent with the GAR policyholders' rights as established by the House of Lords' decision will, effectively, result in the claims of the two classes of policyholder being in competition for the limited funds available. We do not see any way in which, given the competition and the limited funds available, the non-GAR policyholders should be able to escape altogether from bearing any share of the cost of the GARs.*

Specific questions asked

100. *We now set out the specific questions we are asked together with our summary conclusions:*

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[79] Or the provision of benefits of the same value.

a. *Whether the House of Lords decision in binding on non-GAR policyholders.*

Yes; but it is still open to the non-GAR policyholders to assert the contractual rights which their own policies provide for them

b. *Whether the Arguments give rise to the possibility that the House of Lords decision could be "reversed" or otherwise reopened now that the Order made by the House of Lords has been perfected.*

We see no prospect of the Arguments being successfully deployed for those purposes.

c. *If so, what procedure could be adopted to attempt to achieve such "reversal".*

This does not arise.

d. *The prospect of such a step succeeding.*

This does not arise.

e. *Whether the non-GAR policyholders have a claim that their own contracts with the Society prevent the Society from throwing the costs of meeting the GARs onto the non-GAR policyholders in determining their asset share and bonus allocation.*

There is no such claim. But there are arguments that the non-GAR policyholders have contractual rights to share in profits without the GARs being taken into account. The Society's inability to meet its contractual obligation may be a liability which should be taken into account before allocation of bonus. There may also be claims outside the policy itself which would reduce the profit for distribution.

f. *Whether the House of Lords' decision (assuming that it is otherwise conclusive) precludes that argument now being taken.*

The decision does not preclude the argument being taken. The decision does not affect such rights as the non-GAR policyholders may have outside the contractual rights which they have under their policies.

Conclusions

101. Finally, we briefly summarise our conclusions:

a. *There is no reasonable prospect of re-opening the litigation before the House of Lords. In particular*

i. *The arguments raised by EMAG are not ones which, even if they could be presented, stand any reasonable prospect of persuading the House of Lords that its decision on ring-fencing was wrong.*

ii. *Lord Hoffmann's conflict of interest was fully disclosed and effectively waived by the Society on behalf of the non-GAR policyholders. That conflict provides no ground at all for impugning the House of Lords' decision.*

b. *The non-GAR policyholders are bound, as a result of the representation order made, by the decision on the first issue (ie* that differential bonuses within the GAR policies are prohibited). The answer to the ring-fencing issue followed, as Lord Steyn considered it did, from his reasoning on the first issue. The non-GAR policyholders are therefore bound by the decision on ring-fencing notwithstanding the absence of a formal representation order on that issue.

c. However, the House of Lords decision does not prevent the non-GAR policyholders from asserting against the Society (i) contractual rights under

their own policies which may compete or conflict with the rights of the GAR policyholders or (ii) rights outside their own policies as a result of any breach of regulatory requirements or misrepresentations arising from the circumstances in which their policies were acquired. We have discussed some, at least of the issues which may arise and difficulties which will be faced by the non-GAR policyholders in seeking to establish such rights.

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10 May 2001

Addendum 1

1. How does Lord Steyn reach his conclusion on the main issue (*ie* that differential bonuses within the GAR policy are not permitted)? We take the section of his speech "*The approach to be adopted*" step by step:

   a. He identifies the real issue as that identified by Lord Woolf

      > "namely whether the Society is entitled to declare a differential final bonus because the current annuity rates have fallen below the GAR".

      Lord Woolf was clearly looking at differential bonuses within GAR policies and not at the ring-fencing issue [80]. *At this stage, that appears therefore to be all that Lord Steyn is looking at too.*

   b. *In the following passage of his speech, from p 538 letter D to below letter F, Lord Steyn describes the Society's practice in the allocation of bonus and this is the only part of his speech where he analyses the rights under a GAR policy. He sets out Mr Sumption's (Counsel for Mr Hyman) argument quoting directly from the printed Case submitted on behalf of Mr Hyman, a description of the position under the policy which he accepts. He thus accepts the conclusion that the Society is failing to use to the GAR to calculate the contractual annuity when that is what it is obliged to do; instead it uses the CAR - a course which he says is "inconsistent with the rights of the GAR policyholder". This is not altogether easy to explain. Inevitably, current annuity rates ("CARs") will determine the amount available to be allotted by way of bonuses. This will be so at two levels:*

      i. *First, the profit available for bonus declaration takes account of the liabilities of the Society*[81]*; these liabilities include the guarantees*

[80] See the question as he puts it at [2000] 2 WLR 801F. We do not think that para (f) on p 815 should be read in a wider way and as dealing with the ring-fencing issue.

under the GAR policies. In order to ascertain the liability under such a policy, it is necessary to work out the cost to the Society of providing the benefit. Take for example, a person about to draw his benefits. Suppose he has a GAR policy providing a GAR of £12.50 pa for each £100 and suppose, for simplicity that there is no GIR and that there are no Related Bonuses. His accumulated fund is £10,000. His Annuity is £1,250 pa. If CAR is £10 pa for each £100 capital, then the cost to the Society of the benefit of £1,250 pa is £12,500. That capital cost has to be taken into account in ascertaining the amount of profit which can be declared by way of bonus.

ii. *Second, since the terminal bonus is a Related Bonus to which the GAR applies, it is no good, when GARs provide a larger annuity than CARs, simply to allocate capital amounts to each policyholder so that the total allocated adds up to the amount available for distribution by way of bonus. If that were done, the cost to the Society would be more than the amount available. Instead, the cost to the Society of a particular level of bonus must be ascertained. That involves converting the capital bonus into annuity at GAR and then ascertaining the cost of that annuity at CAR. Not even Mr Sumption suggested, nor can even Lord Steyn have intended, that the level of bonus to be allocated to all policyholders alike, must be quantified as if the GAR was not present, and for that level of bonus to be converted to annuity at GAR.*

Further, if the with-profits fund had comprised <u>only</u> GAR policies, then it is almost inevitable that the Society would have had to adopt the practice which it did, since that is the only way in which it would have been able to calculate the amount of bonus which it could afford to give to the single class of GAR policyholders.

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[81] If non-GAR policyholders have contractual claims or even mis-selling claims, resulting liabilities of the Society need to be brought into account.

c.

We think that the critical part of Mr Sumption's description (accepted by Lord Steyn) which he submits, and Lord Steyn accepts, is inconsistent with the GAR policyholder's rights appears from this passage:

> *"What the Society currently does is to start from a capital fund attributable to the policyholder and then to calculate an annuity from that capital sum at the current annuity rates*."

This capital fund is the "asset share" (in the sense of investment plus returns less expenses) which the Society intended to deliver to each policyholder by its bonus policy. Lord Steyn accepts that to apply the CAR rather than the GAR to a capital fund is inconsistent with the policyholder's contractual rights, although he does not appear to go so far as to say that the capital fund to which the GAR has to be applied must be the asset share. Lord Steyn does not expressly state why he accepts that conclusion. We think the reasoning must be along the following lines:

i. The first step in the Society's practice was to allocate a capital fund to GAR policyholders equal to their asset shares.

ii. This translated to a capital terminal bonus was of such an amount that it, together with previous guaranteed amounts (*ie* the Policy Annuity Value ("PAV") prior to the terminal bonus), equalled the allocated capital fund *ie* the asset share.

iii. Since that capital bonus was a Related Bonus, it in turn translated into an annuity at GAR: it would be inconsistent with the rights of the GAR holder to reduce the bonus if he elected for his contractual annuity.

iv. The practice could not be justified the other way round *ie* as the declaration of a smaller terminal bonus but with an *ex gratia* top-up

bonus for the person electing for alternative benefits since such a top-up bonus would nonetheless be a Related Bonus.

d. We can see the force of this reasoning. It appears, however, to start with the concept of a capital fund being allocated to the GAR policies and then to proceed on the basis that the GAR has to be applied to that capital fund. It seems to us that it equates part of the capital sum with the amount of the PAV prior to the declaration of the terminal bonus and treats the balance of the capital sum as a bonus by way of addition to the PAV or, to put the same thing another way, as an additional annuity which has a PAV equal to that balance. This part of the speech does not, however, expressly say anything about how the capital sum is to be ascertained: it assumes that that has already occurred (presumably as an allocation of bonus to the GAR policies). However, as we shall explain when considering the part of Lord Steyn's speech dealing with ring-fencing, it becomes apparent that his reasoning on the first issue must be read going beyond the way we have explained it in paragraph c above.

e. In the final part of this section of his speech, at p 538 letters G to the end of the page, Lord Steyn identifies what he sees as the next issue which is the extent of the power under Article 65. Note, that he addresses this as a matter of construction/implication and that "one never reaches the question whether the power was exercised for an improper or collateral purpose".

2. We now consider the next section of Lord Steyn's speech headed "*The meaning of article 65*"

a. Lord Steyn accepts that there is no process of construction "precluding the directors from overriding GARs": it is all a question of the implication, under the ordinary well-known test of strict necessity, of a term. He concludes that such a term is to be implied. But one must approach with caution the details of precisely what is to be implied. It cannot be - and we do not read Lord Steyn as saying - that it was, and had always been, an implied term of Article 65 that

the Directors could not use it to declare differential bonuses between different types of policy in all circumstances.

b. Suppose, for instance, that the Society, instead of issuing the GAR policies, had issued a "restricted-GAR" policy which spelt out, and expressly authorised the Society to adopt, the type of bonus allocation which it actually adopted and thought it had power to adopt. There could be no question of that type of bonus allocation then being prevented by some implied restriction on Article 65. Lord Steyn's implied term must therefore be that the Directors will not exercise their powers under Article 65 to override or undermine the rights given to policyholders by their policies. The relevant right of a GAR policyholder, taking his policy by itself, is that he is entitled to be treated in the same way whichever election he makes: his bonus is not to be dependant on his choice. But, for the reasons discussed above, he is not in advance of any declaration entitled to any particular level of bonus under the policy taken by itself: and Lord Steyn had not said, in the earlier section of his speech, that he was. His right to bonus arises only under the policy read together with the Articles of Association of the Society, in particular Article 65.

c. It is to be noted that Lord Steyn is looking at the implication of term into the Articles not into the policy. Conceptually the two are different. Conceptually, it would be possible to have a term (express or implied) in the GAR policy to the effect that the Directors would exercise their powers under Article 65 so as to award the same bonus to a GAR policyholder and a non-GAR policyholder without differentiating between them on the basis of the mere existence of the GAR. It would then be a breach of contract for the Directors to seek to exercise their powers under Article 65 in a differential way. But that does not mean that any term is to be implied into the Articles themselves. Lord Steyn did not adopt that approach: instead he decided that the Articles themselves were subject to an implied term. On that basis, the implied term must, we think, have existed from the moment the Articles came into force: an implied term cannot spring into existence at some future date, although the precise

effect of a more general implied term on a particular policy will only be apparent once the policy is granted. In other words the position, we think, is that the implied term which Lord Steyn held to exist (*ie* that Article 65 would not be used to undermine the GAR) is an application to the facts of the GAR policies of a more general implied term to the effect that the Article 65 power will never be exercised so as to conflict with contractual rights or, conceivably, policyholders' reasonable expectations. Indeed, that is the way Lord Steyn himself puts it at one stage when he says[82]*:*

> *"The supposition of the parties must be presumed to have been that the directors would not exercise their discretion in conflict with contractual rights."*

and

> *"In my judgment an implication precluding the use of the directors' discretion in this way [ie* a differential policy which was designed to deprive the relevant guarantees of any substantial value] is strictly necessary. The implication is essential to give effect to the reasonable expectations of the parties."

d. Now, the basis on which Lord Steyn holds that the implication is strictly necessary arises out of the following factors he identifies:

i. **"...final bonuses are not bounty. They are a significant part of the consideration for the premium paid".**

It is correct that, if declared, they are part of the consideration. But if there are no profits and therefore no terminal bonus, it cannot be said that the Society has failed to provide part of the consideration for the premium; and if the profits, and therefore terminal bonus, are small compared with the previously guaranteed benefits, that part of the

82 @ p 540B-C.

consideration for the premium may not be significant as compared with the GIR and previously declared Related Bonuses.

ii. **The Directors' discretion is conferred for the benefit of policyholders.**

On one level, it is not possible to quibble with that. But at another level, there may well be a tension between, on the one hand, all policyholders benefiting from a terminal bonus (all of whom would want as large bonuses as possible) and, on the other hand, the Society as a whole the interests of which might require the Directors to create reserves. But nothing probably turns on this.

iii. **"In this context [presumably both i and ii] the self-evident commercial object of the guaranteed rates in the policy is to protect the policyholder against a fall in market annuity rates by ensuring that if the fall occurs he will be better off than he would have been with market rates".**

That is true, but as a statement by itself it does not answer the questions To what extent? and In what circumstances? The Society argued that this object was sufficiently recognised in the "floor" below which the GAR policyholder's contractual annuity could not fall. It was suggested that this was the Annuity: but clearly it was not for it was the Annuity together with Related Bonus and thus included previously declared reversionary bonuses, a point made by Miss Gloster (counsel for the Society). However, Lord Steyn rejected Miss Gloster's submission: it was obvious, to him at least, that it was strictly necessary to go further. In the context of differential bonuses within the GAR policy, one can see the force of that[83]. *A level of bonus - in practice in the past determined in accordance with the "asset-share" approach adopted by the Society - determined in relation to policyholders who*

elect for alternative benefits should be available to those who elect for the contractual annuity. We shall return later to the extent of the implication in the context of the ring-fencing argument.

iv. ***"It cannot seriously be doubted that the provision for guaranteed annuity rates was a good selling point in the marketing by the Society of GAR policies. It is also obvious that it would have been a significant attraction for purchasers of GAR policies."***

This we think is a real "bootstraps" argument. If it is obvious that the GARs were a good selling point and a significant attraction, it can only be because the provisions mean what Lord Steyn says they mean; if they do have that meaning, then that could have been used as a good selling point. But if, in contrast, they meant what the Society argued they meant, then the selling point would be much weaker - and it would not be possible to make the statement which Lord Steyn did make.

v. ***"This factor [no charge for the GAR] does not alter the reasonable expectations of the parties".***

It is, again, difficult to know what to make of this since nowhere does Lord Steyn expressly articulate what he believes to be the reasonable expectations of the parties (by which he presumably means the GAR policyholders); we think that he can only be referring to the factors identified in i to iv above and vi below.

Similarly in relation to ***"The implication is essential to give effect to the reasonable expectations of the parties".***

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[83] Whether or not one agrees with the conclusion is irrelevant since that was the decision of the House of Lords.

vi. ***"The supposition of the parties must be presumed to have been that the directors would not exercise their discretion in conflict with contractual rights".***

As to this, see paragraph c above. We consider in the body of the Joint Opinion the consequences of this supposition in the light of possible competing contractual rights of other policyholders.

e. *Lord Hoffmann, in argument, put to Miss Gloster a hypothetical policy which he called a "balloon" policy which provided that the final bonus should count for double. Would it, he asked, be a proper exercise of the discretion to allocate the final bonuses on the footing that balloon policies were to get half the final bonus of other people? His clear conclusion was that it would not be a proper exercise of discretion and that it would necessarily be implied that such a right on the part of the Society would be excluded. There are many reasons why Lord Hoffmann's example is not a true analogy with the GAR policies and Miss Gloster, on her feet and in the face of difficult questioning, gave some of them. But we mention this part of the argument because we think it demonstrates the thinking of Lord Hoffmann, reflected precisely in the way Lord Steyn put his decision. It is interesting also because it would raise two questions which were not addressed: How could the Society properly ever issue balloon policies to the detriment of existing policyholders? How could the Society ever properly sell new non-balloon policies? If the answers to those questions are that it could not do so, questions would arise about what, if any, remedy such other policyholders would have; and, assuming that such other policyholders had contractual rights such that an exercise of the Article 65 discretion so as to award balloon policyholders double would result in a breach of those rights, questions would arise as to how the competing contractual rights pf balloon and non-balloon policyholders were to be reflected in the distribution of the Society's assets.*

3. *Next comes "The "ring fencing" issue*". What Lord Steyn is addressing is the suggestion made by Waller LJ which he refers to in these words "that the Society could lawfully have declared a differential bonus which varied not according to the form in which the benefits were taken, but according to whether the policy did or did not include GARs". Waller LJ put his suggestion in slightly different language: he said:

> "It is possible that because there is no contractual entitlement to a final bonus, and because as between different types of policy it is certainly, in my view, legitimate for the board to have regard to the value of the notional asset share of the different policyholders, the guaranteed annuity rate policyholders will not in actual cash terms do very much better than they have done under the differential bonus scheme. I see no reason why different bonuses may not be awarded to different types of policyholder and thus I do not understand why, for example, the board cannot in deciding what final bonus to award to GAR policyholders, keep that bonus at a level which does not deprive different with-profits policyholders of their equivalent asset share."

4. We confess to difficulty in understanding the reasoning in the short passage of Lord Steyn's speech. It is clear, however, that his decision certainly results in the invalidity of the type of ring-fencing envisaged by Waller LJ *ie* the sort of ring-fencing which would leave the non-GAR policyholders with their asset shares and may (an aspect we consider later) result in the invalidity of any sort of differential bonus. Taking the three critical sentences of Lord Steyn's speech on this aspect:

a. **"If the suggestion of Waller LJ is sound in law, the directors could in that way erode the substantial value of the guarantees by different means."**

That is correct, but only in the sense that the contractual right under the GAR policy is to a particular level of bonus - a matter which was not dealt with, as we have explained above, in the earlier parts of the judgment. It is in the following sentences of the speech that further explanation is given. We do not think that, by his use of the word "substantial", Lord Steyn is intending to suggest that an insubstantial erosion would be acceptable. He is simply, as we read him, describing the value of the GAR as substantial - in the same way as

he described the bonuses as a significant part of the consideration for the premiums.

b. **"If my conclusion on the principal arguments is right, it must follow that this suggested route is not open to the Society. After all, the object would still be to eliminate as far as possible any benefit attributable to the inclusion of a GAR in the policy."**

As to that:

i. The reference to "object," might be read as suggesting that one is concerned with purpose rather than effect. We do not think that that is the correct reading of Lord Steyn's speech. It is clear that his decision on the main arguments was based on the construction of Article 65 and not the purpose of an exercise of the power conferred by that Article; he was concerned, therefore, with the effect rather than the object of the exercise of the power. So, too, in the context of ring-fencing, he is concerned with effect. His reference to "object" is by way of emphasis - the case is all the more open to objection where the very object of a proposal is to achieve an illegitimate result.

ii. Why does Lord Steyn say that it must follow from his conclusion on the principal arguments that Waller LJ's suggestion is not open to the Society? It must, we think, rest on the same assumption that there is, in the first place, an allocation of a capital fund to each policyholder[84]. *As before (see paragraph 1d above), the allocated capital sum is to be treated in effect as an addition to the PAV. Once having been allocated in this way, it would be an improper exercise of the Article 65 powers*

[84] Of course, as a result of the House of Lords' decision, the actual allocation of a capital fund to each policy will necessarily be of a lesser amount than the (nominal) asset share - otherwise there will be an allocation of value of more than 100% of the total amount available for bonus distribution. There is bound to be a reduction for all policyholders of the nominal amount of the bonus to take account of the cost of the GARs. For non-GAR policies, the nominal amount of the bonus represents its real value to the policyholder whereas for GAR policies, the value is greater than the nominal amount.

then to declare a terminal bonus which undermined the value of a GAR applied to that capital fund. In the absence of some such assumption, we do not understand why the reasoning on the principal arguments would apply to the ring-fencing issue - and yet what is absolutely clear is that Lord Steyn does regard that reasoning as being applicable. To put this in a slightly different way: to see whether the differential bonus declaration would undermine the guarantee, one needs to see what the bonus would have been in the absence of the guarantee. If that bonus is reduced in a differential way as between GAR and non-GAR policies, the process is invalid.

iii. *His remarks are clearly made in the context of proposals under which the costs of the GARs in their totality are ring-fenced. In other words, non-GAR policy holders would get precisely the same bonuses as they would get under the pre-existing policy (invalidated as a result of the decision in the House of Lords) and the GAR policyholders would get reduced bonuses in order to meet the full cost of the guarantees. Lord Steyn simply says that, if it were right that such a differential bonus could be declared, the Directors could "erode the substantial value of the guarantees by other means" and says that if he is right on the principal argument "it must follow that this suggested route is not open to the Society. After all, the object would still be to eliminate as far as possible any benefit attributable to the inclusion of a GAR in the policy".*

5. *It can be seen from this that Lord Steyn's observations in relation to the ring-fencing issue throw some light on his reasoning on the first issue. It is true, of course, that he explains his decision on ring-fencing as following from his reasoning on the first issue. The reasons why he considers that to be so are these: he sees, quite correctly, that Article 65 is concerned with allocation of bonuses across the board; the purpose of the term which he implies into Article 65 is to ensure that contractual rights or policyholders' expectations are protected, in the circumstances to ensure that the GAR*

is not undermined; and that purpose can only be effected by precluding a difference in the allocation of bonuses to different policyholders rooted only in the existence of the GAR itself. In other words, he perceives the prohibition of differential bonuses within a GAR policy simply as a special case of the wider implication preventing the undermining of the GAR.

6. *There are three points we would make at this stage:*

   a. *First, we accept that it does not logically follow, from a mere decision to the effect that differential bonuses within a GAR policy are prohibited, that ring-fencing is also prohibited. Our point is different: it is that it does necessarily follow from the reasons for that decision that ring-fencing is prohibited.*

   b. *Second, we acknowledge that it is not easy to accept the reasoning, as we have analysed it, for the decision on the first issue even if the actual decision is correct. It is that factor which makes it so difficult to accept that the decision on ring-fencing is correct even for a person who is willing to accept that the decision - but not the reasoning - on the first issue is correct.*

   c. *Third, it might be argued that the analysis of Lord Steyn's reasoning on the first issue at paragraph 5 above is wrong and that he did not go beyond what we have identified at paragraph 1 c above. If we are wrong, then Lord Steyn, too, is wrong in saying that his decision on the ring-fencing issue follows from his reasoning on the first issue. As to that, we are bound to say that any judge attempting to interpret Lord Steyn's speech as a whole would be highly likely - if not bound - to adopt an interpretation of the reasoning on the first issue which does carry, as a necessary consequence, the decision on the ring-fencing issue.*

7. *On that analysis, it follows that the ring-fencing envisaged by Waller LJ is prohibited. But is a more limited form of ring-fencing (as described below) also prohibited*[85]*? The policy adopted by the Society in the past in relation to terminal bonuses was intended to achieve delivery of asset share in the sense in which that term has been used by the Society. It has been held, unequivocally, by the House of Lords that delivery of asset share to non-GAR policies cannot be achieved by the ring-fencing envisaged by Waller LJ. A more limited form of bonus policy would be to achieve delivery not of asset share but of profit share. We take an oversimplified example to illustrate the point:*

> *Suppose A (a GAR policyholder - but assume for simplicity that there is no GIR) and B (a non-GAR policy holder) each pay premiums of £1,000. No interim bonuses have been declared. A and B both draw their benefits in the same year. Their funds in aggregate have grown to £5,000. The GAR provides an annuity of £12.50 for each £100; CAR provides only £10 for each £100. The asset share of each of A and B is £2,500. Whilst a return of £3,000 has been made on the contributions, the profit on the business is not £3,000. Rather, the position before the declaration of terminal bonuses is that the profit is £5,000 less the liabilities: the liability in respect of B is £1,000 (his guaranteed fund) but in respect of A it is £1,250 (his guaranteed annuity of £125 at GAR costs £1,250 to provide at CAR). The profit is £2,750.*

Is it permissible to divide the profit equally? Or must the same nominal terminal bonus be declared for A and B, the GAR then applying to A? If profit can be divided equally - thus effecting a more limited form of ring-fencing - then both A and will obtain the same annuity at market rates acquired with the same capital sum. B can be given a terminal bonus of £1,375 (which can be expressed as 137.5%); A would be entitled to a terminal bonus having a value of that amount, which would need to be expressed as capital sum of £1,100 ie £1,375/1.25 (which can be expressed as 110%). He would already have been credited with the value of the GAR on his guaranteed fund but would not have the GAR applied to the terminal bonus. But if A and B have to be given the same nominal amounts they each have allocated £1,222 *ie* £2,750/2.25 and part of the remaining surplus (*ie* £2,750 less £2,444 = £306) is used exclusively to meet the GAR.

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[85] We think that the limited ring-fencing we proceed to discuss is not, in fact, permitted. We include the discussion for completeness but it does not, in the end, assist the non-GAR policyholders. Readers of

8. It is clear that this limited ring-fencing possibility (in contrast with the suggestion made by Waller LJ) was not expressly addressed either in Lord Steyn's speech or in the arguments before the House of Lords; it is substantially different from that envisaged by Waller LJ:

   a. Under the Society's bonus policy, the practical effect was to reduce the share of profit which would otherwise have been allocated to a GAR policyholder electing to take his contractual annuity, that reduction meeting the cost of the guarantee applicable not only to the bonus itself but also to the guaranteed funds (*ie* premiums plus GIR plus Related Bonuses). It resulted in a differential allocation of the distributable profits of the Society.

   b. In contrast, the limited ring-fencing under consideration preserves the guarantee in respect of accrued guaranteed funds and delivers to each policyholder his share of the profit of the Society without differentiation on the grounds of presence of absence of GAR in the policy.

9. Lord Steyn expressed himself in the way he did in the context of the factual situations he was addressing *ie* differential treatment within the GAR policy in accordance with the Society's policy and differential treatment between GAR and non-GAR policies in the context of Waller LJ's suggestion. The question then is whether his decision applies to prohibit limited ring-fencing.

10. We have considered above Lord Steyn's reasons for deciding that there is a necessary implication. We consider that the reasoning of Lord Steyn on the principal arguments leads inevitably to the conclusion that limited ring-fencing is also prohibited. The whole flavour of his reasoning is that the GAR applies as much to the terminal bonus as to the previously guaranteed amounts so that to diminish that bonus because of the presence of the GAR would be to erode, in an impermissible way, the contractual guarantee. In particular, the observations that "...final bonuses are not bounty. They are a significant part of the consideration for the premium paid" and that ".... the self-

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this Opinion will get little from grappling with the point.

evident commercial object of the guaranteed rates in the policy is to protect the policyholder against a fall in market annuity rates by ensuring that if the fall occurs he will be better off than he would have been with market rates" can surely only be directed at the elimination of all discrimination between GAR and non-GAR policies based on the presence of the GAR. We do not consider that any judge at first instance or even in the Court of Appeal would take a different view on this question.

11. Moreover, reference to the speech of Lord Cooke (with whom Lords Slynn, Hoffmann and Hobhouse agreed) confirms the wide scope of the implied restriction on Article 65. He says this in relation to a GAR policyholder who receives a smaller bonus if he takes his contractual annuity:

> "..I cannot think that such a result is consistent with the purpose of GAR policy. On the contrary, I agree with Lord Woolf MR that the assumption on which the policy was based was that, when current rates fall below the GAR, the annuity which the policyholder should receive would be higher than if there was no GAR. Although discretionary and uncertain, bonuses are a very significant part of the benefits which policyholders expect. The attractions of a GAR policy would be much diminished if it were explained that adverse discrimination in bonuses might be involved. A reasonable reader in the shoes of the policyholder would not understand this unless it had been clearly specified in the policy."

Although apparently addressing differential bonuses within the GAR, the reasoning applies equally to a differential bonus between a GAR and a non-GAR policy.

Addendum 2

Text of part of letter dated 6th December 2000 - Jeremy Lever QC to Alan Nash

(i) To imply a term into a contract one has to look at the situation as it was when the contract was made, including what was then foreseeable.

(ii) When the GAR policies were being marketed I do not think that anyone would have foreseen, let alone assumed, that the GAR option would be "naturalized" by the attribution to a GAR policy of one terminal bonus if the GAR option was not exercised and a lower terminal bonus if the option was exercised.

(iii) Unless the Board were legally and successfully to attribute different terminal bonuses to a GAR policy according to whether or not the Gar option was exercised, it is obvious that the considerations that necessitate different solvency requirements for GAR policies and non-GAR policies would necessitate differentiation of terminal bonuses as between the two classes of policy.

(iv) It follows from (ii) and (iii) that, when GAR policies were being marketed, no-one would have foreseen, let alone assumed that, whatever the terms of the future with-profits policies, the Board would not differentiate terminal bonuses as between the GAR policies and different, new, with-profits policies.

(v) I think that there was general agreement at our meeting that when the Society ceased to issue new GAR policies and began to issue non-GAR policies, the Board *could* have differentiated between terminal bonuses allocated to policies according to whether they contained or did not contain a GAR option.

(vi) *Even if* the Board had been correct in believing that it could allocate to a GAR policy one terminal bonus if the GAR option was not exercised and a lower one if it was, there are powerful arguments for saying, that the Society should still have pursued different investment policies with regard to the funds contributed under GAR policies and the funds contributed under non-GAR policies. This is because in certain economic conditions, the Building Society-type security coupled with a (high) guaranteed annuity rate offered by GAR policies, if the GAR option was exercised, would have resulted in a better annuity than an ordinary with-profits annuity - in the economic circumstances in question there would simply not be sufficient profits to attribute the policy if the option was not exercised to induce the policy-holder not to exercise the option. This is a point with regard to which Adrian Howard-Jones spoke at some length at the meeting because, if it is correct, it is crucial. If the point is correct, then the Society was acting in an economically irrational way if, when making investment decisions, it did not tae into account the distinct economic characteristics of GAR policies, and in particular, the risk that in certain economic circumstances, the option might be exercised - with a resultant used to allow for that possibility.

(vii) If, in making investment decisions, the Society ought to have taken into account the distinct economic characteristics of GAR policies (and ought to have done

so even if it had been correct in believing that it could allocate to a GAR policy one terminal bonus if the GAR option was not exercised and a lower one if it was), then the *necessary corollary* is that the Board was acting in an economically irrational way in not differentiating *from Day 1* between terminal bonuses according to whether policies did or did not contain a GAR option.

(viii) No-one in the 1980s could have foreseen, let alone would have assumed, that the Board would act in an economically irrational way with regard to terminal bonuses when it ceased to market new GAR policies and began to market non-GAR policies.

(ix) If that is correct, then it is impossible to imply, whether into GAR contracts or into the Society's Articles, a term that the Board would not differentiate between terminal bonuses allocated to policies according to whether they did or did not contain a GAR option since that would be to imply a term that the Board would act in an economically irrational way.

(x) Yet that is unfortunately how the Board *did* act; and it was not to be expected that the Society would instruct Counsel to advance to the House of Lords and argument that proceeded on the premise that *the Board had acted in an irrational way* (and therefore certainly not a way in which anyone would have assumed *ex ante* that the Board would act).

(xi) Therefore the Society was not in a position to represent non-GAR policy-holders on this issue in the House of Lords.

(xii) Therefore -

(a) the gates of the courts of justice ought not now to be closed to the non-GAR policy-holders on the ground that, represented by the Society, they have had their say; and

(b) there was never advanced on behalf of the non-GAR policy-holders a cogent argument as to why, although the Board had acted in an economically irrational way in the past, it was not constrained to do so in the future.

Addendum 3

LAUTRO Rules

In the period 1986 to 1997 these rules changed repeatedly and we have not been able to trace back the relevant rules to ensure that in the material respects they remained substantially the same throughout that period. We have been able to trace back the rules to 1990 but this post-dates the amendments to the Financial Services Act 1986 which resulted in the hierarchy of Principles, Core Rules and SRO rules. Substantial amendments to relevant sections of the LAUTRO rules were made by the LAUTRO (Product Disclosure and Disclosure of Commission) Rules 1989. We should also point out that the LAUTRO rules would not have applied to all the affected non-GAR business even after the commencement of the Act. For example, different rules would have applied to the sale of products in Germany. With those reservations the relevant rules can be summarised as follows:-

(c) A firm had to act with due care (General Principle 2 and Code of Conduct Sched 2 pa 2).

(d) Representatives may recommend only suitable contracts (Sched 2 pa 8).

(e) A firm had to take reasonable steps to give customers comprehensible information to enable them to make an informed and balanced decision (General Principle 5). Representatives were subject to a mirror duty to give the investor all information relevant to the transaction and to use best endeavours to enable the investor to understand the nature of the risks involved (Sched 2 pa 6)

(f) Members had to provide "Product Particulars" (see Rule 5.10). These Product Particulars in the case of any "with profits policy" had to:

(i) "*give an indication of the basis on which the amount available for distribution and for allocating that amount to the policyholder … is to be determined and of any special features relating to or affecting the investment of the Members assets or the constitution of its liabilities which the policyholder might reasonably expect to affect the amount available"* (Rule 5.10A(2)(b)).

(ii) *"in addition ….* [provide] *such other information as may be necessary to enable him to understand the nature of the investment concerned and what it is that will determine the ultimate value of his investment…"* Rule 5.10A(4).

(g) Under the heading "effect of charges or expenses" in the case of a with-profits contract, a statement had to be included *"showing the effect of any expenses reasonably determined by the Member to be attributable to the contract on the investment potential of the premiums payable under the Contract"* such figure

having to be shown as a reduction in yield. (Rule 5.10B(1) and see Schedule 4A)

(h) More recently, we believe from about 1994, the so-called "product particulars" have been renamed as a "Key Features " (Rule 5.8 and Schedule 6). The information required by Schedule 6 although expressed in different terms remains very similar. In particular, the Member has to provide the following information:

(i) A brief description of the factors which may have an adverse effect on performance or are otherwise material to a decision to invest (Sched 6 Pt 1 (2)).

(ii) An illustration of how the principal terms of the contract would apply to the investor taking into account the investor's age, sex, the sum assured and other principal factors of the policy (Sched 6 Pt 1 (3)).

(iii) A description of the principal terms of the policy and any other information necessary to enable the investor to understand the proposed investment (Sched 6 Pt 1 (4)).

(iv) A clear indication of the nature and amount of charges or expenses which the investor will or may bear. If charges are levied in the form of reduced investment, both the method and effect must be clearly explained (Sched 6 Pt 1 (9)).

(v) Information about the means of calculation and distribution of bonuses (Sched 6 Pt V A(a)8, a requirement imposed by the 3rd EC Life Directive).

(i) From 1990 Members also had to issue a "With-Profits Guide", *"the purpose being to inform investors as to the nature of the investment represented by the purchase of such a policy"*. The guide had to set out the information required by Schedule including "factors influencing bonus rates" which itself encompassed "expenses of the fund" as identified in Schedule 8 (Rule 5.16A and C). In particular, Schedule 8 required the Member to set out:

(i) In relation to "recent bonus policy", an explanation of the basis on which the amount available for distribution is to be determined and the Member's policy for ensuring fairness of treatment between investors holding policies issued at different times at maturity including with regard to terminal bonuses (see Sched 8 para F1)

(ii) Under expenses of the fund, *"how expenses arise and are charged in relation to with-profits business and shall include an explanation of how the level of expenses is affected by the nature of that business and of the assets in which the with-profits fund is invested"* (Sched 8 para G1).

IN THE MATTER OF THE EQUITABLE LIFE ASSURANCE SOCIETY
AND IN THE MATTER OF GUARANTEED ANNUITY RATE POLICIES

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