THE EQUITABLE LIFE ASSURANCE SOCIETY

JOINT OPINION OF IAN GLICK QC AND RICHARD SNOWDEN
FOR THE FINANCIAL SERVICES AUTHORITY

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Extracts from Lautro Rules Bulletins                         Appendix
Introduction

1. The Equitable Life Assurance Society (“Equitable Life” or “the Society”) is a mutual life assurance society. The Society has no shareholders. Its members are its with-profits policyholders who became members of the Society on the terms of its Articles of Association on taking out a with-profits policy. The Society’s assets are in its long-term fund from which the Society must meet its liabilities to its with-profits and non-profits (including unit-linked) policyholders and any general liabilities incurred in the conduct of the Society’s business.

2. Many of the Society’s with-profits policies are designed to provide a pension for the policyholder on retirement. In their simplest form, such policies are a contract under which, in return for contributions to the with-profits fund (a part of the Society’s long-term fund), the Society promises on maturity to pay the policyholder a sum of money. Amongst other things the policyholder can then use that sum of money to purchase an annuity, the amount of which is calculated by the application of a formula (the “annuity rate”) to the purchase price.

3. In general terms, the sum of money payable on maturity of the policy is an amount comprising a fixed percentage of the contributions made by the policyholder, together with bonuses declared and allotted to the policy by the Society from time to time out of the surplus profits in the with-profits fund pursuant to the discretion contained in Article 65 of its Articles of Association (“Article 65”). Such discretionary bonuses take two forms. Smaller “reversionary” or “declared” bonuses are declared during the term of the policy, and once declared and allotted form a guaranteed part of the final benefits payable under the policy. A larger “final” or “terminal” bonus is declared and allotted to the policy only on maturity.

4. The total benefits payable under the policy at maturity are generally intended by the Society to reflect the investment return achieved by the Society on the contributions paid on the particular policy over its life-time. There is,
however, no precise correlation, because in declaring bonuses the Society applies actuarial averaging techniques to “smooth” out periodical fluctuations in the performance of the fund.

5. Annuity rates take two forms. Current annuity rates (“CAR rates”) are based upon what an insurance company expects will be the investment return on a portfolio of medium-term fixed interest securities purchased using the policy value, and the anticipated period over which the annuity will be paid, which is dependent on the life expectancy of the policyholder. CAR rates fall if interest rates fall or if, on average, people live longer. All of the Society’s with-profits policies enable the policyholder to use his benefits to purchase an annuity from the Society at its CAR rates, and since 1979 they have also permitted the policyholder to use his benefits to purchase an annuity from another company.

6. The second type of annuity rate is a guaranteed annuity rate or “GAR rate”. Between 1957 and July 1988 the Society wrote policies in its with-profits fund which included a term which gave the policyholder, at maturity, an option (a “GAO”) to take some or all of the benefits under his policy in the form of an annuity calculated using a fixed (guaranteed) annuity rate set out in the policy. Until 1975 the interest rate implicit in most of Equitable Life’s GAR rates was 4%. From 1975 until 1988 the rate was 7%.

7. We shall refer to the policies containing a GAO as “GAR policies”, and to those which do not contain a GAO as “non-GAR policies”. We shall refer to the holders of such policies as GAR policyholders and non-GAR policyholders respectively. There are about 70,000 individuals holding with-profits policies containing a GAO and 105,000 members of group schemes whose policies also entitle them to a GAO. There are about 415,000 individual policyholders and 510,000 group members whose policies do not contain a GAO.¹

¹ Ian Glick Q.C. holds a GAR policy from Equitable Life; Richard Snowden is not an Equitable Life policyholder.
8. Whilst the Society’s GAR rates remained below CAR rates, self-evidently a policyholder would be unlikely to elect to take an annuity calculated at the lower GAR rate. However, if CAR rates fell below the Society’s GAR rates as a result of a fall in interest rates and/or an increase in life expectancy, then for a given amount of final benefits, a retiring GAR policyholder would have a clear incentive to take the GAO in respect of at least part of that fund. The selection of an annuity calculated at the GAR rate would commit the Society to provide an annuity in an amount which might exceed the revenues which the Society could obtain from fixed interest securities purchased with that sum and/or for a longer period than had been anticipated when the GAR rate had been set. If this occurred, then the increased cost of providing such annuity, and the need to make a reserve to meet such increased cost, would fall upon the with-profits fund as a whole, thereby reducing the surplus which might otherwise be available for distribution by way of bonuses to other with-profits policyholders.

9. Indeed, the position at all times has been that if CAR rates fell or were likely to fall significantly below Equitable Life’s GAR rates for any substantial period, then unless counter-measures had been taken, the profits available for distribution to the Society’s with-profits policyholders would fall to be reduced because of the need to provide for the cost of keeping the Society’s promise to its GAR policyholders. For convenience we shall refer to the possibility that this might happen as “the GAR risk”.

10. It is apparent that at all material times from the 1980s onwards, Equitable Life was aware of the GAR risk (though it is not clear when the full possible impact of that risk was appreciated). It is also apparent that at no time did Equitable Life ever hedge or reinsure adequately against the GAR risk to counteract it. The reason for this was Equitable Life's belief that it could, in
effect, neutralise the potential effect of the GAR risk through the exercise of its discretion to allocate final bonuses under Article 65.²

11. Accordingly when, in late 1993, CAR rates first fell below the Society’s GAR rates, the board of the Society exercised its discretion under Article 65 to declare that a lower terminal bonus would be paid to those GAR policyholders who opted to take their benefits by way of an annuity calculated using the GAR rates, as opposed to those GAR policyholders who opted to take an annuity at CAR rates. The effect that the Society sought to achieve was that when the higher GAR rate was applied to the lower amount of benefits, the result would be as near as possible to that which would have been achieved if the policyholder had elected to take an annuity at the lower CAR rate on the higher benefits. This would remove the advantage to the policyholder and the extra cost to the Society of any election to take an annuity at the GAR rate.

12. In June last year the House of Lords held in *Equitable Life Assurance Society v. Hyman* [2000] 3 WLR 529 that Equitable Life’s belief as to the scope of its discretion under Article 65 was mistaken. The House of Lords held that the Society could not set a differential level of final bonus depending upon whether a GAR policyholder elected to take his benefits in GAR form.

13. In addition, the House of Lords held that the Society was not entitled to use its discretion under Article 65 to declare a differential level of bonus according to whether a policy did or did not contain a GAO. This meant that the Society could not confine the effect of the GAR risk to the GAR policyholders by reducing the final bonuses of all such policyholders, but leaving the final bonuses payable to non-GAR policyholders unaffected. This was the so-called “ring-fencing” issue.

14. It follows from the House of Lords’ decision that at no time was Equitable Life entitled to counteract the GAR risk by the exercise of its discretion under

² We believe that this is apparent, amongst other things, from the explanation provided by Equitable Life’s Appointed Actuary, Mr. Christopher Headdon, in his affidavit sworn on 28 June 1999.
Article 65. However, so far as we have been able to ascertain, at no time did the Society make any specific disclosure of the GAR risk or of its potential effect in any written material provided to prospective non-GAR policyholders.

15. Following the House of Lords’ ruling, Equitable Life implemented a rectification scheme to compensate GAR policyholders who had retired between 1994 and July 2000, established further reserves for the costs of the outstanding policies which included GAOs, and cancelled annual bonus payments to its with-profits policyholders for the first seven months of 2000 to meet such costs.

16. The Society also sought a purchaser with a view to obtaining a capital injection to strengthen the with-profits fund, but on 8 December 2000, in the absence of any imminent buyer, it closed to new business. In February this year the Society succeeded in selling its business, other than the with-profits fund, to the Halifax Group, and began a consultation process with its with-profits policyholders with a view to formulating a scheme of arrangement under section 425 of the Companies Act 1985 to cap its exposure in respect of the GAOs.

17. The Society also instructed Mr. Nicholas Warren QC and Mr. Thomas Lowe to advise whether the House of Lords’ decision in the Hyman case was binding upon the non-GAR policyholders and to indicate whether the non-GAR policyholders might have claims against the Society in relation to the non-disclosure of the GAR risk.

18. Mr. Warren QC and Mr. Lowe’s first opinion was published on 14 May 2001. That opinion concluded that there was no realistic prospect that non-GAR policyholders could challenge the House of Lords’ decision in the Hyman case. However, Mr. Warren QC and Mr. Lowe suggested that there might well be claims which the non-GAR policyholders could bring against the Society under section 62 of the Financial Services Act 1986 (“section 62”), at common law and in contract. Their opinion suggested that such claims would have the effect (to use
their words) of “neutralising, to a greater or lesser extent the rights of the GAR policyholders, thereby achieving, in economic effect, an element of ring-fencing”.

19. After delivery of their first opinion, Mr. Warren QC and Mr. Lowe were asked to carry out further work and to produce a more detailed opinion on the potential claims against the Society which might be available to non-GAR policyholders.

Our instructions

20. We have been asked to advise the Financial Services Authority (the “FSA”) whether or not an arguable case exists that Equitable Life acted in breach of the Lautro Rules 1988 and later the PIA Rules 1994 (individually and together “the Rules”) in relation to the sale of its non-GAR policies. We have also been asked to consider whether the Society may be exposed to potential claims for compensation by non-GAR policyholders which have a realistic prospect of success. The FSA is interested in these matters as regulator of Equitable Life, both in relation to the past conduct of the Society, in relation to reserving and solvency issues, and in relation to the merits of the compromise scheme to be proposed by the Society.

21. We have confined our inquiry to evidence of systemic mis-selling based primarily upon the documents produced by the Society for distribution to policyholders or prospective policyholders. In the time available it would not have been feasible, and we have not attempted, to ascertain whether representatives of the Society may have made specific representations in individual cases going beyond the printed documents.

22. We would stress that we have been asked to give advice on a preliminary basis. We have not been asked to reach, nor do we regard it as our role to reach any finding or determination in relation to the facts concerning the Society or any individual associated with the company. Accordingly our opinion ought not to be
taken as pre-judging any matter in relation to the Society or any individual. Whether any investigatory or regulatory action may be taken in relation to any of the matters which are the subject of our advice is entirely a matter for the FSA to determine.

23. Further, although this opinion covers much of the same ground as the second opinion of Mr. Warren QC and Mr. Lowe (and we should record that we have benefited from a number of discussions with Mr. Warren QC and Mr. Lowe and from reading their second opinion in draft) we should stress that we have reached our own conclusions on the issues as we see them. We have not been asked, and have not attempted, to produce a point-by-point analysis of Mr. Warren QC and Mr. Lowe’s second opinion. Therefore, except where we so indicate, we should not be taken either to agree or disagree with any part of that opinion.

24. For completeness we should also make clear that we accept no responsibility to any persons other than the FSA for the views which we set out in this opinion. In particular we do not accept any responsibility to the Society or to any of its members or ex-members in relation to the contents of this opinion.

The issues

25. As we see it, the main questions which arise are whether there is an arguable case, or a case which has a realistic prospect of success, under the following headings.

(1) **Section 62 claims** Whether Equitable Life breached the relevant Rules in force from time to time. The principal issue in this respect is whether, and if so from what date, the Rules required the GAR risk to be disclosed to potential policyholders or to those who were intending to make voluntary contributions to existing policies. If there is a case for believing that the Society may have breached the Rules, then the further question
arises as to whether and in what circumstances a policyholder will have a claim against the Society for compensation under section 62.

(2) Other tort claims Whether representations were made or advice given by Equitable Life in connection with the sale of its with-profits policies or the acceptance of voluntary contributions from existing policyholders which are actionable at common law or under the Misrepresentation Act 1967.

(3) Contractual claims Whether Equitable Life’s non-GAR policies carried a warranty or were sold together with some form of collateral contract to the effect that there was no GAR risk or, if there was such a risk, that the cost of meeting it would not fall on non-GAR policyholders. Alternatively, whether a non-GAR policyholder could contend that Equitable Life is estopped from denying the existence of such warranty or collateral contract, and seek to enforce the same against the Society.

(4) Unfair prejudice claims Whether any policyholders can petition the Court for relief under section 459 of the Companies Act 1985 alleging unfair prejudice to their interests as members of Equitable Life.

26. In each case, we will also need to consider one or more of a number of further issues such as causation, the impact of any relevant periods of limitation, and the nature and quantum of the damages or other relief which would be ordered by the Court if liability is established.
Our conclusions in outline

Section 62 and other tort claims

27. In our opinion there is an arguable case that the Society did breach the Rules by failing to disclose the existence of the GAR risk when it was required so to do in the Product Particulars and Key Features documents which were given to prospective non-GAR policyholders. We cannot be sure how early such disclosure should arguably have been made and thus how far back such breaches may go. It is possible that they may go back as far as 1988. There is certainly an arguable case that disclosure should have been made from some point in 1993, which was the year when CAR rates first actually fell below GAR rates, provided that it was then foreseeable that the impact of such a fall in CAR rates on distributable profits might be material.

28. Subject to questions of limitation, a non-GAR policyholder who could show he suffered loss as a result of any such breach of the Rules would have an action for damages under section 62.

29. The Society’s Key Features document, which first appeared in 1995, might arguably also have been understood implicitly to represent that the with-profits policy or policies on offer were not subject to any material risk factors other than those which were disclosed. From the time the GAR risk ought to have been disclosed pursuant to the Rules, such implicit representation, if made, was untrue. It is arguable that the Society did not have reasonable grounds for that representation, and may have been negligent in making it.

30. A non-GAR policyholder who could show he relied on such a misrepresentation in taking a policy, and as a result has sustained loss, would have a claim for damages under section 2(1) of the Misrepresentation Act 1967 and arguably also for negligent misstatement at common law.
31. It is also arguable that from the time at which the GAR risk ought to have been disclosed under the Rules, if the Society, through its representatives, gave advice to a prospective policyholder as to the suitability of the non-GAR policy for him, the Society may have breached a common law duty to take reasonable care to ensure that such advice was accurate.

32. A policyholder who could show that he suffered loss as a consequence of such breach would have an action in negligence at common law.

33. Throughout the relevant period, the Society produced With-Profits Guides for its existing policyholders. It is arguable that these documents also breached the Rules by failing to disclose the GAR risk to existing policyholders from the same time at which the Product Particulars and Key Features documents ought to have disclosed such a risk to prospective policyholders.

34. A policyholder who made a voluntary contribution to his existing policy in reliance upon the Society’s Product Particulars, Key Features documents or With-Profits Guides might have a cause of action under section 62, and in the case of the Key Features documents, under section 2(1) of the Misrepresentation Act 1967 or at common law.

Limitation

35. In relation to the causes of action arising from acquisition of the non-GAR policy, the cause of action would probably accrue on taking the policy. In relation to voluntary contributions, the limitation period would start to run when the contribution was made.

36. The basic limitation period for these causes of action is six years from accrual. However, section 14A of the Limitation Act 1980 provides an alternative limitation period for an action for negligent misstatement or negligence at common law, namely three years from the earliest date on which the policyholder
in question first had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action. We think that the relevant date is unlikely to be before the House of Lords delivered its judgment in June 2000.

37. On the construction of section 32 of the Limitation Act 1980 recently adopted by the Court of Appeal it may well be that none of the six year periods referred to above began to run until the policyholder in question discovered, or could with reasonable diligence have discovered, the fact that there had been a non-disclosure or misrepresentation. That construction, however, is under appeal and we do not think section 32 will be relevant in the present case once the appeal has been decided.

Remedies

38. In order to succeed and recover damages, a claimant will need to be able to show that, but for the non-disclosure, misrepresentation or negligence, he would not have taken the policy from the Society or made the further voluntary contribution, but would have gone elsewhere with his money and done better. If he would have taken the policy from the Society or made the further contribution in any event, or done no better elsewhere, he will have suffered no loss.

39. If a claimant could show that he would have spurned the Society, in determining the level of damages a court would first seek to compare the performance and prospects of the policy in fact taken from the Society and that of the alternative. If no particular alternative can be identified, a court would probably look to the average return and prospects for comparable alternative policies.

40. Subject to the effect of special facts in any individual cases, and subject to the point which we make in relation to damages under section 2(1) of the Misrepresentation Act 1967 below, we believe that whichever way the claims of
non-GAR policyholders are put, the Society should only be liable to the extent to which the losses of a policyholder are attributable to the undisclosed features of the non-GAR policy, namely the GAR risk. We do not believe that the Society should be liable for all of the adverse consequences of a non-GAR policyholder having bought the policy. In particular, we do not think that a court would give damages to compensate a policyholder for any general investment under-performance of the Society’s with-profits fund in comparison with other life offices. Nor do we think that the court should award damages to compensate any one non-GAR policyholder for the possibility that the profits available for distribution from the with-profits fund may be further diminished because the Society may also have incurred mis-selling liabilities to other policyholders. We recognise, however that the law in this area is difficult and to some extent developing, and that it is arguable that the damages should not be limited in the manner in which we have suggested.

41. So far as claims under section 2(1) of the Misrepresentation Act 1967 are concerned, we also recognise that our conclusion is contrary to current Court of Appeal authority on the measure of damages. However, the decision in question produces anomalous results, has been criticised for that reason, and is open for reconsideration in the House of Lords. We think it may well be overruled.

Contractual claims

42. Although we do not deal with what may have been said in individual cases, we do not think that non-GAR policyholders are likely to have contractual claims, whether for breach of warranty, breach of collateral contract or founded on an estoppel by convention.

Unfair prejudice

43. It follows from our rejection of any claims in contract or based upon an equitable estoppel that we also do not believe that non-GAR policyholders have
any prospect of bringing a successful claim under section 459 of the Companies Act 1985. Even if contractual claims or an equitable estoppel were arguable, we very much doubt that a court would grant any relief under section 461 of the Companies Act 1985 which adversely affected the rights of the GAR policyholders. Accordingly, we do not think that any petition under section 459 would succeed.

**Section 62 claims for breach of the Rules**

*Product Particulars from 1988 to 1994 (inclusive)*

44. The Lautro Rules, when they first came into force in 1988, required a firm to give an investor a statement containing certain information about any investment contract to which the cancellation rules applied. This statement was named “Product Particulars” when the Rules were amended in 1990, and it had to comply with the requirements laid down in the Rules.

45. In particular, Rule 5.10(2)(b) prescribed that the statement or Product Particulars, “shall” contain certain information if the contract in question was a with-profits policy. This rule consisted of two limbs. The first limb (which itself had two subsidiary parts) required the member to:

   “give an indication of the basis on which the amount available for distribution and for allocating that amount to the policyholders and shareholders (if any) is to be determined”.

The second limb required the member to:

   “give an indication … of any special features relating to or affecting the investment of the Member’s assets or the constitution of its liabilities which the policyholder might reasonably expect to affect the amount so available”.

3 In 1990 this became Rule 5.10A(2)(b). For convenience we shall refer to both Rules as “Rule 5.10(2)(b)”.

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Moreover, Rule 5.10(4)\textsuperscript{4} required that, in addition to any information required to be given in the statement or Product Particulars,

“...the member shall give the investor 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...”

The Rules were the subject of Rules Bulletins issued by Lautro to assist members in complying with them. Because the Rules Bulletins are not readily available, we have set out extracts from the relevant text in the Appendix to this opinion. As these bulletins were issued by the rule making body itself, and just before or at the time the Rules came into force, it must be right to take them into account in construing the Rules. The Rules Bulletins illuminate what Lautro intended, the mischief with which it was seeking to deal, and the purposes it was seeking to achieve.

What is plain from the examples provided in the Rules Bulletins, and from the use of the word “indication” in the opening part of Rule 5.10(2)(b), is that Lautro contemplated that the information given to investors should mostly be at quite a high level of generality. This no doubt reflected a concern that too much detail could be more confusing and ultimately less informative for the average reader. It is notable, however, that members were clearly expected to state the proportion of the profits of the with-profits business required by the company’s constitution to be allocated to any shareholders.

Whilst we accept that there is a perfectly respectable argument to the contrary, in our opinion the first limb of Rule 5.10(2)(b) is not concerned with the disclosure of quantitative matters that might affect the amount of profit likely to be available for distribution. The words, “the basis on which the amount available for distribution and for allocating that amount to the policyholders and

\textsuperscript{4} In 1990 this became Rule 5.10A(4). Again, for convenience we shall refer to both Rules as “Rule 5.10(4).”
shareholders (if any) is to be determined” require a general description of the process by which the determination of distributable profits and their allocation is to take place. Sufficient indication is given by, for example, saying that the Lautro member will determine how much profit is available and how it will be distributed, and that it will take the form of reversionary and (if so determined) terminal bonuses and so on. In this context the member is also required to indicate the constitutional or other basis by which the split of profits between its policyholders and its shareholders (if any) is to take place.

50. In our view it is the second limb of Rule 5.10(2)(b) rather than the first that is more naturally concerned with disclosure of factors affecting how much is likely to be available for distribution and allocation. The following points can be made about this limb.

(1) What is required to be given is “an indication”, not a detailed description or discussion.

(2) It is not every factor which might conceivably affect the amount available for distribution which is required to be disclosed. It is inherent in a with-profits fund that there are a large variety of market and other factors which might have an effect upon profits available for distribution. The requirement is to give an indication of any special features, not ones which are generally to be found in the market, or ones which are generally inherent in such policies.

(3) A special feature relating to or affecting the investment of assets or the constitution of a member’s liabilities can only be disclosed as required by the Rule if its existence is known, or ought to be known, to the member. Although in theory the rule could be construed to impose absolute liability for non-disclosure, irrespective of whether the member either knew or ought to have known of the existence of the feature, bearing in mind that the Rules are intended to be operated in a practical manner, and that breach
of the Rules exposes the member to the risk of disciplinary sanctions and actions for damages pursuant to section 62, we do not believe that the Rule should be construed so as to render a firm liable for failing to disclose a matter which no reasonable person could have known: see e.g. *Gammon (Hong Kong) Limited v. Attorney General of Hong Kong* [1985] AC 1 per Lord Scarman at 18B-C and 18F-G.

(4) The special feature need only be disclosed if the policyholder might reasonably expect it to affect the amount available for distribution. The focus is on the state of mind of a hypothetical customer, not the state of mind of the Lautro member. Whether a policyholder might reasonably have such an expectation must therefore be an objective, not a subjective, question. That is, if a court or tribunal decides that a policyholder might reasonably have so expected, it would not help the member firm to say that it had in fact thought otherwise. Any other conclusion would rob the provision of much of its value in promoting proper disclosure: see e.g. *Gammon (Hong Kong) Limited v. Attorney General of Hong Kong* [1985] AC 1 per Lord Scarman at 18C-E.

(5) We also believe that the wording of the Rule gives rise to a materiality threshold. The hypothetical prospective policyholder, thinking about how the contract being sold will turn out, would not reasonably expect any special feature to affect the amount of profits available for distribution if,

(i) he would perceive that the risk of events occurring which would bring about such effect was negligible, or

(ii) though he would perceive there was a material risk of such events occurring, he would nevertheless believe that the effect itself would be negligible.
It is further implicit that the materiality of the feature must also be measured by reference to all of the circumstances, including any steps taken by the member firm to counter any adverse effect which it might otherwise have.

51. Applying the observations made above to the present case, we are of no doubt that the existence of the GAOs in certain policies written on Equitable Life’s with-profits fund was a “special feature relating to or affecting…the constitution of its liabilities” within the meaning of Rule 5.10(2)(b). This makes it unnecessary for us to consider whether, subject to considerations of materiality, the existence of the GAOs would need to have been disclosed in any event under Rule 5.10(4).

52. Further, as we have explained above, the existence of the GAOs in certain with-profits policies gave rise to the GAR risk, and the existence of that GAR risk (if not its full possible impact) was at all times known to Equitable Life.

53. In these circumstances, once a prospective non-GAR policyholder would have reasonably thought that there was a material risk that CAR rates might fall significantly below GAR rates for any substantial period during the term of the policy, Equitable Life was, in our view, obliged to disclose the existence of the GAOs in the GAR policies to that prospective policyholder under rule 5.10(2)(b) unless there also existed grounds upon which such prospective policyholder considering the matter reasonably would have concluded that the existence of the GAOs would not materially affect the amount of profits available for distribution. This might have been because the cost and the amount of the reserves which would be required in respect of the GAOs would be of a size which would not materially affect the profits available for distribution, or because the Society had taken effective steps to counteract the potential impact of the GAOs.

54. The point may be illustrated by asking what would have occurred if, for example, Equitable Life had disclosed the GAR risk to a potential policyholder but
had also been able to say “We have hedged the risk by entering into a swap option”. In such circumstances, the potential policyholder would have said “Why are you telling me this? I only need to know of any special features which might affect the profits available for distribution.” A more sophisticated potential policyholder might have asked “Is the hedge legally effective, and is the counter-party creditworthy?” but provided that Equitable Life had a reasonable basis upon which to satisfy him that the risk of the hedge failing was negligible, then there would be no basis upon which the prospective policyholder might reasonably think that the GAR risk would affect the Society’s distributable profits.

55. In short, to justify non-disclosure after the GAR risk became material, Equitable Life had to be in a position to satisfy a reasonable prospective policyholder that the prospect that the GAOs would affect the amount of profits available for distribution was negligible.

56. It will be a matter for expert evidence, and we cannot say on the materials currently before us, precisely when a reasonable person might have appreciated that there was a material risk that CAR rates would fall significantly below GAR rates for any substantial period during the prospective term of his policy. Although there were apparently internal discussions at Equitable Life relating to the potential problems arising from the GAOs in the 1980s, this does not necessarily support a conclusion that the GAR risk was then actually a material one. It is possible that such discussions were simply in the nature of prudent contingency planning.

57. On the other hand, it is possible that a reasonable person might already have had such an appreciation when the Society discontinued marketing policies which included GAOs and the Lautro Rules came into force in 1988. However we do not know whether this is so, and we do not know whether, and if so, to what extent, the decision by Equitable Life to cease selling GAR policies reflected a concern as to the GAR risk.
58. Nevertheless, we can surmise that by, at the latest, October 1993, when CAR rates actually fell below Equitable Life’s GAR rates for the first time, a reasonable prospective policyholder would have realised that the GAOs might have some impact on the distributable profits of the Society.

59. It will then also be a matter for expert evidence whether, at this stage, the impact of the GAOs would have been likely materially to reduce the amount of profits available for distribution. Unlike other life companies, Equitable Life did not have an inherited estate to absorb the possible cost of the GAOs. Further, the Society had not, as it might have done, sought to use reinsurance or any financial instruments such as an interest rate swap option, to hedge or limit its exposure to the GAR risk. Any of these might have led to a conclusion that the effect of the GAR risk had been rendered immaterial for the purposes of Rule 5.10(2)(b). Instead, as indicated above, Equitable Life’s response to the GAR risk was to rely on what it thought was its discretion under Article 65 to adjust final bonuses to policyholders who wished to take their benefits in GAR form. It might be suggested that this move was itself recognition by the Society that the potential impact of the GAR risk was material.

60. Assuming that the GAR risk and its potential consequences had become material, we believe that the question is whether a reasonable prospective non-GAR policyholder would have been satisfied that the Society could use its Article 65 discretion in such a way that the GAR risk would pose no material threat to the amount of profits available for distribution. On the information available to us at the moment we believe that there is an arguable case that a prospective policyholder would not have been so satisfied.

61. Whether Article 65 could lawfully be used in the manner in which Equitable Life proposed to use it was fundamentally a legal, and not an actuarial

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5 The Society effected limited reinsurance in 1999, but that does not affect the position before then.
question. Such use of Article 65 had not been approved by any court, and Equitable Life did not, prior to 1998, seek legal advice as to whether it was legitimate to use Article 65 in that way. Thus it is arguable that at no relevant time was the Society in a position to satisfy a prospective policyholder on reasonable grounds that it had a legally sound antidote to the GAR risk so as to justify not disclosing the GAR risk to him. As such, once the GAR risk and its potential impact were material it is arguable that the Society breached the Rules in failing to make disclosure of it.

62. Given that the Society did not take legal advice so as to justify its belief that the effect of the GAR risk could be neutralized by the use of Article 65, and hence arguably acted in breach of the Rules at the time, it is not, in our opinion, relevant to speculate retrospectively what the Society might or might not have been told if it had sought legal advice. The purpose of the Rules as to disclosure is to ensure, so far as practicable, that prospective policyholders are given correct and adequate information at the time at which they make their investment decision. That purpose is best served by requiring firms actually to go through the correct procedures to ensure that their disclosure is adequate. If a firm knows of a special feature, at the very least it ought to take all reasonable steps to discover the true extent of its potential impact (including the efficacy of any countermeasures) before depriving the prospective policyholder of the opportunity to make his own assessment of the risk. If the firm omits to take such steps, it must do so entirely at its own risk.

63. We accept that difficult questions might arise if a firm sought and relied upon apparently competent legal advice in reaching a conclusion that no special

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6 So far as we have been able to ascertain, the adjustment of terminal bonuses as a means of dealing with GAOs was not in accordance with standard practice in the industry, although it was not uncommon: see e.g. the Report of the Working Party sponsored by the Life Board of the Institute and Faculty of Actuaries dated November 1997 setting out the variety of ways in which life offices dealt with the problems of reserving for Annuity Guarantees.

7 Or as to whether it was entitled to allocate bonuses differentially depending on whether a policy contained a GAO or not, or, indeed, as to the true legal import of the policies which contained a GAO.
feature existed, and that legal advice later turned out to be wrong. But if making careful inquiry and seeking competent advice gave member firms no protection against being in breach of the Rules, they would have little incentive to take such steps.

64. Moreover, we do not think that it can be assumed that had legal advice been sought before Equitable Life embarked upon its course of conduct, such legal advice would necessarily have approved its proposed use of Article 65.

*Key Features Documents from January 1995 onwards*

65. Major changes in the Rules were made by The Lautro (Product and Commission Disclosure) Rules 1994 which came into force on 1 January 1995 and which, among other things, gave effect to the EC Third Life Directive. The new Rules did away with Product Particulars in the interests of what was intended to be short, clearer descriptions of the policy on offer. 

66. The Rules themselves provide as follows.

> “5.7(1) Rules 5.8 and 5.9 together with Schedule 2 to these Rules require investors to be given written information relating to investment contracts which Members sell in the course of their relevant business.

5.7(2) The written information which is required to be given to investors must be produced in accordance with Schedule 6 and the Notes thereto with only such adaptations as the Member can show are necessary to reflect the nature and terms of the policy to which the information relates.

5.7(4) A Member must ensure that information contained in any document which it gives to an investor in compliance with Rules 5.8 and 5.9 below is fair, clear and not misleading.

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8 A firm would not avoid being in breach of the disclosure Rules simply because its lawyers had wrongly advised it that as a matter of law the Rules did not require disclosure.

9 As with the earlier Product Particulars, Lautro issued a Rules Bulletin giving guidance as to how the new Rules were to be applied. The relevant text of the Bulletin is set out in the Appendix.
5.8(1) A Member shall, for each category of policy which its sells to investors in the course of its relevant business, produce a document (“Key Features”) containing information about the contract in accordance with the requirements of this Rule and of Part I of Schedule 6 to these Rules. The Key Features must be separate from any other material given to the investor.

5.8(3) A Member shall ensure that before the investor signs any application or proposal to buy a policy, the Key Features document is supplied to the investor except in circumstances where the contract was recommended or arranged by an independent intermediary. [In certain other circumstances a Key Features documents must be sent to the investor as soon as possible and at the latest within three business days.]

5.8(7) In the case of any policy which was entered into after this Rule came into force and is subsequently varied so that a new cancellation notice must be given, then a Key Features document shall be supplied or sent to the investor before the variation takes effect.”

67. Part I of Schedule 6 provides as follows.

“The following information is required to be contained in the document required by Rule 5.8(1) … and must be set out in the order shown divided by appropriate and prominent sub-headings and no other information may be included -

……

(2) Nature of contract.

……

(b) Under “RISK FACTORS” give a brief description of the factors which may have an adverse effect on performance or are otherwise material to the decision to invest and include, where appropriate, the warnings prescribed in Part III of this Schedule.

……

(9) Further Information
The following information should be included in the Key Features documents, whether shown separately or as part of any of the information set out in accordance with the other provisions of this schedule:

\[\ldots\]

(b) the information required to be communicated to policy-holders pursuant to Annex II of the Third Life Directive which is reproduced at Part V of this Schedule; \ldots\]

Annex II of the EC Third Life Directive requires amongst other things that, before concluding a contract, a prospective policyholder has to be provided in a clear and accurate manner with information about the “Means of calculation and distribution of bonuses”.

68. Paragraph (2)(b) in Schedule 6 refers to factors, “which may have an adverse effect on performance or are otherwise material to the decision to invest.” Although this language is not entirely clear, we read it as meaning that all factors that may have an adverse effect on performance and that are material must be described; not that any factor that may have an adverse effect on performance, however small, is to be deemed to be material and must be described.

69. For the reasons which we have already discussed above, we believe that the Rules requiring disclosure generally apply only where the relevant factor is known or ought to be known to the member firm. But if it is known (or ought to be known) that a factor exists which *may* have a material adverse effect, then to justify non-disclosure the member firm would at very least have to be sure on reasonable grounds that the factor will not in fact have such a material adverse effect.

70. Again, on the information which we have seen, we believe that it is arguable that Equitable Life could not satisfy this test.

71. For virtually the entire period during which Key Features documents were produced, the Society’s GAR rates actually exceeded CAR rates. The GAR risk
had become reality and this was known to the Society. Ultimately the potential impact of that upon the performance of a non-GAR policy will be a matter for expert evidence.

72. We have, however, already made the point that the very fact that the Society had felt it necessary to introduce its differential bonus policy for GAR policyholders under Article 65 could itself be taken to indicate that it considered the potential effect of the GAOs to be material. We have also indicated that the Society had received no legal advice as to the legality of such use of Article 65 before September 1998. In those circumstances, up to the point at which it took legal advice, we believe that it is arguable that the Society could not have been sure on reasonable grounds that the GAOs would not have a material effect upon the performance of its non-GAR policies so as to justify non-disclosure under the Rules.

73. Prompted by media criticism and complaints to the PIA Ombudsman from GAR policyholders in 1998, the Society finally took advice from leading counsel in relation to Article 65 in September 1998. As we read the settled note of his advice, leading counsel gave no assurance to the Society that its past practices would be vindicated if a policyholder were to challenge them in court. He was concerned that the Society might be perceived to have attempted to “charge” GAR policyholders for the costs of their GAOs by reducing their final bonus, thereby seeking to escape from a bad bargain. Leading counsel advised that this would be an illegitimate approach to the exercise of the Society’s discretion under Article 65 and advised against instituting a test case at that stage, among other things because of “the serious potentially adverse result”.

74. Leading counsel was, however, generally much more positive that by adopting a different approach to the exercise of its discretion under Article 65 in the future, the Society could legitimately achieve the same result. In a supplemental written opinion dated 11 October 1998, he confirmed his view that
“...the Society was justified in law in adopting the approach of declaring different final bonuses in order to ensure, (so far as was possible having regard to the operation of guaranteed annuities on previously guaranteed values) that the ultimate “cash value” of any given policy would be a simple sum, irrespective of whether the policy-holder took the guaranteed benefits under his policy, or elected to take an alternative annuity based on an application of current annuity rates.

Having regard to the wording of the policy documentation, in current economic conditions, this approach required a two-stage process of bonus allocation to any particular member of the Society who had a guaranteed annuity policy. First, the allocation of a lower final bonus to guaranteed annuity policies (FBG) than that which would be declared in the case of a policy which did not contain guarantees (FBNG). Second, in the case of any guaranteed annuity policy-holder who wished to take an alternative annuity based on current annuity rates, the allocation of a top-up element of bonus representing the difference between FBNG and FBG.

...The top-up element would be allocated by the Board of the Society as a separate exercise of its discretion under Article 65, which is wide enough to enable bonuses to be allocated amongst members in ‘top-up’ form, as well as in annual and final (or terminal) form as conventionally understood.

The Board’s decision to seek to achieve a result under which all persons holding similar policies achieve the same investment return, irrespective of whether some policyholders had the benefit of guaranteed annuity rates applicable to guaranteed benefits, is perfectly legitimate...”

75. It is apparent that this part of leading counsel’s advice was also consistent with the views later expressed by the Insurance Directorate of HM Treasury (“HMT-ID”) in a “Dear Managing Director” letter of 18 December 1998. In that letter, HMT-ID expressed its own view, which was stated to be “without prejudice to any decision of the courts which may affect it” on how the concept of policyholders’ reasonable expectations (“PRE”) should be interpreted in the
context of GAOs. The letter suggested that as a matter of PRE, policyholders entitled to some form of annuity guarantee or option on guaranteed annuity terms could reasonably be expected to pay some premium or charge towards the cost of their option or guarantee. HMT-ID further ventured the view that in some cases this charge could be achieved through some reduction in the terminal bonus that would be payable if there were no such guarantee attached to the policy. The letter cautioned, however, that this would “ depend on the wording of the contract involved and how it had been presented to policyholders”.

76. The legal advice obtained by the Society in September 1998 cannot, however, be considered in isolation. By this time, the Society had also encountered further difficulties in relation to its GAOs, this time from HMT-ID and the Government Actuary’s Department (“GAD”) in relation to its practice of not reserving for the cost of its GAOs.

77. Up to and including the return for 1997, Equitable Life had not included any reserve in respect of GAOs in its regulatory returns. The basis for the Society’s approach was that whilst it reserved fully for the provision of an annuity at CAR rates on the guaranteed element of policy values, because less than 1% by value of GAR policyholders actually took up their GAR rights, it was not necessary to reserve for the effects of the GAOs on the guaranteed element of policy values. Further, so the Society argued, there was no requirement on any view to reserve for final bonuses which were entirely discretionary.

78. As discussed above, at a time when GAR rates exceeded CAR rates, it might reasonably be assumed that at least one of the major reasons for the low take-up of GAR benefits was the Society’s use of its supposed discretion under Article 65 to declare a lower final bonus for those policyholders electing to take benefits in GAR form by comparison to the higher final bonus for those taking benefits in CAR form.
79. In the summer of 1998 GAD had conducted a survey of the practices of life offices in relation to reserving for GAOs. In its response the Society had explained its reliance upon Article 65 in the following way.

“For any policy for which the annuity guarantee is biting, the amount of the terminal bonus is reduced to pay for the cost of the guarantee.

……

The cost of annuity guarantees has more than adequately been covered by the terminal bonus cushion to date for all but a few small policies…As the business to which annuity guarantees apply ages, the increasing terminal bonus cushion will make it increasingly unlikely that guarantees will actually bite.”

80. After consideration of the GAD survey, in September 1998 HMT-ID and GAD took the view that the Society’s reserving practices were unacceptable and notified the Society that in their view, Part IX of the Insurance Company Regulations 1994 (“the ICR”) required the Society to reserve in full for its liability to provide annuities at the GAR rate on the guaranteed element of the policy value. The argument advanced by HMT-ID and GAD was later summarized in a “Dear Appointed Actuary” letter from GAD to all life companies dated 13 January 1999. That letter said, among other things:

“Where the levels of terminal bonus are to be adjusted with the aim of bringing the value of the guaranteed annuity option close to the value of the alternative benefits, there might at first sight appear to be some room for argument that it was not necessary to reserve on the assumption that almost all policyholders will take the guaranteed annuity benefit. However, it needs to be remembered that, although the benefits formally “guaranteed” under the alternative form of benefit may be lower than those under the guaranteed annuity option, the company’s discretion in setting the value of the terminal bonus applied to the alternative benefit is limited as a result

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10 For present purposes we do not think that the pre-1994 Regulations were materially different to the ICR.
of the existence of the guaranteed annuity. It is likely that close to 100% of policyholders will exercise the annuity guarantee unless the company maintains terminal bonus at a level which ensures that the value to the policyholder of the alternative benefit is at least equal to the value of the guaranteed annuity. Accordingly this constraint will need to be reflected in the valuation assumptions made about either the proportion of policyholders opting for the alternative benefit or the value of that alternative benefit. Consequently any reduction in the reserves held by the insurer by more than a few percentage points below the full value of the guaranteed annuity for this reason would require very careful justification by the actuary.”

81. In the period from September to December 1998 the Society resisted the demands of HMT-ID and GAD that it make substantial reserves for its GAOs. In December it instructed two leading counsel to advise. Their joint opinion was dated 18 December 1998 and was sent to HMT-ID under cover of a letter which also notified HMT-ID that the Society had decided to institute test cases to resolve the legality of its policy of declaring differential final bonuses for GAR policyholders depending upon whether they decided to take their benefits in GAR form or not. The joint opinion included the following passages discussing the potential effect to the Society if it was required to reserve for its GAOs:

“10. The ICR came into force on 1 July 1994. Thus the obligations imposed on the Society by the ICR have been applicable at all material times – that is at all times when GARs have exceeded CARs. This notwithstanding, we are instructed that the Treasury did not seek to take the point now being taken against the Society in respect of the valuation dates falling in 1994, 1995, 1996 or 1997. And yet circumstances giving rise to the alleged necessity to make a reserve will have existed in each of those years (and at the 31 December 1995, 1996 and 1997 valuation dates in particular), if indeed it is necessary on a proper understanding of the ICR to make a reserve at all.
11. In each of those years, the Society has in good faith declared annual bonuses and allotted and paid final bonuses on the assumption that there was no need to make any such reserve. It is obvious that had the Treasury raised with the Society in any of the years 1994 to 1997 the point of interpretation of the ICR which it now seeks to take, the Society would not have been able to declare and allot bonuses to [GAR policies] at any such level, if at any level at all. Further, the Society’s investments strategy over the relevant period would have been different had the Treasury required the Society to make such a reserve…

12. Had the Treasury sought to take a consistent line on this issue from 1994 onwards, it would have been possible for the Society to absorb any need to make reserves progressively, as the downward trend of annuity rates over the 1994 to 1998 period would have dictated a steady increase in reserves. The consequence of the Treasury seeking to impose its interpretation of the ICR on the Society at the end of 1998 for the first time is to require the Society to make a one-off reserve of approximately £1.5 billion, which is massive by any standards, and which threatens the statutory solvency of the institution.

13. At very least, any requirement to make such reserve will severely prejudice the interests of the 1,000,000 or so with-profits policyholders whose policies make no provision for GARs. The implications of having to make such a reserve will be felt by all policyholders in the form of significantly reduced bonuses for years to come…“

82. HMT-ID and GAD were, however, unmoved and continued to insist on reserves being made. The precise level of such reserves depended, among other

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11 At a meeting with HMT-ID and GAD on 2 October 1998 Mr. Nash stated that the need to reserve for GAOs could have severe consequences for the Society and that it might have to switch from equities to gilts to maintain solvency, a move which of itself would harm the company. At a further meeting on 22 December 1998 Mr. Headon further argued that if the Society had to reserve for the full amount of the GAOs, this would seriously constrain investment strategy and the lower solvency margins would threaten the company’s future.
things, upon the amount of the discount which the Society could properly apply to reduce the reserves from 100% of the cost of providing benefits at the GAR rate upon the guaranteed benefits payable under the GAR policies. The discount would reflect the Society’s predictions as to the likely take-up of benefits at GAR rates.\footnote{See the “Dear Appointed Actuary” letter of 13 January 1999 referred to above.}

83. Any discount would, however, only have had a limited effect in reducing the impact of the new reserving requirements. Accordingly, in December 1998 the Society moved to obtain an offer of reinsurance by the relevant date for its statutory returns, namely 31 December 1998. The main purpose of the reinsurance was to off-set some of the reserves required for GAOs so as to enable the Society to be able to declare bonuses in respect of 1998 without endangering its statutory solvency margins. Without such offer of reinsurance it is most unlikely that the Society could have declared bonuses in respect of 1998 at all.\footnote{Even with such reinsurance, the Society declared a reduced bonus for 1998.}

84. In general terms, the effect of that reinsurance was that if more than 25% by value of GAR policyholders elected to take their guaranteed benefits in GAR form, 98% of the additional cost of providing the annuity at the GAR rate would initially be met by the reinsurer, but subsequently recouped by it from surpluses in the with-profits fund. The 25% figure reflected the then low take-up rate of GAR benefits and the reinsurance was conditional upon there being no change in the Society’s bonus policy. In effect, the Society anticipated that provided that it could continue to rely upon Article 65 to declare differential final bonuses to GAR policyholders, the actual take-up rate of GAR benefits would continue to be very low and the reinsurance would never be called upon. Further, so the Society appears to have reasoned, as more and more GAR policyholders retired without taking GAR benefits, the need for reserves would reduce and the GAR risk would disappear.
85. As we understand matters, this meant that the reinsurance did not neutralise the potential effects of the GAR risk. In reality, it simply shifted some of the potential costs of the annuities which might be taken at the GAR rate from the present policyholders to future policyholders in the expectation that in the meantime GAR policies would mature but the policyholders would not actually elect to take annuities at the GAR rate.

86. As we see it, the difficulty with the Society’s approach in relation to the level of its reserves and its reinsurance was that if the Society’s ability to declare reduced terminal bonuses to policyholders electing to take their benefits in GAR form was declared unlawful, GAR policyholders would have a clear incentive to elect to take an annuity at the GAR rate in increased numbers. This would increase the actual cost to the Society of the GAOs, it would mean that the Society would not be able to claim any significant discount in the level of reserves required by HMT-ID based upon an expectation that most GAR policyholders would not elect to take their benefits in GAR form, and it would invalidate the Society’s reinsurance cover.

87. But throughout this period it was quite apparent to the Society that the legality of its approach to the declaration of differential final bonuses to GAR policyholders under Article 65 was under fire in the media and from policyholders who had complained to the PIA Ombudsman. Moreover, by December 1998 the Society had decided to institute the very proceedings that leading counsel had earlier advised carried a risk of defeat.

88. On the basis of this material, it seems to us arguable that once the reserving issue had arisen, if the Society could not lawfully implement its differential terminal bonus policy for GAR policyholders under Article 65, then quite irrespective of the question of whether such costs could have been confined to GAR policyholders by way of declaration of lower bonuses to them alone, the Society would be required to make large reserves which could not be discounted to reflect lower take-up rates of GAR benefits, and reinsurance of the type later
effected in 1999 would have been invalidated or would only have been effective to shift the costs forward, to the later detriment of policyholders. In other words, as the Society’s joint opinion of December 1998 made clear, all with-profits policyholders would be prejudiced.

89. That being so, it seems to us arguable that quite irrespective of the ring-fencing issue, unless the Society could be sure on reasonable grounds that it could lawfully use its discretion under Article 65 to discriminate between GAR policyholders depending upon whether they elected to take their benefits in GAR form, the existence of the GAR policies was a factor potentially affecting the performance of a non-GAR policy which ought to have been disclosed in the Society’s Key Features document.

90. For present purposes we do not need to reach any conclusion as to whether the Society was justified in not disclosing the GAR risk for the period between taking legal advice in September 1998, and that advice being shown to have been wrong by the decision of the Court of Appeal in January 2000. We simply conclude that it must be at least arguable that by the time that the Society felt compelled to consult its lawyers there was already sufficient uncertainty about the legality of its practices under Article 65, which, coupled with its problems over reserving, meant that it could not be sure that the GAR risk would not have an impact upon non-GAR policyholders. Once the Society had been forced to institute the very proceedings which its lawyers had earlier advised it that it risked losing, it is even more difficult to see how the Society could be sure that its reliance upon Article 65 would be vindicated. Manifestly, after the Society lost in the Court of Appeal, it could not be sure that it would ultimately be vindicated.

91. We therefore conclude that there is an arguable case that the Society breached the Rules in relation to the non-disclosure of the GAR risk to non-GAR policyholders in its Key Features documents from the beginning of 1995 onwards.
92. Before leaving this area, we ought to mention the related issue of ring-fencing. As indicated above, we believe that it is arguable that even if the Society lost the *Hyman* litigation only on the question of whether it could lawfully declare differential bonuses to GAR policyholders, the effect of the GAR risk on prospective non-GAR policyholders could itself have been material. However, if the Society was also unable to confine the impact of the extra cost of the GAOs to the GAR policyholders, but was forced to cut bonuses generally across the with-profits fund, then it would follow that the potential effect upon non-GAR policyholders would be that much greater.

93. The ring-fencing issue was not expressly raised in the test cases which the Society instituted in January 1999. However, it was canvassed in the evidence from the outset. In his affidavit evidence sworn in support of the Society’s case, Mr. Nash stated as follows.

“76. If the Court decides that the Society is not entitled in principle to determine final bonus on the maturity of the policy to take account of the contribution of GARs to “asset share” where the policyholder takes a guaranteed annuity form of benefit, this would have a substantial impact on the allocation of bonuses by the Society in future years. Predicting the precise impact depends on a number of variables. These include the relationship between GARs and the Society’s current annuity rates, the investment returns earned for the Society by the Society’s investment managers, the take-up of guaranteed annuities (in practice the availability of more modern and more flexible alternative products) and how the costs of providing higher benefits to those taking benefits in guaranteed annuity form is spread among the other with-profits policyholders.

77. However, what should immediately be clear from the …nature of the Society and its with-profits fund…is that one thing that the Society could not do is to allot the same levels of final bonuses as are currently being allotted to with-profits policies which do not contain GARs and as are currently being made available to with-profits policyholders with GARs who nevertheless elect to take annuities at current
rates, to policyholders taking their benefits in guaranteed annuity form. There is only one cake to be divided up amongst all with-profits policyholders, and if the Society is obliged to allot the same proportionate final bonuses to all GAR with-profits policyholders irrespective of whether or not benefits are taken in guaranteed annuity form or not, then the level of final bonuses must necessarily be adjusted downwards so as to enable this to take place. This would require the Society to review all bonuses for all with-profits policyholders, particularly those policyholders having GARs in their policies. The Society’s directors, in the exercise of their discretion as to bonuses would have to decide whether the cost of any increased final bonus for policyholders taking their benefits in guaranteed annuity form should be borne by all with-profits policyholders, or simply those with GAR policies whether or not they take benefits in guaranteed annuity form. The directors have made no decision yet, although they have sympathy with the argument that providing benefits at a higher level to GAR policyholders should not be at the expense of policyholders who have no GARs.”

94. In his evidence in response, Mr. Hyman’s solicitor indicated that if the Society lost on the main point in the proceedings, it was hoped that the issue of whether the consequential extra cost of the GAOs could be ring-fenced, should be determined in the proceedings. Given the decision of the Scott V-C in favour of the Society at first instance on 9 September 1999 it was not necessary for that issue to be decided at that stage. The issue resurfaced in argument in the Court of Appeal in late 1999 but was only addressed explicitly in the judgment of Waller LJ, who took the view that the Society could use its discretion under Article 65 to ring-fence the GAR liabilities: see [2000] 2 WLR 798 at 833.

95. Faced with the prospect that the Society might use Article 65 to ring-fence the GAR liabilities, Mr. Hyman requested that the ring-fencing issue be decided as an additional point in the House of Lords. In her opening speech, leading counsel for the Society drew their Lordships’ attention expressly to those paragraphs of Mr. Nash’s evidence which are set out above but did not suggest that the Society
had in fact decided to ring-fence any GAR liabilities. The issue was argued and decided as a point of principle.

96. From this material we believe that there is an arguable case that at no time during the Hyman litigation was the Society in a position to assure a prospective non-GAR policyholder that the GAR liabilities would be ring-fenced, and that as a consequence he would definitely not be affected by any decision in favour of the GAR policyholder on the narrow issue. It appears that at no time had the Society decided how it would exercise what it believed was its discretion to ring-fence. Moreover, after the Court of Appeal’s decision, the Society’s ability to do so was challenged by Mr. Hyman, so that whatever Waller LJ had said, the Society could give no assurance that the House of Lords would take the same view. And the House of Lords then decided that the Society had no discretion to ring-fence the GAR liabilities in any event.

*The Advertising Rules*

97. The content of the Rules in relation to the content of investment advertisements was at all times materially identical to the Rules relating to the contents of Product Particulars and Key Features documents. In particular, until 1995, Rules 6.19(1)(b) and 6.19(4) in relation to direct offer advertisements for with-profits policies were in materially identical form to Rules 5.10(2) (b) and (4), and from the beginning of 1995 Rule 6.19(1) has required such advertisements to contain essentially the same information as the Key Features document.

98. The advertising materials which we have seen which were designed for prospective non-GAR policyholders do not disclose the GAR risk any more than did the Product Particulars or the Key Features documents. It follows that for the same reasons as set out above we believe that there is an arguable case that the Society may have breached the Rules in relation to advertising, but we do not believe that such breaches would add anything to the breaches of the disclosure Rules which we have identified above.
With-Profits Guides from 1990 onwards

99. With effect from 31 August 1990, a member of Lautro that issued with-profits policies was obliged to produce a With-Profits Guide. Rules 5.16A-F (which, from July 1994, were renumbered Rules 5.13-5.18) provided, so far as material, as follows.

“5.16A(1) Rules 5.16B to 5.16F together with Schedule 8 to these Rules require a Member which issues with-profits policies to produce a with-profits guide relating to the fund maintained by the Member in respect of the business of which such policies form part (“the with-profits fund”), the purpose of the guide being to inform investors as to the nature of the investment represented by the purchase of such a policy, …

5.16C(2) Subject to paragraph (3) below -

(a) a with-profits guide must contain the headings, tables and information set out in, or required to be included in, Schedule 8 to these Rules,

(b) The Sections set out in that Schedule … must appear in the order set out in the Schedule and (except where the text of the Schedule or the footnotes indicate that the Member may use its own words) in the same words, but the information required to be included in each Section may be given in a different order within the Section from that given in Schedule 8, …

The Member must not use any wording which would or might mislead an investor.

(3) A Member may alter any of the wording required by Schedule 8 to be included in a with-profits guide if that wording is misleading in the case of that guide. …

5.16(F)(1) The Member shall give or send by post a copy of the Member’s with-profits guide or guides to any person who requests a copy, …”
100. Schedule 8 sets out the required contents of a With-Profits Guide, and Section A contains what is required to go into the introduction to the guide, in particular:

“1. All insurance companies, and the larger friendly societies, which market with-profits policies in the United Kingdom, are required to make available a guide containing information about the company or society and its with-profits fund. This is because the benefits under such policies depend in part, and sometimes to a considerable extent, on bonus additions which are made by the company or the society from time to time and which cannot be known in advance. It is therefore important that potential policyholders and their advisers should have access to information about the most important factors influencing such bonuses.

... 3. [The company/society] is satisfied that this guide fairly presents information as at [date] about the [company] [society] in accordance with the Rules of the Life Assurance and Unit Trust Regulatory Organisation.”

101. Section C has the heading “Factors influencing bonus rates” and provides as follows.

“1. [Under this heading the Member shall include an introduction to the following sections of the guide, identifying the main factors which are likely to influence bonus rates of the Member’s with-profits business including, in particular -

(a) the assets in which the fund is invested;

(b) the effect of inflation;

(c) the effect of taxation;

(d) the effect of surpluses from miscellaneous sources;

(e) the expenses of the fund.]
2. [The Member shall relate the factors to each other, so far as is possible, and shall indicate that individual factors will be covered in more detail elsewhere in the guide.]

102. Section F has the heading “Recent bonus policy” and says this.

“1. [Under this heading the Member shall set out an explanation of -

(a) the basis on which the amount available for distribution to policyholders and shareholders (if any) is to be determined and on the actual level of transfers to shareholders;

(b) the nature of each series of bonuses payable in respect of the with-profits policies currently marketed by the Member (as at the guide date) and the relative importance of each series;

(c) the Member’s policy for ensuring fairness of treatment at maturity or earlier surrender, so far as possible, between investors holding policies issued at different times, including the Member’s policy with regard to terminal bonuses, stating whether the policy is subject to frequent change and identifying in particular the factors which might lead to any change in the policy.]

103. Section J is headed “Other Factors” and says this.

“1. [Under this heading, the Member shall describe any other factors not dealt with under any of the preceding headings of the Guide which the Member regards as relevant to its with-profits business, commenting on the importance of the different factors.]

There is a footnote to the text which says:

“Members are expected to include here a description of the effect of the surpluses from miscellaneous sources on the with-profits business.”
This is clearly a reference to paragraph 1(d) of Section C.

104. As is evident from the passages quoted, the schedule closely prescribes what is to go into a With-Profits Guide. If there are “main factors … likely to influence bonus rates of the member’s with-profits business” that are not already listed in Section C, then they are to be described as, or amongst, the “Other Factors” provided for in Section J. This means that they must be factors, “which the member regards as relevant to its with-profits business”.

105. Although subjective language is used in Section J, we do not think it is open to a member unreasonably to ignore a factor of which it knows and which is in fact relevant to its with-profits business, a fortiori one likely to materially influence bonus rates, and then to plead that in its own opinion that factor was not relevant.

106. Once a member knows of a factor which (if uncounteracted) is likely to influence bonus rates, in our opinion it is only entitled to omit reference to it if, on reasonable grounds, it concludes that the factor will not in reality materially influence bonus rates and so can reasonably be regarded as irrelevant to its with-profits business. For the reasons which we have outlined above, once the GAR risk and its potential effects became material, we believe that it is there is an arguable case for believing that the Society did not have reasonable grounds for so concluding.

107. We thus come to the conclusion that, as soon as Equitable Life was obliged to disclose the GAR risk pursuant to the Rules in its Product Particulars, in its Key Features documents, or in its investment advertisements, it was also required to disclose it in any With-Profits Guide. If that obligation arose earlier than 1990
then Equitable Life was required to disclose the GAR risk in all its With-Profits Guides from the first.\textsuperscript{14}

\textit{Did the Society disclose the GAR risk?}

108. As we have said above, so far as we have been able to ascertain, at no time did the Society make any specific disclosure of the GAR risk or of its potential effect in any written material provided to prospective non-GAR policyholders. This is hardly surprising as the Society believed that it could effectively neutralise the risk by its use of its discretion under Article 65.

109. However, in its Product Particulars, its With-Profits Guides and much of its sales material, the Society did make clear, and indeed placed great emphasis upon the point that,

\begin{quote}
“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.”
\end{quote}

110. After the House of Lords’ decision, the Society sought to suggest in communications with its policyholders that this form of words gave due warning of the GAR risk. The Society’s reasoning appears to have been that the cost of the GAOs was simply a loss incurred in the running of the business, and that the non-GAR policyholders ought to have understood that they would be exposed to such risks.

111. We do not agree. The wording does not begin to satisfy the requirements of the Rules either to disclose “special features” that might be expected to affect profits available for distribution, or to disclose “factors that might have an adverse effect on performance”. The statement discloses no features and no factors.

\textsuperscript{14} If the costs of honouring the GAR policies can properly be described as expenses of the fund then they would have had to be disclosed under Section G of the schedule. But this adds nothing material to the obligation to disclose discussed above.
Non-disclosure of the mis-selling itself

112. Any policy written in a with-profits fund is, by its nature, exposed to the risk that the company providing the policy may have in the past or may in the future mis-sell policies, or commit other breaches of the Rules, or commit torts, compensation for which may have to paid out of the fund, thereby reducing the profits available for distribution by way of bonus on the policy. Provided that the company neither knows nor ought to know that this has actually happened, such possibility is not, of itself, a risk that requires specific disclosure. It is certainly not a “special feature”.

113. However, if the company knows or ought to know that mis-selling has actually occurred or that it has committed some other breach of the Rules or tort, with the result that its with-profits fund is exposed to claims which might materially affect distributable profits, that fact may require disclosure under the Rules.

114. In the present case the question therefore arises whether the Rules may have been breached not only by Equitable Life failing to disclose the GAR risk to prospective non-GAR policyholders, but also by a failure on its part to disclose that it might have incurred a liability to other non-GAR policyholders by reason of having failed to disclose the GAR risk to them as well. For convenience we shall refer to the possibility that the Society had incurred such a liability as the “non-GAR mis-selling risk”.

115. We do not believe that there was any such breach of the Rules. As we have indicated above, we believe that the Rules must be interpreted so as only to require disclosure by the member firm of special features of their liabilities, or factors which might materially affect the performance of their products, of which the firm is, or ought to be, aware.
116. Whilst the Society plainly appreciated that there was a GAR risk, and arguably breached the Rules in failing to disclose it because it could not be sure on reasonable grounds that the risk had been neutralised, it does not follow that the Society knew or ought to have known that in turn this gave rise to a non-GAR mis-selling risk.

117. We have seen no evidence to suggest that the Society actually knew at any material time that it might have breached the Rules by not disclosing the GAR risk. We do not know when the Society first actually appreciated that there was a non-GAR mis-selling risk, but this may not have been until some time after the decision of the House of Lords.

118. A conclusion that the Society ought to have known of the non-GAR mis-selling risk would mean that it not only ought to have discovered that the GAR risk could not be neutralized by the use of Article 65, but it also ought to have discovered that as a consequence it might be breaching the Rules in relation to disclosure to non-GAR policyholders. We think that such an argument is untenable.

119. It is arguable that the Society ought to have obtained legal advice as to the ambit of its discretion under Article 65. It is also the case that if it had done so it might have been alerted that failure to disclose the GAR risk might constitute a breach of the Rules in relation to its sales of non-GAR policies. But the Society did not in fact obtain advice in relation to Article 65 until September 1998. It does not follow from the point that the Society ought to have obtained advice as to Article 65 earlier, that not having obtained such advice it also ought to have realised the existence of a non-GAR mis-selling risk. We reach our conclusion by parity of reasoning with the principle that a person who has acted negligently does not come under a continuing duty to take care to remind himself of, or to disclose to someone else, the negligence of which, ex hypothesi, he is unaware: see per Oliver J. in *Midland Bank Trust Co. Limited v. Hett Stubbs and Kemp* [1979] Ch

120. We have not seen sufficient materials to form a view as to whether the position in this regard might arguably have changed after the Society had consulted leading counsel in 1998 and had been told that there was a risk that it might be found to have misused its discretion under Article 65.

*Additional premiums*

121. Clearly the payment of non-voluntary continuing contributions pursuant to the terms of an existing policy does not give rise to any additional cause of action. It is, however, possible that additional claims could arise in relation to the payment of voluntary additional contributions. Under the policies issued by Equitable Life, policyholders could, in practice, pay premiums over and above any contractual minimum whenever they liked and (subject to Inland Revenue rules) as large as they liked.

122. In some, but certainly not all cases, those paying such premiums should have received Product Particulars or Key Features again. It may also be possible for individual policyholders to show that they made payments of further premiums after having received, and in reliance upon, the Society’s With-Profits Guides.

123. Whether any such payments will give rise to a cause of action will depend upon the individual circumstances of the case. Accordingly, the most which we feel able to say is that it is possible that some non-GAR policy holders may have suffered from breaches of the Rules on more than one occasion.
124. Rule 3.4(4) of the Lautro Rules, which was in force until the creation of the PIA in July 1994, imposed an obligation upon the Society to ensure that its company representatives complied with the Code of Conduct which was set out in Schedule 2 to the Rules.

125. Under paragraph 2 of the Code of Conduct, a company representative was obliged to exercise due skill, care and diligence in his business dealings and to deal fairly with investors. Paragraph 3(3)(b) required him, when making a call on an investor, to explain that the contracts the sale of which he was authorised to arrange or procure, and as to the merits of which he might advise investors, were those offered by the member whose company representative he was, or by other members of the same marketing group, and no others. He was not, however, obliged to make such statement if he had previously explained his status and the investor might reasonably be expected to realise that the representative’s position had not changed.

126. Under the general heading of “Best advice to be given”, paragraphs 6 and 8 of the Code of Conduct provided as follows.

“6. A company representative who, in the course of any relevant investment business, has dealings with an investor –

(a) shall give the investor all information relevant to those dealings…;

(aa) shall use his best endeavours to enable the investor to understand the nature of any risks involved…;\(^{15}\)

(e) shall not advise the investor to convert, cancel or allow to lapse any investment contract or realise any investment under an investment contract unless the representative has previously -

\(^{15}\) Paragraph 6(aa) was added with effect from 1992.
(i) ...made a comprehensive study of the investor’s need to make any investment and of his financial resources; and

(ii) disclosed to the investor all relevant consequences and disadvantages likely to follow from the action advised....

and the representative shall not in any event advise the taking of such action unless he bona fide believes it to be in the best interests of the investor.

8(1) A company representative shall, in advising an investor as to the suitability for that investor of any investment contract, have regard, in particular, to the investor’s financial position generally, to any rights he may have under an occupational pension scheme or the State earnings-related pension scheme, (if such rights are relevant in the particular case) and to all other relevant circumstances; and he shall use his best endeavours to ensure –

(a) that he recommends only that contract or those contracts which are suited to that investor; and

(b) that there is no other contract available from the members, or if the members belongs to a marketing group, from any member of that group, which would secure the investor’s objectives more advantageously.”

127. We believe that it is arguable that at a time when the Society should have been disclosing the GAR risk in its Product Particulars, a failure by the Society’s representatives to disclose the GAR risk to a prospective non-GAR policyholder would also have meant that the Society was in breach of Lautro Rule 3.4(4) because it failed to ensure that its company representatives had the necessary information concerning the GAR risk to impart to prospective policyholders under paragraph 6 of the Code of Conduct. We do not, however, believe that this breach adds anything to the other breaches of the Rules which we have identified above.
128. It might also be suggested that at least after the GAR risk and its effect became material, the Society was also in breach of Lautro Rule 3.4(4) because it permitted its company representatives to recommend non-GAR policies in breach of paragraph 8(1)(a) because they were unsuitable for the particular investor or in breach of paragraph 8(1)(b) because they were not the most advantageous contracts available from the Society, in each case because of the existence of the GAR risk. We do not think that such a claim would be well founded.

129. The obligation under each of paragraphs 8(1)(a) and (b) of the Code of Conduct was for the company representative to use his best endeavours. It was not an absolute obligation as under paragraph 6(a). It seems to us that a company representative could have used his best endeavours even though, for reasons entirely outside his control, the information with which he was working was incomplete. If the company representative was not in breach of the Code of Conduct, then we do not think that the Society would have been in breach of the Rules in failing to ensure that he complied with the Code.

130. With effect from July 1994, as we have already discussed, it was the Society's responsibility under the PIA Rules to produce proper Key Features documents. Paragraph 6A(1) of the Code of Conduct (as amended) required the Society’s representative to hand these to prospective policyholders prior to contract. As we have already explained above, we believe that it is arguable that the Society was in breach of the Rules in relation to the contents of its Key Features documents.

Reliance and causation

131. Section 62 itself provides that a person only has a cause of action if he suffers loss as a result of the contravention of the relevant Rules. The position is, in effect, the same as at common law where, in order to have a cause of action in misrepresentation, a representee has to show that he has acted in reliance upon the misrepresentation and thereby suffered loss.
132. Whilst it will be for each non-GAR policyholder to show that he relied upon the relevant non-disclosure, we think that the court may readily accept that a policyholder relied upon a document which the Rules required to be prepared and given to him prior to contract. This would include the Product Particulars and the Key Features documents, but would not include the With-Profits Guides, which were only available on request. It may also be relatively easily accepted that the prospective policyholder would have relied upon the information and any recommendation which may have been given to him by the Society’s representative.

133. More difficult issues may arise in relation to causation. The first issue will be whether an individual non-GAR policyholder would have acted any differently had the Rules been complied with and the GAR risk been disclosed. The policyholder must show that disclosure of the GAR risk would have caused him to decline to take the policy offered by Equitable Life, or, in the case of a voluntary contribution, would have resulted in his investing his money elsewhere. If he would have taken the Equitable Life policy or made the voluntary contribution to the Society in any event, the policyholder will have suffered no loss as a result of the non-disclosure.

134. Even if the policyholder can show that he would have acted differently, there are difficult issues as to the precise nature of the losses which the law will regard as having been caused by the breach. We shall return to these questions of causation as part of the general discussion of the issue of quantification of loss later in this opinion.

Conclusion

135. In our view there are grounds for believing that the Society may have breached the Rules in relation to sale of its non-GAR policies, and that subject to the issues of reliance and causation, limitation and quantification of loss, some non-GAR policyholders may have claims against the Society under section 62.
Other tort claims and contractual claims

Introduction

136. It is convenient to consider together the questions of whether non-GAR policyholders have claims against Equitable Life at common law or under the Misrepresentation Act 1967 for misrepresentation inducing them to enter into the non-GAR policies, or in contract for breach of warranties of, or collateral contracts to, such policies. This is because any such claims can only be based upon representations made expressly or implicitly by Equitable Life to prospective policyholders concerning their entitlement to bonuses from the Society.

137. We shall then consider separately the questions of whether non-GAR policyholders could bring contractual claims based upon the principle of estoppel by convention. In this section we shall finally consider whether non-GAR policyholders arguably have claims at common law for negligent advice given by the Society.

The contract terms and Article 65

138. Before turning to the statements in the relevant sales materials and other documentation concerning the bonus entitlement of non-GAR policyholders, we should set out the material parts of the contract which the non-GAR policyholders actually made with the Society. Although we accept that not every prospective policyholder might have scrutinised or even seen the terms of the policy which he was buying, it is at least likely that some will have done so, and it would be inappropriate to reach any conclusion on contractual warranties or collateral contracts without reference to the express terms of the non-GAR contract.
139. There is no express term of the non-GAR policies dealing with the existence and effect of the GAR policies. Nor is there any express term entitling non-GAR policyholders to any particular level of bonuses or to any return on their “asset share” (however defined) of the with-profits fund.

140. A typical non-GAR with-profits policy contained the following conditions:-

“1. Participation in profits

The policy shall confer no right to participation in the profits of the Society except to the extent that it is expressly stated to confer such right in respect of the Sum Assured secured by a With-Profits Segment.

2. Membership of the Society

If and for so long as the Policy shall confer a present entitlement to participate in the profits of the Society the Grantee shall by virtue of the Policy shall be entitled to be a Member of the Society in accordance with and subject to the Society’s Articles of Association…..”

The section of the Policy applying to a With-Profits Segment said this.

“1. Participation in profits

The Policy shall confer a right to participation in the profits of the Society in respect of the Sum Assured secured by a With-Profits Segment (as varied from time to time) until the date upon which the said Sum Assured (or the last part thereof) has become payable.

2. Calculation of the Sum Assured and Related Bonuses

…..

(b) Related Bonuses are also variable and will be calculated by the Actuary at any particular date in accordance with the rules and regulations of the Society.”
“Related Bonuses” were defined in the following way.

“Related Bonuses means in relation to the Sum Assured by a With-Profits Segment such amounts (if any) as shall under the rules and regulations of the Society have been allotted by way of addition thereto or bonus thereon.”

141. The relevant “rule and regulation” of the Society was, of course, Article 65, sub-paragraphs (1) and (3) of which provided in material part as follows.

“(1) The directors shall, at such intervals as they may deem expedient, but at least once in every three years, cause an investigation to be made into the financial condition of the Society, including a valuation of its assets and liabilities, by the actuary....After making such provision as they may think sufficient for such liabilities, and any special or other reserve they may think fit, the directors shall, at a special board meeting declare what amount of the surplus (if any) shown by such valuation may, in their opinion, be divided by way of bonus, and they shall apportion the amount of such declared surplus by way of bonus among the holders of the participating policies on such principles, and by such methods, as they may from time to time determine. The directors may pay or apply the bonus so apportioned to each participating policy holder, either by way of reversionary bonus (that is to say by way of addition to the sum assured when it shall become a claim), cash payment, reduction or premium for the whole or life or any less period, or in any other way they and any participating policy holder may agree.

(3) The amount of any bonus which may be declared or paid pursuant to paragraph (1) or paragraph (2) of this Regulation and the amount (if any) to which any participating policyholder may become entitled under any mode of payment or application of any such bonus, shall be matters within the absolute discretion of the Directors, whose decision thereon shall be final and conclusive.”
**Pre-contractual express representations**

142. Generally, it is only statements made by or on behalf of the Society prior to a non-GAR policy being granted which could amount to an actionable misrepresentation,\(^\text{16}\) or constitute a warranty forming part of, or being collateral to, the policy. We therefore turn to the statements made to prospective policyholders concerning their bonus entitlements in the sales brochures which we have seen and in those documents which were specifically required by the Rules to be provided to them.

143. We reiterate that we do not know whether or in what circumstances any other documents may have been provided voluntarily by Equitable Life’s company representatives to prospective non-GAR policyholders prior to contract, or indeed what oral statements may have been made by them.

144. Between 1988 and the beginning of 1995, Equitable Life’s Product Particulars explained its “with-profits approach” in the following terms,

> “The essential feature of the Society’s with-profits contracts is that they effectively provide the opportunity for investment in an actively managed fund of assets covering a very wide range of fixed interest securities, equities (both UK and overseas) and properties.

> With this contract, after deducting 4½% for expenses from each contribution, the balance is increased by a guaranteed rate of interest of 3½% per annum compound up to the date benefits are taken. Earnings on the assets by way of interest, dividends and rent, as well as appreciation in market values of the assets in excess of those required to meet the guarantees are passed on to the policyholders by way of bonuses.

> Each year the Appointed Actuary carries out a valuation of the Society’s assets and liabilities.

\(^{16}\) A voluntary contribution might have been induced by an earlier, but post-contractual, misstatement which is actionable at common law.
Bonuses are then declared by the Directors, on the advice of the Appointed Actuary, using the powers given to them by the Society’s Articles of Association. These bonuses, once allotted, themselves become guaranteed additions to the contracts. A final share of profits is also allotted at the point the benefits become contractually payable.

The with-profits system smoothes out fluctuations in earnings and asset values. The benefits of the investments accrue steadily throughout the lifetime of the contract.

The major part of bonuses arises from the activity associated with the investment of the contributions on with-profits contracts. 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.”

145. After 1 January 1995, prospective policyholders were provided with Key Features documents which included statements to the following effect.

“RISK FACTORS

• The fund available from the plan is not guaranteed and will depend on a number of factors:
  - the contributions paid into the plan
  - the returns achieved from your chosen investment route,
  - the charges made by the Society.

• The terms for converting the fund of money into pension are not guaranteed and will depend upon financial conditions at the time of conversion.

• The benefits arising may fall short of your expectations and, therefore, you may need to review your contributions from time to time.
WHAT INVESTMENT FACILITIES ARE AVAILABLE?

• The WITH-PROFITS route provides the opportunity for investment in a managed fund of fixed interest securities, equities (both UK and overseas) and property.

Total earnings on the invested assets are averaged and passed on to policyholders by way of guaranteed interest and bonuses of various kinds. Annual bonuses become part of the guaranteed benefits under the policy. A final (non-guaranteed) bonus may be added when the benefits become contractually payable.

With-profits contracts have the essential feature of smoothing out fluctuations in earnings and asset values - thereby reducing the investment risk.”

146. We have also seen advertising materials which contain a description of the Society’s with-profits approach in the following or substantially similar terms,

“The Equitable offers a choice of investment routes encompassing a with-profits fund and a range of unit-linked funds....

The with-profits fund invests in a wide range of assets, including fixed-interest securities, equities and property. An essential feature of the with-profits system is the smoothing out of fluctuations in earnings and asset values generally associated with investment in such portfolios.

Above is a graph which shows how the fluctuations of the with-profits fund’s performance have been smoothed by this system of investment. The white line demonstrates the smoothed returns allocated to with-profits investors.”

The graph showed a relatively flat white line of the overall return to investors over time, as compared to a wildly fluctuating blue line signifying the return on the with-profits fund with time.
147. All of the above documents clearly identified Equitable Life as a company regulated by Lautro, and subsequently by the PIA.

148. Whilst we repeat that we do not know whether oral representations in any way different to those which appear in the documents were ever made, in themselves these documents do not seem to us expressly to have made any relevant promises nor to have contained any express representations as to whether or not non-GAR policyholders would be affected by the presence or absence of GAOs.

*Pre-contractual implied representations*

149. In the absence of any relevant express representations, the question is whether the Society made any relevant implied representations or promises to prospective policyholders prior to sale of the non-GAR policies.

150. We do not believe that any prospective policyholder could reasonably have understood the Product Particulars, Key Features Documents or advertising materials to which we have referred above to have contained any implied representations as to the amount of the bonuses which would be declared in favour of non-GAR policyholders.

151. The pre-contractual documents are in quite general terms and simply describe how, as was the case, with-profits policyholders would become entitled to such guaranteed bonuses (if any) as were declared by the directors annually and such (non-guaranteed) final bonuses (if any) as might be declared upon the policy benefits becoming contractually payable. Although the Product Particulars refer to “a final share of profits” being allotted at the point the benefits become contractually payable, we do not consider that this statement implicitly says anything about the size of that share. Nor do we believe that the statement that with-profits policyholders effectively stood in the position of the proprietors of the business carried with it any implicit representation excluding any particular
category of loss or reserves for liabilities from the discretionary process by which the directors would determine bonuses.

152. We recognise that in this respect our views differ from those of Mr. Warren QC and Mr. Lowe. They believe that the form of words routinely used in the pre-contractual documents such as the Product Particulars and Key Features documents consistently assured investors that the return on their funds would be passed on to them broadly in the same way as if they had invested in unit trusts or building society deposits, subject only to smoothing and deduction of administrative expenses. We believe that this reads too much into the statements which we have identified in the pre-contractual documents.

153. The Society’s statements indicated that returns to policyholders would be by way of such bonuses (if any) as would be declared by the directors in the exercise of their discretion. Whilst plainly a policyholder would expect the discretion to be exercised in good faith and for proper purposes, he could not read any other constraint into it than that. Indeed, inherent in the concept of “averaging and smoothing” was the idea that the directors had the discretion to depart from any precise correlation between the actual investment return upon the policyholder’s contributions to the fund and the bonuses declared.

154. Mr. Warren QC and Mr. Lowe also believe that references to policyholders obtaining a “slice of the fund” in certain brochures – for example those for free standing with-profits AVC pension policies – should be taken to be a representation “assuring policyholders of a so-called asset-share”. Again, we cannot agree. It seems to us that unless the reader was an actuary already steeped in the actuarial debate over the concept of delivery of an asset share or familiar with the profession’s search for the elusive meaning of PRE, he could not reasonably derive any such representation or assurance from the pre-contractual documents.
155. It might also be suggested that merely by producing its Product Particulars and Key Features documents, the Society made an implied representation to prospective policyholders that it had disclosed all matters to them which the Rules required to be disclosed. But we do not believe that a court would strain to hold that the Society made a general implied representation to the effect that it had, or believed that it had, complied with the Rules, simply to enable a claimant to recast a straightforward claim under section 62 as a claim for misrepresentation.\(^\text{17}\)

156. At common law, most cases of this nature are dealt with as cases of non-disclosure, pure and simple. It is generally only if, because of special circumstances or because the transaction is of a well-known kind, so that the representee would naturally expect that a fact which was unusual and abnormal in such a transaction would be disclosed if it existed, that the courts are prepared to find that there is an implied representation that no such fact exists.\(^\text{18}\) And if the recipient did not know what to expect, it is difficult to see how he can claim to have relied upon the implied representation that nothing else existed.

157. Accordingly, in the present case we think that it is only if the recipient of one of the documents produced by the Society actually knew what the Rules required to be disclosed in such a document that he would even arguably be able to say that he thought that the Society was impliedly representing that no other matters existed. Whilst it is possible that some prospective policyholders might have been sufficiently familiar with the requirements of the Rules, we very much doubt that most prospective policyholders would have been sufficiently familiar with the Rules to be able to make such a claim.

158. That being so, we do not think that most non-GAR policyholders would be able to make a positive case in misrepresentation or misstatement simply based

\(^{17}\) We have no information upon which to assess whether any misrepresentations may have been made to prospective policyholders prior to the coming into force of the Lautro rules, but it is difficult to envisage how any implied representation based on non-disclosure could be advanced in the absence of a duty to disclose prior to that date.

\(^{18}\) See e.g. *Spencer Bower, Turner and Handley, Actionable Misrepresentation, 4\textsuperscript{th} ed.*, para 91 and the cases there cited.
upon the fact that the Product Particulars and Key Features documents were produced in purported compliance with the Rules.

159. However, we do think that it is arguable that, irrespective of a prospective policyholder’s knowledge of the Rules, by expressly listing a number of factors under the heading “Risk Factors”, the text of the Key Features documents produced from 1995 onwards carried an implied representation that there were no other material risk factors. The implied representation was, in effect, that the list of “Risk Factors” which did appear was complete.

160. If inaccurate, made without reasonable grounds, relied upon\textsuperscript{19} and causing loss, this implied representation would render the Society liable for misrepresentation under section 2(1) of the Misrepresentation Act 1967. For the reasons set out above we believe that it is arguable that after the GAR risk and its potential effect had become material, the representation was inaccurate, and the Society may not be able to establish that it had reasonable grounds for omitting reference to the GAR risk.

161. It is also possible that the omission of any reference to the GAR risk in the Key Features documents would, if it was relied on and caused a policyholder to sustain loss, render the Society liable at common law for negligent misstatement under the principles in \textit{Hedley Byrne v. Heller} [1964] AC 465. Equitable Life sold its policies directly through its own salesmen rather than relying upon sales through independent financial advisers. It may be arguable that if, by its company representative, the Society gave information or an explanation to a prospective policyholder of the nature of the non-GAR policies, it assumed a responsibility, and hence a common law duty, to take reasonable care to ensure that the information which it gave was complete and accurate.\textsuperscript{20} Such a duty of care would

\textsuperscript{19} Whether to take out a policy or to make a voluntary contribution to an existing policy.  
\textsuperscript{20} This, we believe is the true ratio to be derived from \textit{Rust v. Abbey Life} [1978] 2 Lloyd’s Rep. 386. The judgment in that case might be taken to suggest that at common law an insurance salesman is obliged to give a customer an explanation of the nature of his product: see [1978] 2 Lloyd’s Rep. 386 at 391. But any such finding was \textit{obiter} because on the facts there was no dispute that the salesman had chosen to make a presentation as to the nature of the property bonds he was selling. The issue was
probably not be excluded by the fact that the Society’s representative was operating within the framework of the Financial Services Act 1986 or because the omission to disclose the GAR risk might also give rise to a statutory claim under section 62: see Gorham v. British Telecommunications plc [2000] 1 WLR 2129 at 2140-2141.

162. On the materials available to us, and for the same reasons that we do not believe that there was any breach of the Rules in failing to disclose the non-GAR mis-selling risk (see paragraphs 112-120 above), we do not believe that a policyholder would have a claim under section 2(1) of the Misrepresentation Act 1967 or at common law based upon a failure to disclose the non-GAR mis-selling risk.

163. The claim we have identified under the Misrepresentation Act 1967 might carry a higher measure of damages than the section 62 claim (see below). The common law claim would add nothing to section 62 claims which were not statute-barred, but would enable claimants whose section 62 claims were statute-barred to take advantage of a more generous limitation period by reason of section 14A of the Limitation Act 1980 (see below).21

Post-contractual representations

164. In order to have a full picture of the type of representations customarily made by the Society concerning its with-profits policies, we need to examine the post-contractual documentation produced by the Society and circulated to its existing policyholders. We do, however, stress that on any conventional analysis, such documents are irrelevant to the construction of the non-GAR policies, or to the existence of any implied or collateral warranties, or to the existence of any actionable misrepresentations.

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21 As the Key Features documents only appeared from about the start of 1995, this may be of benefit to relatively few policyholders.
165. Once policyholders had taken out their policies, they would have received further documentation explaining the bonus policy of the Society. This documentation included the bonus notices and covering letters produced annually by the Society, together with, if requested, its With-Profits Guide.22

166. The most detailed exposition of Equitable Life’s approach to with-profits bonuses was contained in the bonus notice letters for 1989 and 1990. In the letter of February 1989, after setting out the Society’s approach to the pricing of non with-profits policies, the letter continued:-

“It follows from the above comments that the benefits under our with-profits policies depend primarily on the successful investment of the premiums under these policies and only marginally on profit arising from other policies. Further we aim to ensure that the total proceeds members receive reflect the investment returns on the fund during the course of the policy. However, the essential nature of with-profits business, namely the steady addition of declared and, therefore, guaranteed bonuses, means that there is no automatic link between asset values and policy benefits. In simple terms there is a smoothing of asset values over time and of the peaks and troughs through the bonus system. So the with-profits system provides a level of security between the fully-guaranteed policy, which is independent of investment performance, and the unit-linked policy which is dependent on the levels of the market in the sector or sectors in which the unit is invested.

Although the with-profits system contains within it an essential element of smoothing, nevertheless the Society's practice is to limit that to evening out peaks and troughs and unduly sharp changes from year to year. Specifically we do not set out to build up excessive “free reserves” which some describe as “strength”. This could only be done by deliberately, or worse still, accidentally, withholding part of the return due to members for the benefit of their successors. What is important is that there should be

22 As we have indicated, we simply do not know whether any of these documents might have been given or shown to prospective policyholders on a voluntary basis by the Society’s sales force prior to sale of a policy.
sufficient strength to avoid any unplanned constraints on investment freedom or growth in business, whilst still giving a “full value” return to existing members.”

167. The equivalent letter accompanying the bonus declaration for 1990 stated that in addition to the diversity of investments made by the with-profits fund,

“There is, however, a further and unique sense in which with-profits business spreads the investment risk. The with-profits system provides, uniquely, processes for spreading investment results over time and smoothing out short-term fluctuations in investment experience. This is important because many clients have only limited or no scope to vary the time at which the policy benefits are taken.

The major part of the returns for with-profits policies arises from the investment of the contributions paid. 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 earnings available, above the level needed to cover the build-up of the basic guaranteed policy benefits, are passed on by way of bonuses of various types.

An important feature of our philosophy is that we aim to pay out by way of bonuses the averaged returns actually achieved. The Board does not hold back on benefits to policyholders to achieve so-called strength beyond that which is prudent and necessary as part of the smoothing process.

Bonus additions

The Society’s with-profits contracts contain a basic guaranteed level of benefits, expressed as, for example, a guaranteed amount of fund. A certain level of investment return is needed to cover the build-up of these guaranteed benefits. The return in excess of that basic level is available for distribution as bonuses.
The form in which the bonuses are added to policies is consistent with the blend of security and profitable investment described above. Part of that excess is translated each year into a “declared bonus”. Such bonuses are additional, fully guaranteed, benefits and are added to all previously guaranteed benefits. In this way, the annual addition of declared bonuses provides an increasing underlying value below which the ultimate benefits cannot fall. The accumulated amount of the basic guaranteed benefits and declared bonuses represents the consolidated value of the policy benefits.

The balance of the overall return is carried forward unconsolidated but is credited immediately as final bonus when benefits become payable under the terms of the policy. The retention of part of the accumulated total policy value in consolidated form is a vital ingredient in the operation of with-profits business. In that way the Society retains the flexibility to manage its investments in a way compatible with achieving the best results it can for the with-profits policyholders.”

168. More recent bonus notice letters contained a shorter statement of the Society’s bonus policy, along the following lines,

“With-profits contracts provide the opportunity for investing in a managed fund of assets including equities, property and fixed-interest stock, together with the unique feature of smoothing out the fluctuations in the investment returns which are associated with such assets.

Under the with-profits approach, the Society determines an appropriate smoothed overall rate of return for the calendar year, taking into account the actual investment experience of the current and recent past years. That smoothed return is distributed in the following three ways:

1. By accumulating, at the minimum rate of interest guaranteed either explicitly or implicitly in the policy, both the part of the benefits which was guaranteed at the beginning of the year and the amounts of
further contributions after deducting the expense charge. This increases the benefits guaranteed under the policy.

2. By annual declared bonus additions which, once added, further increase the guaranteed benefits under the policy.

3. By passing on the balance of the overall rate of return for the year through final bonus, which does not add to the guarantees under the contract. The amount of final bonus is illustrated on the statement and, on request, from time to time, but the amount is only finally determined when a claim becomes contractually payable.”

169. The With-Profits Guides were not required to be provided to policyholders prior to or after contract, but were available on request. The lengthy sections in the Guides on “Factors influencing bonus rates” and “Recent bonus policy” contain many statements which mirror those set out above. The Guides contained the following significant passages.

“Factors influencing bonus rates

The Society’s approach means that each policyholder’s benefits should reflect the earnings on the assets during his or her membership of the fund, whilst avoiding short-term fluctuations in those earnings...

All of the Society’s contracts contain a charge which is the required contribution from that contract to the management expenses of the Society...

The with-profits policyholders effectively stand in the position of proprietors and stand the losses on expense provision. Therefore it is important that the expense position is carefully monitored and controlled...

With-profits policyholders similarly stand in the position of proprietors in respect of the Society’s guaranteed and unit-linked business. Operating
profits and surplus and losses are a charge on surplus....

Recent Bonus Policy

The Society’s bonus system aims to pass on, subject to some smoothing and averaging, the full investment return on the fund, together with any other profits (or losses) made in the running of the business. The intention is that earnings should not be held back from current policyholders to benefit future policyholders...

In 1989 and subsequent years, the Society has attempted to make clearer the link between the investment return earned, the bonus allocated and the smoothing process. In the light of the overall return on the fund, taking income and capital growth together, and an assessment of longer-term financial conditions, specific rates of growth are regarded as available for allocation to policies. Those rates are applied to meet any taxation (for relevant contracts only) and any underlying guaranteed interest rate, the balance being available for bonus addition. Part of that balance is applied to provide declared reversionary bonuses, with the rest remaining unallocated but payable as final bonuses on policies becoming claims under the contractual terms of the contract. The difference between the return achieved and the returns passed on arises as a result on the smoothing and averaging processes referred to earlier, and which is an established feature of the with-profits business.”

170. It is suggested by Mr. Warren QC and Mr. Lowe that the more detailed statements about the Society’s “With-Profits Approach” to the determination of bonuses, which are to be found in its post-contractual documents such as its With-Profits Guides and its Bonus Declarations, might have passed into general circulation via the market or financial press, or might constitute evidence of what the Society’s representatives may have told prospective policyholders.

171. Absent specific evidence that such a document was shown to a prospective policyholder or that the Society’s representative made an oral presentation to
similar effect, we do not, however, believe that the possibility of such diffusion of the Society’s approach could form a proper foundation for an actionable misstatement by the Society or could form the basis for implication of contractual terms or a collateral warranty, all of which require precise identification of the statement in question. Nor would it be possible to permit the limited meaning of the pre-contractual representations to be coloured by the possibility that more extensive statements in the post-contractual documents had been generally disseminated.

172. In short, whilst we do not rule out the possibility of actionable misstatements or promises having been made in individual cases, there is no basis for an arguable case that the Society is liable in this way on a systemic basis founded upon its post-contractual documents.

Implied terms, warranties and collateral contracts

173. Although we consider that non-GAR policyholders may have claims based upon an implied representation in its Key Features documents that there was no material risk known to the Society which it had not disclosed, we do not believe that it follows, necessarily or at all, that a non-GAR policyholder would be able to elevate such an implied representation into a contractual obligation.23

174. It is simply not the case that non-disclosure in breach of a duty to disclose, whether statutory or at common law, is automatically also to be taken to amount to an implied contractual promise or warranty that there are no further facts to disclose. That is illustrated by the fact that non-disclosure in the case of a contract uberrimae fidei does not give rise to a claim for damages for breach of an implied

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23 Nor do we think it would constitute an agreement as to what the policy, once issued, should contain, enabling a policyholder to have the policy rectified to accord with that agreement, as in Sun Life Assurance Company of Canada v. Jervis [1943] 2 All ER 425 (CA). We should add that we would take the same approach to all of the implied representations which Mr. Warren QC and Mr. Lowe suggest were made in the pre-contractual documents in the event that we were wrong in our view that such implied representations cannot be derived from the documents.
term of the contract: see e.g. *Banque Keyser v. Skandia* [1990] 1 QB 665 (CA), affirmed on other grounds [1991] 2 AC 249.

175. It is possible to construct an argument to the effect that the implied representation to which we have referred became a contractual warranty. In our opinion, however, such an argument would fail.\(^{24}\) If the implied representation is a warranty then so, by parity of reasoning, are all the express ones. Thus all the representations in the Key Features metamorphose into warranties. But all are clearly information about the policy, not part of it. And in our view the parties did not intend these statements to be contractual promises given by the Society to the policyholder.

176. So far as a collateral contract is concerned, the critical point is whether, viewed objectively, the representation in question was intended by both parties to have contractual force. Self-evidently this test will be more difficult to satisfy in the case of a representation which is only made by implication rather than where the statement is made expressly. It will also be more difficult to find a contractual intention where the representation is essentially negative in character. And whilst it is certainly not impossible, a court will be less likely to find that both parties had the intention to create a collateral contract where they are intending to sell and purchase a well-defined contractual product such as a pension policy in standard written form.

177. In the instant case, the suggested contractual obligation would have the effect of an endorsement on the non-GAR policy that it was free of any material risk known to the insurer and not previously disclosed to the policyholder. We simply do not believe that the Society’s pre-contractual documents could have been intended by both parties to have this effect.

\(^{24}\) So also would an argument that the implied representations had become implied terms of the non-GAR policy. Not only would the test of contractual intention not be satisfied, but neither would the strict test of necessity for implication of terms into contracts: see e.g. the speech of Lord Steyn in the *Hyman* case.
Estoppel by convention

178. We have thus far been considering the effect upon the non-GAR policies of the pre-contractual statements made by Equitable Life to its prospective policyholders. In the absence of specific evidence to the contrary, we have rejected the suggestion that the Society’s post-contractual documents had become sufficiently known to prospective policyholders so as to supplement the pre-contractual statements made to them.

179. There is, however, an equitable doctrine under which if contracting parties have proceeded after contract to conduct the dealings between them upon a common assumption as to the meaning of their contract, an estoppel (traditionally called an estoppel by convention) might operate so as to prevent either party from asserting as against the other that the contract had a different meaning if it would be unjust or unconscionable for him to do so: see e.g. Amalgamated Investment and Property Co v. Texas Commerce International Bank [1982] QB 84 and Johnson v. Gore Wood [2001] 2 WLR 72.

180. In their second opinion, Mr. Warren QC and Mr. Lowe suggest that this doctrine might provide a further means by which a non-GAR policyholder could allege that Equitable Life is contractually obliged to ensure that non-GAR policyholders receive, by way of bonuses, amounts which reflected a smoothed return on their premiums invested, less only the costs of the Society and any losses incurred in the business. Critically, this supposed entitlement of the non-GAR policyholders would not allow for any reserve to be made by the Society for the costs of honouring the GAOs in its GAR policies.

181. The basis for this estoppel is said to be a common assumption on the part of the Society and the non-GAR policyholders that there was nothing like the GAOs, no special feature, which would diminish the level of bonus of the non-GAR policyholders or which would prevent the Society from delivering to them their asset-share. It is argued that this shared assumption, coupled with the
dealing which had taken place between the Society and the non-GAR policyholders on that basis, means that the Society is unable to deny that non-GAR policyholders are contractually entitled to bonuses ascertained on the basis that there are in fact no such special features.

182. We do not agree that there was any such shared understanding between the Society and the non-GAR policyholders. The Society was well aware of the existence of the GAOs and seems to have been aware of their potential, if not counteracted, to have a significant effect upon the availability of profits. It was also well aware of the terms of the non-GAR policies. It certainly did not believe that the non-GAR policies entitled their holders to bonuses on the basis that the GAOs in the GAR policies did not exist. The understanding of Equitable Life was based upon an entirely different premise, namely that it could counteract the special feature in the GAR policies by using the discretion under Article 65 to reduce the final bonuses which would otherwise be payable to policyholders who elected to take their benefits in GAR form and that at very least it could ring-fence the GAR liabilities using Article 65. In short the Society’s understanding was as to the manner in which its board could exercise its discretion under Article 65, and not as to the absence of any “special features” or as to the meaning of the non-GAR policies.

183. Of itself this conclusion negates any suggestion of a common understanding between the Society and the non-GAR policyholders so as to found the basis for any estoppel by convention. However, we believe that when properly analysed, the understanding which non-GAR policyholders themselves could reasonably have derived from the Society’s documentation also related to the manner of exercise of the Board’s discretion in relation to the declaration of bonuses and did not relate to the meaning of the non-GAR policies or to the absence of any special features affecting bonus rates.

184. All of the Society’s post-contractual literature such as the With-Profits Guides and the bonus notices to which we have referred above represented,
expressly or implicitly, that the Society’s “With-Profits Approach” or “with-Profits Policy” was,

“to pass on, subject to some smoothing and averaging, the full investment return on the fund, together with any other profits (or losses) made in the running of the business.”

It should be recalled that these statements were made to GAR policyholders and non-GAR policyholders alike. In context, and having regard to the use of words such as “Approach” and “Policy”, and the undefined references to “smoothing” and “averaging”, these statements were plainly only a statement of the Society’s aims and the policy which it currently followed in the exercise of the Article 65 discretion to declare bonuses.

185. In short, we do not see how such statements by Equitable Life as to how its Board intended to exercise its discretion under Article 65, could form the basis of any common understanding as to the meaning of the Society’s policies. Indeed, if it did, it would arguably have been a common understanding which applied to the GAR and the non-GAR policies alike. In truth, the common understanding was as to the with-profits approach of the Society, and no more. This common understanding could not give rise to an estoppel permanently precluding the Society either adjusting its bonus policy so as to give full effect to the GAR policies or from consequentially paying the non-GAR policyholders smaller bonuses than would otherwise be the case.

*Negligent advice*

186. Prior to the introduction of the Rules, if an insurance salesman took it upon himself to give an explanation of the nature of his product, he might, depending upon the circumstances, fall under a common law duty to take reasonable care to ensure that his explanation was complete and accurate: see *Rust v. Abbey Life* [1978] 2 Lloyd’s Rep. 386. In the ordinary case, however, the salesman
promoting his product would not be regarded as giving advice to the potential buyer as to whether he should enter into the transaction at all, or advice as to whether the buyer should enter into that, or some other transaction. In the words of the judge in Rust, within the limits of his duty to take care about what he said concerning his explanation of the product, the salesman was entitled to recommend what he was offering: see [1978] 2 Lloyd’s Rep. 386 at 391. Moreover, whilst he had not to make any misrepresentations, the salesman was under no general duty of care to advise the potential buyer, for example, that he already owned a better product, or that there was a better product to be had from an alternative supplier.

187. The Rules changed this common law position. As we have indicated above, firms are now required to produce accurate and complete product information, and their representatives are obliged to provide such information to prospective investors prior to the time of sale.

188. It is still the case, however, that a company representative has no duty under the Rules to advise an investor that there is a better product to be had from another firm. Indeed, the Rules positively prohibit company representatives from giving any advice as to the merits of the products of other firms and restrict what they can say by way of adverse comment.  

189. Further, neither the Rules nor the Code of Conduct place any positive duty upon a company representative to give comprehensive advice or recommendations to a potential investor.

190. However the Code of Conduct is expressly made for the purpose of ensuring that member firms and their company representatives generally take

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25 See paragraphs 3(3)(b) and 6(c) of the Code of Conduct in Schedule 2 to the Rules.
26 The affirmative duties of the company representative are listed in paragraph 6 of the Code of Conduct. See also the observations in Gorham v. British Telecommunications plc [2000] 1 WLR 2129 at 2135B and 2143H that the scope of a company representative’s duty under the Code of Conduct is specific and is narrower than the duty owed by an independent financial adviser.
proper account of the interests of investors.\footnote{Paragraph 1(1)(c) of the Code of Conduct.} So, for example, if a company representative \textit{does} give advice to an investor as to the suitability for him of an investment contract, then the representative must have regard to the financial position generally of the investor, including any existing products which he holds. In such circumstances the representative must also use his best endeavours to ensure (a) that he recommends only that contract which is suited to the investor, and (b) that there is no other contract available from his own firm which would secure the investor’s objectives more advantageously.\footnote{See paragraph 8(1) of the Code of Conduct. Paragraph 6(e) of the Code covers the conversion, cancellation, allowing to lapse or realising existing contracts. So, for example, a company representative who recommends that an investor takes a pension policy when the investor already is, or could become, a member of an occupational pension scheme which would give him superior benefits, may well breach the Code. Although not directly in issue, this seems to have been accepted by the defendant firm in \textit{Gorham v. British Telecommunications plc} [2000] 1 WLR 2129.}

191. Whether the company representative has given advice as to the suitability of a product for an investor so as to bring these provisions of the Rules into play will depend upon the individual circumstances of each case, including the nature of the approach made to the investor and what was said and done between the representative and the investor. But as many companies proclaim the expertise of their representatives in financial services matters, it is not difficult to envisage that advice and recommendations are offered in many cases.

192. In the present case, however, even assuming that the Society’s company representative may have given advice as to the suitability of the non-GAR policies for investors, for the reasons which we have already given, he would not have been in breach of paragraph 8(1) of the Code of Conduct. The representative would have used his best endeavours as required by paragraph 8(1), being innocently unaware that the GAR risk needed to be disclosed. It therefore follows that the Society was not itself liable under the Rules, because its representative had not broken the Code of Conduct.
193. By parity of reasoning, even if the company representative had a duty of care at common law, he would not have been personally guilty of any breach of that duty (i.e. negligent) for which the Society could be vicariously liable.

194. But the question arises whether, and if so, to what extent, there was a common law duty upon the Society itself to take reasonable care in giving any advice through its representatives as to the merits or suitability of a non-GAR policy for a prospective investor.

195. We believe that if the Society’s representatives gave advice as to the merits or suitability of a non-GAR policy for an investor, then depending upon the nature of that advice and the circumstances in which it was given, it is arguable that the Society itself may have assumed a duty to take reasonable care to ensure that such advice was accurate. Although the point was not directly in issue, there is support for such an approach in *Gorham v. British Telecommunications plc* [2000] 1 WLR 2129 where the members of the Court of Appeal spoke in terms of a common law duty being owed by the company in question.

196. Whether such a duty was assumed by the Society in any individual case, and if so, the precise scope of the duty, will, as we have indicated above, depend upon the particular facts and circumstances. Such a duty may not have arisen at all if the representative merely explained what the non-GAR policy was, but offered no opinion as to whether it would suit the particular needs or objectives of the investor.

197. We anticipate, however, that in many cases the Society’s representative will have said, at least implicitly, that the non-GAR policy was generally suited to

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29 It may also be arguable that the Society had a duty to take care in providing information to its representatives to enable them to inform and advise prospective policyholders properly. But we think that such a duty would add nothing to the duties under Part V of the Rules and the duty discussed in this paragraph.

30 The point was not a live one because it was admitted on the facts both that the company owed a common law duty of care to the investor and that it had been breached. The only issue was whether, by application of the principle in *White v. Jones* [1995] 2 AC 207, such common law duty of care should be extended to the policyholder’s dependents, who were the beneficiaries under the policy.
the prospective policyholder. Hence the Society, by its representative, may have
assumed a common law duty beyond that of simply giving accurate details of the
product. In particular it may have assumed a duty to take reasonable care to
disclose any potential material disadvantages of the policy for the individual
concerned, or to take such disadvantages into account when giving any advice as
to the suitability of the policy.

198. On the other hand, especially bearing in mind the limitations placed upon
the Society’s representatives under the Rules, the Society by its representative
should not have assumed a duty to give advice as to whether its non-GAR policy
was better than an equivalent policy from a rival company. 31

199. If the Society did give advice as to the suitability of its non-GAR policy for
a prospective policyholder, and that advice was of such a nature to require it to
take reasonable care to disclose or take into account any potential material
disadvantages of the policy for the individual concerned, then for the reasons
which we have already discussed above, we believe that from the time at which
the GAR risk and its potential impact were foreseeably material, it must be
arguable that the Society acted in breach of such duty. Prior to September 1998 it
is arguable that there was a lack of care in failing to obtain legal advice concerning
Article 65, and from that date it is arguable that there was a lack of care in failing
to appreciate the potential consequences of losing the Hyman litigation and of the
new reserving requirements.

200. On any footing, however, we cannot see how any such common law duty
of care would have required the Society to disclose or take into account the
existence of matters of which it neither knew nor ought to have known. Therefore,
for the reasons set out above we do not believe that the Society was in breach of
any such common law duty by failing to disclose or take into account the non-
GAR mis-selling risk of which it neither knew nor ought to have known.

31 This would not include statements which were clearly understood by all concerned to be
simply the representative doing his job to promote (“puff”) the Society’s products.
Conclusion

201. In our view, subject to questions of reliance, causation and limitation, non-GAR policyholders may have arguable claims against the Society under section 2(1), or for negligent misstatement, or for negligent advice as to the suitability of non-GAR policies.

202. We think that non-GAR policyholders have little chance of establishing contractual claims or claims based upon estoppel by convention against the Society.

Limitation

203. The limitation period in respect of claims under section 62 is 6 years from the date when the cause of action accrued. This is also the case in relation to claims under section 2(1) of the Misrepresentation Act 1967.

204. When such causes of action arose depends on when the non-GAR policyholders first sustained measurable, relevant loss: *Nykredit Mortgage Bank v. Edward Erdman Group Limited* [1997] 1 WLR 1627. Where, as we shall assume to be the case here, but for the breach of duty the non-GAR policyholders would not have entered into the relevant transactions, it is necessary to compare their position if they had not entered them with their position under those transactions. When were they first financially worse off than they would otherwise have been? This gives rise to issues of fact. It is likely that the causes of action accrued when the non-GAR policyholders bought their policies, as they were then exposed to a material undisclosed risk which made the policies less valuable than alternative ones they would otherwise have acquired: see *Martin v. Britannia Life Limited*

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32 This is the case whether the position is covered by section 2 of the Limitation Act 1980, which has conventionally been thought to cover claims for breach of statutory duty (see Halsbury’s Laws (4th edition) Vol. 28, paragraph 891), or section 9, which was assumed to be the relevant provision in *Martin v. Britannia Life Limited* [2000] Lloyd’s Rep. PN 412.
[2000] Lloyd’s Rep. PN 412. It may be, however, only later that some measurable financial loss was sustained.33

205. An action for negligent misstatement at common law and an action for negligent advice at common law are actions for damages for negligence. Under section 2 of the Limitation Act 1980 the limitation period in relation to such actions is six years from the date on which the cause of action accrued. However, there is an alternative limitation period under section 14A of that Act if the action is commenced after this six year period. In such a case the limitation period is three years from the earliest date on which the claimant first had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action, subject to a fifteen year long stop from the date of the negligence that caused the damage. The knowledge required is, so far as relevant, knowledge both of the material facts about the damage in respect of which damages are claimed, and that the damage was attributable in whole or in part to the misstatement.

206. The purpose of section 14A of the 1980 Act is to avoid the injustice which arises if a cause of action accrues without the person who is entitled to sue appreciating that the damage which has given rise to the cause of action has occurred: see Oakes v. Hopcroft [2000] Lloyd’s Rep. PN 946. The enquiry under section 14A will be approached in a common sense way, with the aim of determining at what point the claimant had the knowledge with sufficient confidence to embark upon the preliminaries to litigation: see Glaister v. Greenwood [2001] Lloyd’s Rep. PN 412.

207. Applying this test, though the relevant date might, at least in theory, vary according to circumstances from policyholder to policyholder, as a general rule we think that it is unlikely that the three year period under section 14A for claims by non-GAR policyholders will be held to have started any earlier than when the

33 It may also be possible that some individual causes of action accrued later in relation to individual voluntary contributions.
House of Lords delivered its ruling in the Hyman case in June 2000. Until that point, and especially in light of the reassuring comments made by the Society to its policyholders about the litigation while it was progressing, we think that it is well arguable that a reasonable non-GAR policyholder would not know whether or not the GAR risk could be neutralised as the Society claimed and hence would not know whether he had suffered any, or any serious damage.

208. If the causes of action accrued on the acquisition of the policies then, prior to the decision of the Court of Appeal in Brocklesby v. Armitage & Guest [1999] Lloyd’s Rep PN 888, we would have had little hesitation in saying that (except in relation to claims for negligent misstatement and negligent advice) non-GAR policyholders who bought their policies more than 6 years ago were now statute-barred from pursuing their claims.

209. On the basis of the decision in Brocklesby, it now appears, however, that where a defendant intentionally commits an act or omission which amounts to a breach of duty in circumstances in which it is unlikely to be discovered for some time, the claimant can rely on section 32 of the Limitation Act 1980 to postpone the commencement of the period of limitation on the grounds of deliberate concealment. The fact that the defendant did not know it had committed such a breach of duty is immaterial. Here it would be said that the Society intentionally produced the documents or gave the advice to which we have referred above, in breach of duty failed to disclose material risks it was under a duty to disclose, and that failure was unlikely to be discovered for some time.

210. On this basis accrual of the causes of action would have been postponed until Equitable Life’s failure to disclose was discovered after the decision of the House of Lords in Hyman. But this approach may well prove to be wrong. Brocklesby was considered and followed by the Court of Appeal in Cave v. Robinson, Jarvis and Rolf [2001] Lloyd’s Rep PN 290 on the basis that the Court of Appeal was bound by its earlier decision, but both Potter and Jonathan Parker LJJ expressed unease about the decision. Leave to appeal has now been given by
the House of Lords in Cave, and, for the reasons mentioned by the Court of Appeal in that case, in our view Brocklesby will not survive the appeal.

**Remedies under Section 62 and in tort**

211. This and the succeeding section are written on the footing that, subject to questions of reliance and causation, some non-GAR policyholders are able to establish the causes of action under section 62 or in tort which we have discussed above.

212. The normal measure of damages in tort where, as a result of a misrepresentation a claimant enters into a contract, is the difference in value between the price paid and the (lower) value received. That is not likely to be a relevant measure here as, save perhaps in the case of the most recently acquired policies, a non-GAR policy will, we assume, be worth more than the premiums invested plus interest.

213. Such a claimant is, however, entitled to claim as consequential losses what he would have gained by following an alternative course, to the extent that exceeds what he has in fact obtained, provided he can demonstrate he would have followed that course but for the misrepresentation: Esso Petroleum Co. Limited v. Mardon [1976] 1 QB 801. In our view the same principle will apply to a claim under section 62 or in negligence.

214. We do not know whether non-GAR policyholders will be able to demonstrate that if the GAR risk had been disclosed, they would have spurned Equitable Life. But if they can, then given the nature of these transactions, we think a court would readily accept that such policyholders would have sought an alternative with-profits policy from another life office, or a unit-linked policy from the Society itself or from another office. Of course in most cases such a claimant will not be able to say which other contract he would have taken. The court would
doubtless then look to the average return on equivalent policies available at the relevant time from other, comparable, offices.

215. The first step in identifying recoverable loss will then be to make a basic comparison between the value of a claimant’s actual Equitable Life non-GAR policy and the value of this other, equivalent, policy (“the alternative policy”). For the claimant to recover anything, the alternative policy must be worth more than the claimant’s actual policy, and he cannot recover more than the difference in value between the two.\(^{34}\)

216. The claimant may, however, recover less. This is because, for the reasons given by Lord Hoffmann in South Australia Asset Management Corporation v. York Montague Limited [1997] AC 191 (“SAAMCO”), a defendant whose breach of duty causes a claimant to enter into a transaction the latter would not otherwise have entered into, is not always liable for all the consequences that flow from the breach of duty, or even for all the foreseeable consequences of the breach of duty.

217. In the present case this is a matter of potentially great significance, because the difference in value of a claimant’s non-GAR policy with the Society and the alternative policy may be attributable to the impact of any one or more of three factors:

(1) reserving for the costs to the Society of honouring the GAOs;

(2) reserving for, and in due course paying, compensation to other non-GAR policyholders who may also have been mis-sold non-GAR policies; and

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\(^{34}\) We recognise, of course, that in practice it may prove quite difficult to make a comparison between Equitable Life with profits policies and other policies on a like for like basis. Moreover there might also be considerable difficulty in taking account of the fact that, in the case of a pension policy, on the one hand, the hypothetical alternative policy would enjoy all the tax benefits available to such an investment, but a sum of damages would not, and on the other hand, money in a pension policy is subject to significant statutory restrictions on use, whereas money received as damages is not. We should add that, in our view, any windfall gains the claimant would have made by holding a policy from another office on its demutualisation have to be ignored in this exercise as being too remote.
any investment underperformance of the Society’s with-profits fund relative to the other fund upon which the alternative policy is, or is notionally written.

Alone or in combination, these factors could mean that the value of the benefits available under a non-GAR policy, now and into the future, is less than the value of the benefits available under the alternative policy.

218. In *SAAMCO* Lord Hoffmann stated the general principle as follows.

“A plaintiff who sues for breach of a duty imposed by the law (whether in contract or tort or under statute) must do more than prove that the defendant has failed to comply. He must show that the duty was owed to him and that it was a duty in respect of the kind of loss which he has suffered. Both of these requirements are illustrated by *Caparo Industries plc v. Dickman* [1990] 2 AC 605.”

Lord Hoffmann then continued,

“How is the scope of the duty determined? In the case of a statutory duty, the question is answered by deducing the purpose of the duty from the language and context of the statute…In the case of tort, it will similarly depend on the purpose of the rule imposing the duty…”

Lord Hoffmann further observed,

“Rules which make the wrongdoer liable for all the consequences of his wrongful conduct are exceptional and need to be justified by some special policy. Normally the law limits liability to those consequences which are attributable to that which made the act wrongful….

I can illustrate [this] by an example. A mountaineer about to undertake a difficult climb is concerned about the fitness of his knee. He goes to a doctor who negligently makes a superficial examination and pronounces the knee fit. The climber goes on the expedition, which he would not have undertaken if the doctor had told him the true state of his knee. He suffers an injury which is an entirely foreseeable consequence of mountaineering but has nothing to do with his knee…”
On what I have suggested is the more usual principle, the doctor is not liable. The injury has not been caused by the doctor’s bad advice because it would have occurred even if the advice had been correct.…

Your Lordships might, I would suggest, think that there was something wrong with a principle which, in the example which I have given, produced the result that the doctor was liable. What is the reason for this feeling? I think that [such a] principle offends common sense because it makes the doctor responsible for consequences which, though in general terms foreseeable, do not appear to have a sufficient causal connection with the subject matter of the duty. The doctor was asked for information on only one of the considerations which might affect the safety of the mountaineer on the expedition. There seems no reason of policy which requires that the negligence of the doctor should require the transfer to him of all the foreseeable risks of the expedition.”

219. In SAAMCO, the House of Lords held that the valuers were not responsible for all the consequences of the course of conduct that their negligent valuation had set in train, but only for the foreseeable consequences of the valuation which they had supplied being wrong. This approach requires a court to compare the actual position of the claimant with what it would have been had he not entered into the transaction in question and, if the comparison shows he has suffered a loss, then to ask what element of that loss is attributable to the inaccuracy of the information provided: see per Lord Hoffmann at [1997] AC 216E.  


“…a defendant valuer is not liable for all the consequences which flow from the lender entering into the transaction. He is not even liable for all the foreseeable consequences. He is not liable for consequences which would have arisen even if the advice had been correct. He is not liable for these because they are the consequences of risks the lender would have

35 SAAMCO was a claim for the normal measure of damages, not for what is usually described as consequential loss. Though in reality nothing could be more in the nature of consequential loss than the loss occasioned by the fall in the market; and we do not see why the principle should not apply even where the only relevant loss claimed is consequential loss. Nor do we see why it should make a difference that information is being provided by party A in order to induce party B to enter into a contract with him.
taken upon himself if the valuation advice had been sound. As such they are not within the scope of the duty owed to the lender by the valuer.

For what then is the valuer liable? The valuer is liable for the adverse consequences, flowing from entering into the transaction, which are attributable to the deficiency in the valuation.”

221. Lord Hoffmann also drew a distinction in SAAMCO between cases involving the giving of inaccurate information (which resulted in lower damages) and cases involving the giving of general advice as to a course of conduct (which resulted in damages covering all the adverse consequences of the transaction). Whilst this distinction may often assist in identifying the scope of the duty owed, we do not think that Lord Hoffmann was suggesting that it should be the relevant test which the court should apply, nor do we believe that he was intending to suggest that a rigid distinction must in all cases be drawn between the provision of information and the provision of advice.

222. This can be seen from Lord Hoffmann’s example of the mountaineer and the doctor. It is perfectly plain that the doctor in question was providing medical advice as to the fitness of the mountaineer’s knee for the purpose for which the mountaineer was intending to put it. He was not just providing information. Lord Hoffmann’s point was that the doctor was only assuming a responsibility to protect the mountaineer from injury which might be caused to him if he went mountaineering on his weak knee. So the doctor might be liable if the mountaineer aggravated an existing weakness in his knee, or suffered injury as a result of the knee giving way whilst on his expedition. But the doctor was not assuming a responsibility to protect the mountaineer against, for example, the risk of injury in a rockfall.

223. The point can also be illustrated by a reference to the facts of the lead case in SAAMCO itself. It is clear from the decision at first instance, South Australia

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36 See [1997] AC 191 at 214E-G.
that the negligent valuer not only provided an inaccurate figure for the open market value of the property, but also, having been provided with a good deal of information about the proposed transaction, reported to the lender as follows,

“Recommendation

In our opinion based on the stability of the Joint Venture Agreement...We consider this property provides adequate security for making available mortgage finance, although we would expect you to take a first charge over the site...”

It plainly made no difference to Lord Hoffmann’s approach in *SAAMCO* that the valuer in question had provided a report which not only set out his view as to the open market value of the property in question, but added a recommendation as to the suitability of the property as security for the loan which the claimant was intending to make.

224. It is also the case that the result does not appear to depend directly upon the amount of information available to the defendant concerning the plans of the claimant. It is implicit in Lord Hoffmann’s example that the doctor knew that the patient was planning to go mountaineering, and, as is apparent from the judgment at first instance in the lead case in *SAAMCO* itself, the defendant valuer knew a great deal about the proposed transaction. Although the knowledge of the defendant may help to inform the court as to the scope of the duty which he owed, it is not decisive.

225. We believe that in each case, the key issue is to identify the kind of damage against which the statute obliged the defendant to protect the claimant, or from which the defendant undertook to take care to protect the claimant. Damage that

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37 Indeed, in the extracts set out above, Lord Hoffmann refers to the doctor as giving “bad advice”. Moreover, Lord Hoffmann agreed with the speech of Lord Nicholls in *Nykredit* where Lord Nicholls referred to the giving of negligent “valuation advice”.

the claimant would have risked, even if what the defendant had said had been the true position, is not recoverable. This is because such damage is not the kind of damage against which the defendant had a duty, which he has breached, to protect the claimant.

226. We therefore turn to consider the duties imposed by the Rules upon the Society, or arguably undertaken by it at common law, to seek to ascertain the kind of damage against which the Society had to protect its non-GAR policyholders.

227. We deal first with the claims that the Society breached Part V of the Rules relating to the contents of its Product Particulars, Key Features or With-Profits Guides by failing to disclose the GAR risk. The purpose of Part V of the Rules is to protect an investor from deciding to enter into a contract in ignorance of a material risk affecting that contract that is known or ought to be known to the product provider. If the Rules are breached, the investor will enter into the contract in ignorance of the risk and will unwittingly be exposed to it. The Rules are designed to ensure that the investor is not exposed without his knowledge to the losses which might arise from such risk materialising. If the risk does materialise and causes loss, the product provider will be liable for it under section 62. It is the very kind of damage against which he was supposed to protect the investor.

228. Hence in the present case, if, as we believe is arguable, the Society breached Part V of the Rules by failing to disclose the GAR risk, then it will be liable for the losses caused to a non-GAR policyholder resulting from the costs of honouring the GAOs.

229. But as indicated above, the Society had no duty under Part V of the Rules to give general investment advice concerning the likely performance of its with-profits fund as against alternative funds. The risk that the investments in the Society’s fund might not perform as well an alternative fund was one which was obviously inherent in any with-profits policy bought from the Society rather than...
any other provider. Moreover, any investment under-performance of the Society’s with-profits fund would have occurred even if the non-GAR policy had not been exposed to the undisclosed GAR risk.\footnote{We think that any investment underperformance relative to an alternative policy is clearly analogous to the losses caused by the fall in the market in \textit{SAAMCO}.} Hence we do not believe that the Society should be liable under section 62 for any losses resulting from such investment under-performance.

230. Nor in our view, do we think that the Society should be liable under section 62 for losses caused by the mis-selling of non-GAR policies to investors other than the claimant. For the reasons which we have already given, we do not believe that Part V of the Rules imposed upon the Society a duty to disclose risks of which the Society neither knew nor ought to have known. We therefore do not see why the Society should be liable for that part of any loss suffered by a non-GAR policyholder which is attributable to matters other than those against which the Society had a duty to protect the investor.

231. It is true that if there had in fact been no GAR risk there would have been no non-GAR mis-selling either. But that is not enough to make loss caused by the non-GAR mis-selling risk a loss which is attributable to non-disclosure of the GAR risk. The non-GAR mis-selling risk was part of a more general risk that the Society might mis-sell products to other policyholders. A non-GAR policyholder would have taken the risk that the Society might have mis-sold policies in the past, or might mis-sell them in the future, even if there was no GAR risk to him.

232. Mis-selling policies to policyholders B, C and D is not a wrong to policyholder A, even if its effect is to reduce the profits available for distribution to him. Not disclosing such mis-selling to A before he takes his policy is not a wrong to him either, unless the policy provider knows or ought to know of its mis-selling to others. It would therefore be somewhat surprising if the law attributed the loss caused to A by such mis-selling to B, C and D, to the breach of a duty to A to disclose something other than the mis-selling.
233. We believe that the scope of the duty implicit in section 2(1) of the Misrepresentation Act 1967 or at common law for misstatement was also limited in a similar way. The duty was in effect not to assert that all material information had been disclosed when in fact it had not been.\textsuperscript{40} The same analysis applies as in relation to the non-disclosure under the Rules.

234. So far as any liability which the Society might have at common law for negligent advice is concerned, as we have indicated above, we believe that it is arguable that if the Society, through its representative, gave advice to the non-GAR policyholder as to the suitability for him of the non-GAR policy, it owed him a duty of care in so doing.\textsuperscript{41} In the present case, however, any breach of this duty sprang from the Society’s failure to disclose or take into account the very same information that it knew or ought to have known, and should have disclosed pursuant to the Rules, namely the existence of the GAR risk. This is not a case of a person engaged to give comprehensive advice, nor is it a case of negligent advice being given by reason, for example, of carelessly failing to understand the investor’s general financial position. The only reason the advice was wrong, for which the Society could be blamed, is its failure to appreciate that the GAR risk could not be neutralised in the way in which it intended.

235. Any recommendation made by a representative of the Society as to the suitability of a non-GAR policy for an individual investor in these circumstances seems to us to be little different from the recommendation given by the valuer as to the suitability of the security in \textit{SAAMCO}. In both cases the incorrect advice simply reflected the root cause of the problem, which was the careless piece of misinformation. Lord Hoffmann did not think that the additional recommendation as to suitability made by the valuer in \textit{SAAMCO} made him liable for loss not

\textsuperscript{40} The question of the proper measure of damages under section 2(1) is, however, affected by the words of the section itself. This point, and the controversial decision in \textit{Royscot Trust Limited v. Rogerson} [1991] 2 QB 297 are dealt with below.

\textsuperscript{41} We should emphasise that the question of damages for negligent advice can only arise if some sort of recommendation or advice was in fact given, if such advice was inaccurate, and if it induced the policyholder to acquire his policy.
attributable to the misinformation. It seems to us that in the present case the same result should follow.

236. Moreover, it does not seem realistic to suggest that the Society assumed a responsibility at common law to protect the investor from a policy which was unsuited to him by reason, not of a factor which the Society knew or ought to have known, but by reason of a factor which the Society neither knew nor should have known.

237. We nevertheless accept, not least because the approach of the courts in relation to the application of the *SAAMCO* principles is still evolving, that an argument could be made to the opposite effect. It could be argued that the breach of a duty of care in recommending the non-GAR policy as a suitable investment should result in an award of damages both for loss attributable to the existence of the GAR risk and for loss attributable to the non-GAR mis-selling risk. Applying Lord Hoffmann’s and Lord Nicholls’ test, it could be argued that assuming that the information or advice provided to non-GAR policyholders had been correct, there would have been no GAR risk at all. Hence, it would be said, there would have been no mis-selling to other non-GAR policyholders either. In other words, it could be argued that the non-GAR mis-selling risk cannot be severed from the GAR risk and non-GAR policyholders must be compensated for the effects of both.

238. We would, however, find such a result a little surprising, because in substance what the Society was doing was selling its products rather than giving the sort of comprehensive advice which one might expect from, say, an independent financial adviser. Although it can be argued that at common law the Society had a duty of care in relation to giving of advice of a limited nature, it seems to us that the type of loss against which the Society undertook to protect non-GAR policyholders was loss arising from the GAR risk it should have appreciated, rather than loss arising from the non-GAR mis-selling risk of which it was unaware and had no reason to appreciate.
239. The position for claims under section 2(1) of the Misrepresentation Act 1967 may be different, as Lord Hoffmann himself pointed out in *SAAMCO*. Section 2(1) says, in relation to damages:

“…if the person making the representation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently …”

240. This appears to create what McGregor on Damages (16th edition) calls a “fiction of fraud”. In an action for deceit, a court is not concerned with identifying the scope of a duty of care or of a statutory duty; and if Equitable Life had fraudulently induced non-GAR policyholders into taking their policies we could well understand a court treating the loss of the entire additional benefit of an alternative policy as the direct consequence of the fraud, and compensating the claimant for the whole of it. In such a case, the court looks to the loss caused the entire transaction, not just the loss caused by the misrepresentation: see *Smith New Court Securities Limited v. Citibank* [1997] AC 254 per Lord Steyn at 282H-283G.

241. In *Royscot Trust Limited v. Rogerson* [1991] 2 QB 297 the Court of Appeal held that the Misrepresentation Act required fraud damages to be awarded for claims made under section 2(1). McGregor on Damages thinks this is wrong. The learned editor focuses on the question of remoteness of damage, where the rules for fraud and negligence are ordinarily different.

242. We are concerned with the different point of relating the recoverable loss to the scope of the duty breached. In our view, the scope of the duty breached is something that is, or ought to be, just as relevant to a claim under section 2(1) as to a claim for negligent misstatement or a claim under section 62. Awarding

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42 [1997] AC 191 at 215E-216C.
44 See paragraph 2002.
damages on a fraud basis makes it irrelevant to take into account the type of damage from which the representor should have protected the representee. But this seems anomalous in a non-fraud case. Accordingly we also think that the result reached by the Court of Appeal in *Royscot* cannot be supported. The point is open in the House of Lords; and as McGregor notes, in *Smith New Court* Lord Steyn expressly declined to comment on the correctness of *Royscot*. It is in our view plainly arguable, albeit only on final appeal, that damages under section 2(1) should be limited to those attributable to the existence of the GAOs.

243. Whether a policyholder who has left the Society will, in addition to any damages resulting from the non-disclosure of the GAR risk, be able to recover any charges incurred as a consequence of his move to another insurer, will depend on whether the move was carried out to mitigate his loss, and whether, in all the circumstances, he acted reasonably in moving.

244. In this respect, as we understand it, the market value adjuster (“MVA”) which is applied to policy values by the Society when a policyholder leaves, is a reduction that is designed primarily to ensure that the policyholder does not leave the Society with more than his asset share of the Society’s funds at the time at which he leaves. But if he had stayed with the Society, a non-GAR policyholder would have no expectation (still less any right) of obtaining more than his asset share when his policy matured. To that extent, the policyholder who leaves suffers no loss as a result of the application of the MVA which is attributable to any breach of duty by the Society.

245. The only potential difference from the policyholder’s point of view is that by leaving early he only takes his unsmoothed asset share, whereas if he had stayed, he may have benefited, at maturity, from smoothing over the life of his policy. But smoothing might not ultimately have produced a better result for him.

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45 The MVA also reflects dealing costs incurred by the Society being required to liquidate assets and the general level of surrenders from time to time.
It is impossible to predict whether this would be so or to quantify any potential loss in this regard.

246. As such, on the basis of our understanding of the Society’s MVA, we do not think that it would be recoverable as damages by a non-GAR policyholder who had left the Society.

247. Finally, we should also point out the need for care in comparing the damages remedies discussed above with any remedy proposed by the Society under a section 425 compromise scheme. The former would involve payments being made out of the with-profits fund to successful claimants, and would therefore actually deplete the fund and so reduce future distributable profits. A notional reallocation of assets by way of an adjustment to policy values within the fund as part of a section 425 compromise scheme, would not. If, moreover, the scheme had the effect of reducing the costs attributable to the GAOs by extinguishing them for less than it would cost to honour them in the long term, that would in turn reduce the loss sustained by non-GAR policyholders as a result of the existence of the GAOs, and would correspondingly reduce the amount necessary to compensate them for that loss.

Conclusion

248. Subject to the effect of special facts in any individual cases, and subject to the point which we have made in relation to damages under section 2(1), we believe that whichever way the claims of non-GAR policyholders are put, the Society should only be liable to the extent to which the losses of a policyholder are attributable to features of the non-GAR policy which should have been disclosed, but were not disclosed, namely the GAR risk. We believe that the courts would probably not hold the Society liable for all the consequences of a non-GAR policyholder having bought the policy. We recognise, however, that the contrary view is arguable.
Unfair prejudice

249. The scope of section 459 of the Companies Act 1985 has been examined by the House of Lords in O’Neill v. Phillips [1999] 1 WLR 1092. In general, the statutory remedy for unfair prejudice is limited to cases in which a company has acted (or proposes to act) in breach of its articles or of some other agreement with the member in his capacity as such (which includes cases in which the directors have exercised their powers for improper purposes or other than in good faith in the best interests of the company), or where settled equitable principles make it unfair for those conducting the affairs of the company to rely upon their strict legal powers: see also Re Guidezone Limited [2000] 2 BCLC 321.

250. As we have concluded that there is unlikely to be any contractual cause of action in favour of non-GAR policyholders, or any equitable estoppel by convention, we do not believe that a non-GAR policyholder would have any prospect of success in a petition under section 459 if the Society was to continue to abide by the decision in Hyman and to declare bonuses in accordance with Article 65 based upon an appropriate provision having been made for the cost of meeting the GAR obligations.46

251. Mr. Warren QC and Mr. Lowe are also of the opinion that no case for unfair prejudice can be raised by non-GAR policyholders on the basis of events until the date of the decision of the House of Lords in the Hyman case.

252. However, they suggest that since the decision of the House of Lords, the Society may have unfairly prejudiced non-GAR policyholders by permitting GAR policyholders to take the full GAR benefit on retirement and making provision for the costs of the GAOs, so “using Article 65 to honour the commitments to the GAR policyholders but leaving out of account the expectations of the non-GARs”.

46 And, presumably, any section 62 claims which might be made on the basis which we have identified above.
They suggest that “the funds necessary to meet the additional GAR liability should be treated as being in dispute”.

253. Mr. Warren QC and Mr. Lowe’s opinion is, of course, based upon their view that there may exist implied contractual warranties or an estoppel by convention in favour of the non-GAR policyholders, entitling them to insist on the receipt of bonuses reflecting a smoothed return on their premiums invested, less only the expenses of the Society and any losses incurred in the business. Their argument is to the effect that as the non-GAR policyholders can insist that the Society declares bonuses on this basis, any use of the Society’s funds or provisioning on account of the GAR policies is a breach of contract prejudicing the non-GAR policyholders.\(^\text{47}\) Obviously if, as we believe to be the case, there are no such warranties and no such estoppel, there is also no claim under section 459.

254. So far as remedies are concerned, Mr. Warren QC and Mr. Lowe pose the question of whether, under section 461 of the 1985 Act, the court could grant relief on the basis that the Society can “arbitrate” between the GAR and non-GAR policyholders “by an exercise of discretion under Article 65, giving neither side a complete victory but taking advantage of the limitation of liability clause in the Articles” (a reference to Article 4 of the Society’s Articles of Association). We take this to be a suggestion that the court should itself, or by order to the Society, require a variation of the terms of the GAR and non-GAR policies so as to eliminate the inconsistency between them.

255. Quite apart from the very difficult question of whether Article 65 and/or Article 4 could be operated in this way, even if the non-GAR policyholders could establish the implied contractual rights suggested by Mr. Warren QC and Mr. Lowe, we do not think that a court would ever exercise the jurisdiction under

\(^{47}\) If Mr. Warren QC and Mr. Lowe’s hypothesis is followed to its logical conclusion, the non-GAR policyholders were unfairly prejudiced as soon as the Society declared reduced bonuses as a result as a result of setting full reserves for the cost of meeting the GAR promise. The implementation of the rectification scheme in favour of retired GAR policyholders following the House of Lords’ decision was also presumably unfairly prejudicial, as it reduced the amount otherwise available for distribution to non-GAR policyholders.
section 461 in effect to rewrite the policies of all of the members of the Society in this manner.

256. Whilst the court certainly has wide powers under section 461, it would seem axiomatic that any remedy must be fair. It is difficult to see how a remedy which directly prejudices, or takes away the rights of innocent third parties could ever be thought to be fair. It is for this reason that a remedy will generally only be granted by the court against a party who has participated in, or derived some benefit in an illegitimate way from the unfair prejudice of which complaint is made: see e.g. per Lindsay J. in *Supreme Travels Limited v. Little Olympian Each-Ways Limited* [1994] BCC 947 at 957. Whilst orders are frequently made which indirectly affect the interests of persons other than the main respondents, we are aware of no case under section 459 in which the court has made an order directly interfering with or altering the contractual rights of persons who acquired those rights for full value and in good faith and were in no way responsible for, or privy to, the unfairly prejudicial conduct of the company’s affairs of which complaint was made.

257. In the instant case, the GAR policyholders, whose contractual rights were purchased by them earlier than most non-GAR policyholders, plainly cannot be criticised for seeking to enforce those rights against the Society according to the decision in *Hyman*. Still less can they be criticised if the Society chooses to honour its contractual obligations to them. On the hypothesis of Mr. Warren QC and Mr. Lowe, the current problem has arisen because the Society, which is plainly a separate legal entity from the GAR policyholders, made, or is estopped from denying that it made, an inconsistent promise to the non-GAR policyholders.

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48 See, in relation to determining the price for a buy-out order, the comments to this effect of Nourse J. in *Re Bird Precision Bellows Limited* [1984] Ch 419 at 429. In the Court of Appeal in that case, Oliver LJ observed that such orders could only be made on proof of unfair prejudice, and that the court could not simply “undertake a sort of arbitration in vacuo”: see [1986] Ch 658 at 672.

49 Such third parties should at least be given notice of the intention to make such orders, and it is for this reason that all of the shareholders in a small private company should generally be joined to a petition seeking a buy-out of shares which will affect the balance of power in the general body of corporators: see e.g. *Re BSB Holdings Limited* [1993] BCLC 246 at 253.
We cannot see how the GAR policyholders were in any way involved in this process.

258. On this basis, we see no grounds upon which the court would exercise its discretion to make an order under section 461 depriving, or requiring the GAR policyholders to be deprived, of their contractual rights. As there is no other means by which the court could resolve the inconsistency between the GAR policies and the assumed rights of the non-GAR policyholders, we cannot see that any petition by a non-GAR policyholder under section 459 would succeed.

**Summary**

259. Our advice to the FSA has been upon a preliminary basis and we have not made any findings or pre-judgments concerning the Society or anyone connected with it. We have advised primarily on the basis of the documents produced by the Society. Our advice does not cover the consequences of any further representations which may have been made by the Society or its salesmen in individual cases.

260. There is an arguable case that the Product Particulars, Key Features and With-Profits Guide documents produced by the Society breached the Lautro and later the PIA Rules by failing to disclose that some of the existing policies written in the with-profits fund contained terms providing guaranteed annuity options and that there was a risk that if current annuity rates were to fall below the guaranteed annuity rates used in those policies, this could materially affect the bonuses payable under their policy (“the GAR risk”). This would give rise to a claim under section 62 of the Financial Services Act 1986.

261. It is uncertain how early such disclosure should arguably have been made and thus how far back such breaches may go. It is possible that they may go back as far as 1988. There is certainly an arguable case that disclosure should have been made at some point in 1993, which was the year when current annuity rates
first actually fell below the Society’s guaranteed annuity rates, provided that it was then foreseeable that the potential impact of this on bonuses might be material.

262. It is also arguable that the Society’s Key Features document, which first appeared in 1995, implicitly represented that the non-GAR policy on offer was not subject to any material risk factors other than those which were listed. From the time the GAR risk ought to have been disclosed in that document, such implicit representation was untrue, and it is arguable that the Society did not have reasonable grounds for that implied representation. This would give rise to claims under section 2(1) of the Misrepresentation Act 1967 and for negligent misstatement at common law.

263. It is also arguable that from the time at which the GAR risk ought to have been disclosed under the Rules, if the Society, through its representatives, gave advice to a prospective policyholder as to the suitability of the non-GAR policy for him, the Society may have breached a common law duty to take reasonable care to ensure that such advice was accurate. This would give rise to a claim in negligence.

264. To succeed, non-GAR policyholders will have to show that they were induced to take their policies or make voluntary contributions by the Product Particulars or Key Features documents, or by any advice given by the Society’s representative, or by the With-Profits Guides. If they would have taken the policy from the Society or made the further contribution in any event, they will have suffered no loss and have no claim.

265. Causes of action arising from acquisition of a non-GAR policy would probably accrue on taking the policy. Causes of action based upon the making of voluntary contributions to existing policies would accrue when the contribution was made. The basic limitation period for these causes of action is six years from accrual, after which the causes of action are barred by statute. However, common law actions for negligent misstatement or negligence will probably not become
statute barred until three years after the House of Lords delivered its judgment in June 2000.

266. Although this is a difficult and controversial area, and the contrary is arguable, the Society should only be liable for damages to the extent to which it can be shown that the reduction in value of a non-GAR policy in comparison to a similar product from another company is attributable to the undisclosed GAR risk. The Society should not be liable for any other adverse consequences of a non-GAR policyholder having bought his policy from the Society, such as any general under-performance of the Society’s with-profits fund in comparison with other companies, or any diminution in bonuses attributable to the fact that the Society may have incurred mis-selling liabilities to other policyholders.

267. In relation to claims under section 2(1) of the Misrepresentation Act 1967, as the law presently stands, damages for all of the consequences mentioned above would be recoverable. However we believe that the measure of damages under the 1967 Act should be the same as for other negligent misstatements, and that there is a strong chance that the authority to the contrary will in due course be overruled.

268. Although we repeat that we have not considered what may have been said in individual cases, in general non-GAR policyholders are not likely to have contractual claims for breach of warranty, breach of a collateral contract or founded on an estoppel by convention. They are also unlikely to be able to petition the court successfully for unfair prejudice under section 459 of the Companies Act 1985.

Ian Glick QC                    Richard Snowden
1 Essex Court                    Erskine Chambers
Temple                         Lincoln’s Inn
19 September 2001
APPENDIX

EXTRACTS FROM LAUTRO RULES BULLETINS

Product Particulars: Rule 5.10

Rules Bulletin No. 9, dated 28 March 1988, dealt amongst other things with cancellation notices. So far as material it said this.

“Enclosed are two specimen Cancellation Notices for (a) a with-profit low cost endowment assurance and …. These specimens replace the drafts sent out last year and reflect the final Lautro Rules and the SIB consultative document dated March 1988 on the Cancellation Rules.

When reading these specimens, which are intended primarily to give an indication of the detail expected to be disclosed under rule 5.10, please bear in mind the following:

…

The Notices are specimens only and clearly make a large number of assumptions about the form of the two contracts selected and the way they have been sold. It is hoped that Members will appreciate where these assumptions have been made. Apart from (immaterial exceptions) Members are free to adopt their own form of words to describe their own contracts. **Particular care will be needed for with-profits policies in the area of the description of the bonus system.**”

(Emphasis added)

The with-profits specimen referred to, under the heading “Product Particulars” said this.

“…. The policy is with profits which means that it is entitled to receive a share of the profits of the company’s life fund (appropriate to this class of
business) in the form of bonus. The determination of the total profit and the distribution among participating policyholders and shareholders will be decided by the company. At the last bonus declaration 93.2% of the distributed profit in respect of the profit business was paid to the policyholders and 6.8% to shareholders but this split may be changed at future declarations subject to maximum shareholders’ proportion of 9%.

There are currently two types of bonus. A “reversionary” bonus is added over the term of the policy and once added, becomes part of the guaranteed benefits. This type of bonus is not payable at face value until the policy becomes a claim. In addition, a “terminal” bonus may be payable when a policy becomes a claim by death or maturity; the level of this bonus is reviewed every six months to reflect changes in the value of the life fund’s equity and property assets averaged over a two year period. The assets backing this class of business consist of a wide spread of fixed interest stocks, shares (both UK and overseas) and property assets, with property recently representing around 50% of the total. …

The values set out in this notice have been calculated according to rules prescribed by Lautro. The company does not guarantee that the amount to be paid in [sic] the contract is terminated at one of the durations specified will be as high as the amount indicated. The amount actually payable will depend on the bonuses added to the policy and the surrender basis in force at the time. …”

Rules Bulletin No. 11, dated 20 April 1988, enclosed a specimen cancellation notice in respect of a unitised with profit/unit linked appropriate person pension scheme. The covering text noted:

“This specimen should be read in conjunction with the comments made on the two specimens included with Rules Bulletin No. 9.”

The Product Particulars contained in the specimen said, amongst other things, this.
“… Initially £25 of the monthly premium (less the charges detailed below) will be used to credit units in a unitised with profit fund ….

The with profit fund is purely notional and forms part of the main life fund of the Company which means that this part of your policy is entitled to receive a share of the profits of that latter fund (appropriate to this class of business) in the form of bonus. The determination of the total profit and the distribution among participating policyholders and shareholders will be decided by the Company. Under the Articles of Association shareholders are entitled to 10% of the distributed profits arising from the with profit business.

There are currently two types of bonus. An “interest” bonus is added over the term of the policy and is reflected in the price of the units of the with profit fund. The price of units is guaranteed never to decrease. In addition a “terminal” bonus in the form of additional units may be payable on death or on reaching the retirement date. The level of this bonus closely reflects the underlying values of the life fund’s equity and property assets and is reviewed regularly. The assets backing this class of business consists of a widespread of fixed interest stocks, shares (both UK and overseas) and property assets and the proportions held in each of these classes has, in the recent past, varied substantially.”

Key Features

In Rule Bulletin No.66, Lautro gave some guidance as to how the new Rules were to be applied after 1 January 1995. Paragraph 3.26 said this.

“Key Features are meant to provide a short and punchy synopsis of the product which is easy to read and capable of being understood by the investor. As indicated, research has shown that investors are put off by lengthy documents. The content of the Key Features document is set out in Schedule 6 and examples of the type of document which market research shows both appeals to investors and informs them, are set out at Appendices D, E and F which are
inserted with this Bulletin. Lautro expects Members to produce their material in similar style.”

Appendix D set out a specimen Key Features document for a low-cost with profits mortgage endowment. Under the heading “RISK FACTORS”, the illustration said this.

“1. The proceeds will depend on investment performance. The amount you get back may not necessarily cover the mortgage.

2. Your circumstances may change, forcing you to cash in early.

3. Our deductions may turn out to be higher than expected.”

Under the heading “BONUSES” it said this.

“Bonuses calculated on the basis of investment performance are added to your policy each year at the discretion of the Board of Directors of the Life Assurance Company acting on the advice of the appointed actuary. Once a bonus is added, it cannot be taken away. There may be a terminal bonus which is added when your policy matures.”