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IN THE UNITED STATES BANKRUPTCY COURT

STATE OF UTAH

Central Division

In re STEPHEN M. HARMSEN, Debtor.	Bankruptcy No. 03-33637 JAB (Involuntary Chapter 7) **LLOYD'S SUPPLEMENTAL TRIAL BRIEF**

The Society of Lloyd's ("**Lloyd's**"), the sole petitioning creditor in this Involuntary Bankruptcy Case, hereby submits the following Supplemental Trial Brief addressing issues raised in the Debtor's trial brief and additional issues which may arise during the course of the trial.

LLOYD'S CLAIM AGAINST THE DEBTOR IS NOT IN "BONA FIDE" DISPUTE

Mr. Harmsen's contention that he has an unadjudicated offsetting claim of fraud against Lloyd's is baseless. Mr. Harmsen's fraud claim against Lloyd's was adjudicated in the very action in which Lloyd's obtained the Judgment against Mr. Harmsen (the enforcement of which has not been stayed pending Mr. Harmsen's appeal to the Tenth Circuit) that is the subject of Lloyd's claim in this Chapter 11 proceeding.

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In that action Mr. Harmsen asserted his fraud claim as a counterclaim against Lloyd's. *See*, Mr. Harmsen's Objection, Answer, Counterclaim and Cross Claim, a copy of which is attached hereto as Exhibit "A." In its November 12, 2002 Order granting Lloyd's Motion for Summary Judgment ("**Summary Judgment Order**"), a copy of which is attached hereto as Exhibit "B," the District Court (Judge Campbell) also granted Lloyd's Motion to Dismiss Mr. Harmsen's Counterclaim for fraud and negligent misrepresentation. *See*, Summary Judgment Order, pp. 5-6, 18-19.

The Court ruled that Mr. Harmsen's Counterclaim is barred by provisions in the General Undertaking he signed with Lloyd's, requiring him to litigate any disputes he has with Lloyd's in English courts, applying English law. *Id.* In so ruling, the Court relied on a Tenth Circuit decision holding that these provisions are enforceable. *Id.*, citing *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953, 958 (10th Cir. 1992).

The Court also noted that many Names like Mr. Harmsen (*i.e.*, underwriters in the Lloyd's insurance market) brought their fraud claims against Lloyd's in England and that the English courts rejected those claims. *See*, Summary Judgment Order, p. 12 n.5, citing *Society of Lloyd's v. Jaffray*, 2000 WL 1629463 (Q.B. November 2, 2000), *aff'd.*, 2002 WL 1654876 (C.A. July 26, 2002)(A copy of the English appellate court decision in *Jaffray* is attached hereto as Exhibit "C."). It is undisputed that all of the Names, including Mr. Harmsen, were sent notice of an order in *Jaffray*, requiring any Names who wished to assert a fraud claim against Lloyd's to join the *Jaffray* action. *See*, *Jaffray*, Exhibit "C" hereto, ¶¶ 500, 502; *Society of Lloyd's v. Webb*, 156 F. Supp.

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2d 632, 637, 642 (N.D. Tex. 2001), *aff'd sub. nom., Society of Lloyd's v. Turner*, 303 F.3d 325 (5th Cir. 2002). Nevertheless, it is also undisputed that Mr. Harmsen elected not to participate in *Jaffray*.

Thus, Mr. Harmsen's contention that his fraud claims against Lloyd's are unadjudicated is simply false. Moreover, even if those claims had not been adjudicated, they are time barred by the three year statute of limitations in UTAH CODE ANN. § 78-12-26(3). In addition, Mr. Harmsen could not offset his fraud claims against Lloyd's Judgment, because of a "pay now, sue later"provision in a reinsurance contract to which Mr. Harmsen was bound. The English courts enforced this provision against Mr. Harmsen and other Names, and the District Court here ruled that Mr. Harmsen was given a full and fair opportunity to litigate this issue, and all of the other issues (including the fraud issue in *Jaffray*), in the English courts. *See*, Summary Judgment Order, pp. 3-5, 10-13.

DIRECT PAYMENTS OF MR. HARMSEN'S DEBTS BY HIS EMPLOYERS ARE RECOVERABLE UNDER §§ 547 AND 549 AS DISBURSEMENTS OF § 541 PROPERTY BECAUSE THEY DEPLETE THE ESTATE

The evidence at trial will show that Mr. Harmsen controls several businesses, including Steve Regan Co. ("**SRC**") and West American Finance Co. ("**WAFCO**") and that as part of long-standing practice these companies pay most of Mr. Harmsen's monthly expenses directly, with a final accounting and adjustment being made at the end of each year in which Mr. Harmsen elects to accept the payments as income or dividends. Mr. Harmsen testified in his deposition that if he were to die as of the Petition Date, the companies he controls would owe his heirs a considerable

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amount of money for services rendered for the 2003 year up through the Petition Date of August 9, 2003, over and above what he had received by way of a modest monthly stipend and the direct payments to his creditors (in the form of the payment of his credit card bills and other bills). When asked how one might know whether funds paid by his companies on his behalf after the Petition Date were paid in consideration of post-petition services or pre-petition services, Mr. Harmsen testified that one could not know and he did not know how to explain how one might know.

The law seems to be well-settled that if the Debtor controls the disposition of funds and may designate creditors to whom monies will be paid by third parties that those funds are considered property under § 541 and recoverable under § 547. *See, In re Jaggers*, 48 B.R. 33 (W.D. Tex. 1985); *In re Kemp Pacific Fisheries, Inc.*, 16 F.3d 313 (9th Cir. 1994); *In re S.E.L. Maduro, Inc.*, 205 B.R. 987 (Bankr. S.D. Fla. 1997). *See also In re Ogden*, 314 F.3d 1190 (10th Cir. 2002) (funds borrowed by debtor for purposes of paying other creditors recoverable under § 547).

PAYMENT OF MR. HARMSEN'S ALTA CLUB MEMBERSHIP DUES IS INCOME TO MR. HARMSEN, A DISBURSEMENT OF § 541 PROPERTY, AND THEREFORE RECOVERABLE UNDER §§ 547 OR 549

Section 274 of the Internal Revenue Code generally prohibits an employer from deducting club dues paid for the benefit of an employee. In order to qualify for a deduction and thus avoid income to the employee, the employee must keep a detailed record of his expenses at the club showing that the expenses qualify as ordinary and necessary business expenses.

Attached hereto as Exhibit "D" are excerpts from CCH pertaining to the treatment of club expenses such as the Alta Club. The Alta Club payments made by WAFCO must be considered

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as income by Mr. Harmsen in exchange for pre-petition services to that company. Thus the payments WAFCO made to the Alta Club on Mr. Harmsen's behalf are § 541 property recoverable under §§ 547 or 549.

CONCLUSION

Creditors who receive transfers recoverable under § 547 or 549 are not eligible to be counted under § 303(b)(2) of the Bankruptcy Code.

DATED this 9th day of March, 2004.

PRINCE, YEATES & GELDZAHLER
A Professional Corporation

By: _____
Michael N. Zundel, Esq.
Adam S. Affleck, Esq.
Attorneys for The Society of Lloyd's

CERTIFICATE OF SERVICE

I hereby certify that on the 9th day of March, 2004, I served the foregoing by causing a true and correct copy thereof to be hand delivered to the following:

Mona L. Burton, Esq.
Holland & Hart
60 East South Temple, Suite 2000
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_____

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

THE SOCIETY OF LLOYD'S, Plaintiff, vs. WALLACE R. BENNETT, GRANT R. CALDWELL, CALVIN P. GADDIS, DAVID L. GILLETTE, STEPHEN M. HARMSEN, KELLY C. HARMSEN, JAMES R. KRUSE, EDWARD W. MUIR, and KENT B. PETERSEN, Defendants.	Case No. 2:02CV - 0204C
STEPHEN M. HARMSEN and KELLY C. HARMSEN, husband and wife, Counter Claimants, vs. THE SOCIETY OF LLOYD'S, Counter Defendant.	OBJECTION ANSWER, COUNTERCLAIM AND CROSS CLAIM Jury Demanded
STEPHEN M. HARMSEN & KELLY C. HARMSEN, husband and wife, Cross Claimants, vs	

4-2

CALVIN P. GADDIS,

Cross Defendant.

COMES NOW Stephen M. Harmsen and Kelley C. Harmsen, husband and wife, by and through their counsel of record, Steven A. Wuthrich, and in Answer, Counter Claim and Cross-Claim to the Complaint allege and respond as follows:

FIRST DEFENSE

The Complaint fails to state a claim upon which the named relief may be granted.

SECOND DEFENSE

1. All averments of the Complaint not specifically admitted herein are denied.

2. Admit that Lloyds is a corporation with its principle place of business in London, England and deny the remainder of paragraph 1 as written.

3. These Defendants are without information as to paragraphs 2, 3, 5, 8, 9 and 10 and accordingly deny same.

4. Paragraphs 4, 6 and 7 of the Complaint are admitted as to Utah State Residence and denied as to underwriting insurance.

5. Subject matter jurisdiction as to amount in controversy is admitted as plead in paragraph 12 of the Complaint. As to complete diversity of citizenship, jurisdiction is denied inasmuch as it is believed Lloyds or one or its components had a place of business in Utah.

6. In response to paragraph 14 of the Complaint, admit that these Defendants were fraudulently induced to execute and "agency agreement", true copies of which are attached as Exhibits 1 and 2 respectively, and deny the remainder thereof.

7. Deny that paragraph 15 of the Complaint is applicable when the underlying contract was

induced by fraud as defined by the situs of the contract, i.e. Utah law.

8. Paragraph 16 of the Complaint is denied. While Lloyds purported to be profitable in the 1980s and 1990s, in fact, such profit was illusory. In reality, millions of dollars of liability for asbestos claims went "unrecognized" in Lloyds accounting. In other words, Lloyds intentionally placed liabilities "off book" which, if properly accounted, would have shown Lloyds to be essentially bankrupt. This liability (although scientifically recognized) was not disclosed on the books and records of Lloyds inasmuch as Plaintiff, or its syndicate components and assignors, intended to recruit, and did recruit, some 20,000 new "names" from unsuspecting Americans to suffer the asbestos loss rather than the original English name respondents.

9. Paragraph 17 of the Complaint is denied as written. In reality, the scheme to deal with the overwhelming asbestos losses was to solicit new "names" from America, shift them mandatorily into "Equitas", effectively reshuffling the players such that the original names were "let off the hook", partially or in whole. Admit that a settlement offer was made to these Defendants and that they refused same. The effect of the settlement with the other Equitas names was to release these Defendants pursuant to common law.

10. Paragraphs 18 and 19 of the Complaint are denied inasmuch as these Defendants are without information as to the truth of said allegations.

11. Paragraph 21 is denied. Specifically, the English court requires specific intent to prove fraud, applying English rather than American law to the transaction and effectively denying Defendants due process of law.

12. Paragraphs 22, 23, 24 and 25 are denied insofar as the Plaintiff seeks recognition of the English judgment as same are not entitled to comity or recognition under the circumstances

herein plead.

13. Paragraphs 47, 49 and 50 of the Complaint are denied.

14. Paragraphs 52, 54 and 55 of the Complaint are denied.

AFFIRMATIVE DEFENSES

15. Plaintiff is without legal capacity to sue in this state and the present action is barred pursuant to U. C. A. § 16-10a-1502.

16. These Defendants affirmatively plead fraud, the specifics of which are hereinafter set forth.

17. These Defendants plead that the English judgment is not entitled to comity or other recognition for want of both substantive and procedural due process.

18. These Defendants plead release pursuant to common law if this Court determine to apply English law.

19. These Defendants plead lack of personal jurisdiction by the English court over these Defendants such that the judgments should be held void.

20. These Defendants plead set-off and offset.

21. These Defendants plead negligent misrepresentation, the specifics of which are hereinafter set forth.

22. These Defendants plead latches, waiver and estoppel.

23. These Defendants plead frustration of purpose in response to the original contract.

24. These Defendants plead illegality including, but not limited to, the fact that Plaintiff, or its component syndicates, were in actuality soliciting and selling a security in contravention to state and federal securities regulations.

25. These Defendants affirmatively plead failure of accounting. Nowhere did Harmsen Defendants agree to assume the risk of the asbestos industry and the damages claimed bear

no relationship to these Defendants.

26. These Defendants plead breach of the covenant of good faith and fair dealing.

27. These Defendants plead failure to join indispensable parties and failure to sue in the name of the real party in interest. In actual fact, Equitas lacked in personam jurisdiction over these Defendants, and the assignment was made to Plaintiff for collusive purposes.

28. Defendants plead lack of privity.

29. Defendants plead contractual and equitable inconcionability.

30. Defendants plead that their inclusion in Equitas was involuntary, without consent or any reasonable purpose, made under duress or collusion by Plaintiffs and/or their agents.

31. Defendants plead breach of fiduciary duty.

32. Defendants plead negligence.

33. Defendants plead the Plaintiff is barred by the doctrine of unclean hands.

WHEREFORE, Defendants pray the Plaintiff take nothing on its Complaint and the action be dismissed.

JURY DEMAND

Defendants request trial by jury of the maximum number allowed by law.

COUNTERCLAIM

1. Counter-Claimants Stephen M. Harmsen and Kelley C. Harmsen are husband and wife residing, at all relevant times, in the State of Utah.

2. Counter-Defendant, Society of Lloyds is an English corporation which has submitted itself to the jurisdiction of this Court by the filing of the Complaint.

3. Subject matter jurisdiction is proper pursuant to 28 U. S. C. § 1332 inasmuch as the amount in controversy exceeds $75,000.00 and by diversity.

FACTS IN COMMON TO ALL COUNTS

4. Defendants Stephen and Kelley Harmsen were approached by one Calvin P. Gaddis, co-Defendant herein, acting as agent for a syndicate of the Plaintiff. Mr. Gaddis made numerous and sundry representations to the Defendants about the benefits of joining Lloyds including, but not limited to, a representation set forth on Exhibit 3 hereto. Said representations included the fact that Defendants could acquire a profitable interest by joining Lloyds.

5. That the Plaintiff and its agents knew, or should have known, that there would be no profit, but to the contrary, they were attempting to "spread the loss".

6. That these Defendants reasonably relied upon the representations of the Plaintiff, or its agents, to their detriment.

7. That the false representations were made knowingly, or with such reckless disregard for the rights of these Defendants as to impute knowledge, and were intended by the Plaintiffs to be relied upon by these Defendants.

8. That these Defendants in fact so relied.

9. That the representations were made pursuant to a common scheme to defraud.

10. That these Defendants have already incurred damages of approximately $150,000.00, or such greater amount as shall be proven at trial, and are threatened with greater damages as set forth in the Complaint.

11. That the true purpose of soliciting American "names" into Lloyds was to relieve English names from liability for asbestos claims and to transfer such liability to the newly solicited American names.

12. That said action is tantamount to fraudulent conveyance in addition to actual fraud.

COUNT ONE-Fraud in the Inducement

13. All prior averments contained herein are incorporated herein by reference.

14. That Plaintiff knowingly or recklessly made representations to these Defendants, including but not limited to as set forth on Exhibit 3 hereto, which representations the Plaintiffs knew or should have known were false when made.

15. That the Plaintiffs intended the Defendants rely on said representations, and the Defendants in fact relied upon such representations.

16. That the Defendants reliance was reasonable under the circumstances.

17. That the Defendants have incurred damages by virtue of the fraudulent representations including, but not limited to, loss of $150,000.00 heretofore captured by the Plaintiffs, and such further and accruing damages as are prayed for in the Complaint, and damages for attorney's fees and costs thus far incurred and accruing herein, in such amounts as shall be proven at trial in this matter.

COUNT TWO- Negligent Misrepresentation

18. All prior averments are incorporated herein by reference.

19. That the Plaintiffs were negligent in making the false representations to the Defendants herein and Defendants should have and recover their damages as shall be proven at trial hereof.

COUNT THREE-Accounting

20. All prior averments are incorporated herein by reference.

21. These Defendants are entitled to an accounting as against the Plaintiff showing the relationship between the damages claimed, and the monies already seized, and the liability asserted.

22. That these Defendants claim there is no relationship between the losses attempted to be imputed to them and any agreed upon insurance or reinsurance contract with these particular Defendants.

23. That this Court should order a full accounting including, but not limited to, an audit of the books and records of the Plaintiff insofar as any relationship to liabilities of these Defendants is concerned.

24. That all surplus monies improperly taken by the Plaintiffs be ordered returned to these Defendants.

COUNT FOUR-Declaratory Judgment

25. All prior averments are incorporated herein by reference.

26. That these Defendants are entitled to declaratory judgment that the English judgment relied upon by the Plaintiffs is void and unenforceable in the United States of America, and/or its territories.

WHEREFORE, Defendants pray for judgment against the Plaintiff as follows:

1. Ordering and directing an accounting be done as to any relationship between the alleged damages and these Defendants; and

2. Awarding the Defendants $150,000.00 thus far seized, and such other damages as shall be proven at trial, to the Defendants and against the Plaintiff; and

3. Entering a declaratory judgment rendering the English judgment null and void and unenforceable in the United States of America and/or its territories; and

4. Awarding the Defendants their costs and attorney's fees incurred herein; and

5. Such other and further relief as is appropriate.

CROSS CLAIM against Calvin P. Gaddis

1. Cross Claimants Stephen M. Harmsen and Kelley C. Harmsen are husband and wife, residing in the State of Utah.

2. Defendant Calvin Gaddis is a resident of the State of Utah.

3. The amount is controversy on this cross claim exceeds $75,000.00.

4. Jurisdiction is appropriate inasmuch as parties are co-defendants and complete relief cannot be afforded without allowing the cross claim.

5. That the cross-defendant Calvin Gaddis made representations to the cross-claimants that enjoining Lloyds there was a potential for profit. While risk was acknowledged, risk was never explained or defined to be absolute and certain, nor did cross-defendant Calvin Gaddis ever acknowledge to the cross-claimants that there was no possibility whatsoever of incurring a profit, or that by joining Lloyds these cross-claimants would merely be "on the hook" for already known and accruing damages related to the asbestos industry.

6. That cross-defendant is liable to the cross-claimants for all damages they have incurred under theories of fraud, negligent misrepresentation, breach of warranty, breach of promise, promissory estoppel, and breach of the covenant of good faith and fair dealing.

7. That cross-defendant Calvin Gaddis is further liable for violations of Securities Act registration and regulation laws, both federal and state.

8. That Calvin Gaddis is liable under theories of negligence.

9. That the cross-claimants are entitled to have and recover all losses incurred as a result of the conduct of this cross-defendant, including, but not limited to, the $150,000.00 already seized on these cross-claimants lines of credit by the Plaintiff, together with any judgment, costs or attorney's fees this Court may award in the future to the Plaintiff, and such attorney's fees

and costs as cross-claimants have already incurred in defending against these wrongful claims, all of which will be proven in specific amounts at trial.

WHEREFORE, these cross-claimants Harmsens pray for judgment against cross-defendant Gaddis as follows:

1. For a judgment for monies heretofore seized in the sum of $150,000.00, or such greater amount as shall be proven at trial; and

2. For costs, expenses and attorney's fees incurred in defending against the Plaintiff's claims, both in England and in the United States of America; and

3. For an award equal to any judgment granted the Plaintiff in this action; and

4. For such other and further relief as the Court may deem appropriate under the circumstances.

DATED THIS 29th day of April, 2002.

STEVEN A. WUTHRICH

CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the foregoing was mailed on this 29th day of April, 2002 to the following:

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IN THE UNITED STATES COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

THE SOCIETY OF LLOYD'S,

Plaintiff,

vs.

WALLACE R. BENNETT, GRANT R. CALDWELL, CALVIN P. GADDIS, DAVID L. GILLETTE, STEPHEN M. HARMSEN, KELLY C. HARMSEN, JAMES R. KRUSE, EDWARD W. MUIR, and KENT B. PETERSEN,

Defendants.

ORDER

Case No. 2:02-CV-204TC

Plaintiff The Society of Lloyd's ("Lloyd's") filed this lawsuit to enforce money judgments it had obtained against the Defendants in England. Lloyd's has now filed the present Motion for Summary Judgment. For the reasons explained below, Lloyd's Motion for Summary Judgment is hereby GRANTED.

Various parties have also filed a number of motions, all of which are collateral to the Motion for Summary Judgment. The court's decision as to each of these motions is set forth in this Order.

BACKGROUND

I. Factual Background

Through Parliamentary Acts—the *Lloyd's Acts* 1871–1982—the United Kingdom

89

Parliament has created and authorized Lloyd's to regulate the English insurance market. Lloyds promulgates and enforces regulations under the *Lloyd's Acts*, and exercises disciplinary authority over persons in the Lloyd's markets.

In Lloyd's, individual and corporate members known as "Names" underwrite insurance. The U.K. *Insurance Companies Act* permits Names to conduct insurance business only as long as they become and remain subject to Lloyd's regulatory jurisdiction.

As a condition of becoming members of Lloyd's, Names, including the Defendants, entered into agreements governing their membership in Lloyd's and underwriting in the Lloyd's market. Among these agreements and central to the issues in this lawsuit is the General Undertaking. In the General Undertaking, Defendants agreed, in part, (1) that they would comply with the provisions of the *Lloyd's Acts* 1871–1982 and any bylaws or regulations promulgated thereunder in connection with their membership of and underwriting at Lloyd's; and (2) that any dispute arising out of or relating to their membership of and underwriting insurance business at Lloyd's would be resolved in English courts pursuant to English law. Pursuant to the *Lloyd's Acts*, Names could only participate in the Lloyd's market through an underwriting agent, who would contractually assume management responsibilities over Names' underwriting activities.[1]

Names underwrite insurance by forming groups known as "syndicates." Names' liability is several rather than joint. Each of the Defendants incurred liabilities with respect to insurance commitments that he or she undertook by assuming a portion of a syndicate's risk in the Lloyd's market. In order to close the syndicate at the end of each underwriting year of account,

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[1]This underwriting agent is not to be confused with the substituted agent, discussed below, whom Lloyd's appointed to implement its reconstruction and renewal ("R&R") plan.

reinsurance is purchased to cover any outstanding liabilities as well as liabilities that have been incurred but not reported.

Underwriting in the Lloyd's market was historically a profitable venture. In the late 1980s and early 1990s, however, Names in the Lloyd's market incurred substantial losses. As a result of these losses, Names underwriting in those years were unable to purchase affordable reinsurance for their outstanding liabilities, thus facing open-ended liabilities. Many Names defaulted on their underwriting obligations as they came due, putting policyholders at risk of non-payment.

To address these issues, Lloyd's devised the reconstruction and renewal ("R&R") plan. The R&R plan provided reinsurance otherwise unavailable to each Name in respect to his or her pre-1993 underwriting obligations through a newly formed company, Equitas Reinsurance Ltd. ("Equitas"). The R&R plan also provided an offer of settlement (the "Settlement Offer") to each Name with pre-1993 underwriting liabilities to end litigation and assist the Names in meeting their underwriting obligations. According to Lloyd's, the cost of reinsuring each Name's pre-1993 liabilities (the "Equitas Premium") was individually calculated and charged to the particular Name. Names who wished to resign their membership in Lloyd's would be able to do so upon payment of their Equitas Premium and other outstanding obligations. Names who did not accept the Settlement Offer did not receive credits to offset their Equitas premiums. The non-settling Names, however, could continue to litigate with Lloyd's and others who did business in the Lloyd's market. If the Settlement Offer was not accepted, a Name was still required to pay the full amount of his underwriting obligations, including the Equitas Premium.

Lloyd's, in implementing the R&R plan, required each Name to become a party to the Equitas reinsurance contract through an appointed, substituted agent. This substituted agent

signed the contract on behalf of the Name.

The Equitas policy contained two key provisions, both at issue in this case. First, the Equitas reinsurance contract contained a "pay now, sue later" clause that precluded Names from asserting claims they might have had against Lloyd's as a set-off or counterclaim. The Equitas reinsurance contract also contained a "conclusive evidence" clause which provided that, "in the absence of manifest error," Lloyd's determination of a Name's Equitas premium was conclusive.

According to Lloyd's, less than five percent of all Names did not accept the Settlement Offer. A still smaller number, including the Defendants, refused to pay the Equitas Premium. The R&R plan became effective on September 3, 1996, and the Equitas Premium became due and payable on September 30, 1996. Equitas subsequently assigned the right to recover payment of the Equitas premium to Lloyd's.

Beginning in late 1996, Lloyd's brought separate actions in England against the Defendants and other Names who had not paid the Equitas Premium. In the English Actions, Lloyd's sought payment of each of the Defendants' respective Equitas Premiums plus unpaid interest and costs. The English Actions were commenced by filing a Writ of Summons in the English Court against each of the Defendants.

Lloyd's notified each of the Defendants of the commencement of the English Action against him or her by serving each Defendant through his or her agent, duly appointed to accept service, with a writ of summons. Each of the Defendants filed an Acknowledgment of Service of Writ of Summons through their solicitors of record, the firm of Epstein Grower and Michael Freeman. By filing the Acknowledgment, each Defendant appeared in the English Court and notified Lloyd's of his or her intent to contest the claim.

In lengthy hearings, the Names raised several defenses to entry of the judgments by the

English Court. The defenses included the following, all of which were rejected: (1) that Lloyd's lacked the regulatory authority under the *Lloyd's Acts* 1871–1982 to mandate that all Names purchase reinsurance coverage from Equitas; (2) that Names were entitled to rescind their membership of Lloyd's as a result of alleged fraud in the inducement of their membership of, or underwriting at, Lloyd's; (3) that Names were entitled to litigate claims of fraud in the inducement of their membership of, or underwriting at, Lloyd's as a defense or set-off to their obligation to pay the Equitas premium; and (4) that the Names were not bound by certain provisions of the Equitas reinsurance contract, namely the "pay now, sue later" clause and the "conclusive evidence" clause. See Society of Lloyd's v. Dennis Hugh Fitzgerald Leighs and Others, [1997] (Demery Aff., Ex. J); Society of Lloyd's v. Wilkinson & Ors. (Q.B. 1997) (Demery Aff., Ex. J); Society of Lloyd's v. Lyon; v. Leighs; v. Wilkinson, (C.A. 1997) (Demery Aff., Ex. J) (affirming rulings of lower court); Society of Lloyd's v. Fraser & Ors. (C.A. 1998) (Demery Aff., Ex. K).

The English Court entered judgments in favor of Lloyd's against the Names on March 11, 1998. (See Demery Aff. Exs. A–I.) A three judge panel of the United Kingdom Court of Appeal heard argument on the application for leave to appeal by Names from June 15–19, 1998. Leave to appeal was denied on July 31, 1998. See Society of Lloyd's v. Fraser & Ors. (C.A. 1998) (Demery Aff., Ex. K). All appeals from the entry of the judgments have been exhausted.

The Defendants have not satisfied their judgment debts. On March 8, 2002, the Society of Lloyd's filed a Complaint in this court to enforce the English judgments against the Defendants.

II. Pending Motions

The following substantive motions are pending before the court:

(1) Wallace Bennett's motion to declare a particular foreign writ to be subject to Utah substantive law and unenforceable;

(2) Lloyd's motion for summary judgment,

(3) Lloyd's motion to dismiss the counterclaim of Stephen and Kelly Harmsen;

(4) Mr. Bennett's motion for certification of state law questions;

(5) The Caldwell Defendants'[2] motion for certification; and

(6) The Caldwell Defendants' motion for discovery under Federal Rule of Civil Procedure 56(f).

Additionally, the following procedural motions are pending:

(7) Lloyd's motion to strike paragraph 6(g) of motion to declare a foreign writ unenforceable;

(8) Lloyd's motion to strike affidavit of Wallace Bennett;

(9) The Caldwell Defendants' motion to strike declaration of Nicholas Demery;

(10) Lloyd's motion to strike portions of the affidavit of Stephen Harmsen; and

(11) Lloyd's motion to strike exhibits in support of the Caldwell Defendants' combined memorandum in opposition to motion for summary judgment and in support of motion in the alternative for discovery under Rule 56(f).

ANALYSIS

I. Motions for Summary Judgment

The Plaintiff moves for summary judgment. Defendant Wallace R. Bennett moves to declare a particular foreign country writ to be (1) subject to Utah substantive law and (2) unenforceable. Mr. Bennett's motion is, in essence, a motion for summary judgment and the court will treat it as such.

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[2]The "Caldwell Defendants," who are represented by the same counsel, consist of Grant R. Caldwell, Calvin P. Gaddis, David L. Gillette, James R. Kruse, Edward W. Muir, and Kent B. Peterson.

A Legal Standard

Under Federal Rule of Civil Procedure 56, a court may enter summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); see Celotex Corp. v. Catrett, 477 U.S. 317, 322–23 (1986); Adler v. Wal-Mart Stores, Inc., 144 F.3d 664, 670 (10th Cir. 1998). The party moving for summary judgment bears the initial burden of demonstrating that there is an absence of evidence to support the non-moving party's case. Celotex Corp., 477 U.S. at 323; Adler, 144 F.3d at 670 71. A movant "may make its prima facie demonstration simply by pointing out to the court a lack of evidence for the nonmovant on an essential element of the nonmovant's claim." Adler, 144 F.3d at 671. In applying this standard, the court views the factual record and must construe all facts and reasonable inferences therefrom in the light most favorable to the nonmovant. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986); Aramburu v. Boeing Co., 112 F.3d 1398, 1402 (10th Cir. 1997).

Once the moving party has carried its initial burden, Rule 56(e) requires the nonmovant to "go beyond the pleadings and 'set forth specific facts' that would be admissible in evidence in the event of trial from which a rational trier of fact could find for the nonmovant." Adler, 144 F.3d at 671 (quoting Fed. R. Civ. P. 56(e)). The specific and pertinent facts put forth by the nonmovant "must be identified by reference to an affidavit, a deposition transcript or a specific exhibit incorporated therein." Thomas v. Wichita Coca-Cola Bottling Co., 968 F.2d 1022, 1024 (10th Cir. 1992). Mere allegations and references to the pleadings will not suffice. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).

B. Discussion

1. Can the English Judgments be Enforced under Principles of Comity?

> "Comity," in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.

Hilton v. Guyot, 159 U.S. 113, 164 (1895).

The court's jurisdiction is based on diversity of citizenship. Utah law therefore applies concerning whether to enforce foreign judgments. See Smith v. Toronto-Dominion Bank, 166 F.3d 1222 (10th Cir. 1999), available at 1999 WL 38160, at **2 (applying Utah law when determining whether to recognize a Canadian judgment) (unpublished decision).

The Utah legislature, unlike many other states' legislatures, has not adopted the Uniform Foreign Money Judgments Recognition Act (the "Uniform Act"). See Smith, 1999 WL 38160, at **2. In Mori v. Mori, the Utah Supreme Court indicated that in Utah, "[a]bsent a treaty or statute, a foreign country judgment can be enforced only under principles of comity." 931 P.2d 854, 856 (Utah 1997) (citing Hilton, 159 U.S. at 163-64). General principles of comity require a court to recognize a foreign judgment if

> there has been an opportunity for a full and fair trial abroad before a court of competent jurisdiction, conducting the trial upon regular proceedings, after due citation or voluntary appearance of the defendant, and under a system of jurisprudence likely to secure an impartial administration of justice between the citizens of its own country and those of other countries, and there is nothing to show either prejudice in the court, or in the system of laws under which it was sitting, or fraud in procuring the judgment.

Smith, 1999 WL 38160, at **2 (quoting Hilton, 159 U.S. at 202). Determining whether to enforce another country's judgment is a matter of "judicial discretion." Mori, 931 P.2d at 856 (quoting Pan Energy v. Martin, 813 P.2d 1142, 1146 (Utah 1991)).

In an unreported decision, the Tenth Circuit has provided guidance regarding the proper analysis of comity under Utah law. See Smith, 1999 WL 38160, at **2. In Smith, a diversity action in which the Tenth Circuit applied Utah law, the court determined whether Utah courts would recognize a Canadian judgment. Id. at **2. No Utah court had yet "been called upon to recognize a Canadian Judgment." Id. The court, however, found it "reasonable to believe the Utah courts would [] recognize a Canadian judgment if that judgment satisfied the requirements outlined in Hilton and otherwise comported with Canadian law." Id. In making its finding, the court relied upon "the Utah Supreme Court's statements in Mori, as well as the long history of other courts recognizing Canadian judgments under principles of comity." Id.

a. The English system of jurisprudence

In Hilton, the Supreme Court required that a foreign judgment sought to be enforced come from a country with "a system of jurisprudence likely to secure an impartial administration of justice between the citizens of its own country and those of other countries." Hilton, 159 U.S. at 202. As stated by the Ninth Circuit in a decision recognizing an English judgment, "[i]t has long been the law that unless a foreign country's judgments are the result of outrageous departures from our own notions of 'civilized jurisprudence,' comity should not be refused." British Midland Airways Ltd. v. Int'l Travel, Inc., 497 F.2d 869, 871 (9th Cir. 1974) (citing Hilton, 159 U.S. at 205).

There is little argument that the English courts are part of a judicial system that has procedures compatible with American standards of due process and impartial tribunals. See Riley v. Kingsley Underwriting Agencies, Ltd., 969 F.2d 953, 958 (10th Cir. 1992) ("We have been shown nothing to suggest that an English court would not be fair, and in fact, our courts

have long recognized that the courts of England are fair and neutral forums."). As stated by Judge Posner for the Seventh Circuit in an opinion upholding the lower court's decision to enforce judgments against American Names, "[a]ny suggestion that [the English] system of courts 'does not provide impartial requirements of due process of law' borders on the risible." Soc'y of Lloyd's v. Ashenden, 233 F.3d 473, 476 (7th Cir. 2000).

b. Opportunity for a full and fair trial

The Defendants contend that they were not given an opportunity for a full and fair trial. According to the Defendants,[3] they were denied due process in a number of ways. Specifically, they contend that (1) they were unlawfully bound to unlawful contracts because an appointed substitute agent signed the Equitas contracts, (2) they could not assert affirmative defenses in the English proceedings, and (3) they could not engage in discovery or present evidence to challenge the existence or amount of liability. These alleged deficiencies all stem from the "pay now, sue later" and "conclusive evidence" provisions in the Equitas contract and the fact that an appointed agent signed the contract for the Defendants.

As a threshold matter, in cases in which the particular proceedings that are being challenged by the Defendants here were at issue, both the Seventh and Fifth Circuits have found that English courts provided adequate due process. See Ashenden, 233 F.3d at 476–77; Soc'y of Lloyd's v. Turner, 303 F.3d 325, 329–30 (5th Cir. 2002). These courts were deciding cases from jurisdictions which had passed the Uniform Foreign Money-Judgments Recognition Act. The

[3]Although the various Defendants filed separate memoranda and raised a number of independent arguments, the court will treat all Defendants and their arguments collectively, unless otherwise indicated.

courts' analyses, however, apply here, even though Utah has not adopted the Uniform Act.[4] In Ashenden, the court explained that the Uniform Act merely required that a foreign country's due process doctrines must be "compatible" with American doctrines. 233 F.3d at 477. This meant that foreign procedures must be "fundamentally fair" and not offend "basic fairness." Id. (quoting Ingersoll Milling Machine Co. v. Granger, 833 F.2d 680, 687-88 (7th Cir. 1987), and citing Hilton, 159 U.S. at 202-03). The court emphasized that "[h]ow much process is due depends on the circumstances." Ashenden, 233 F.3d at 479. The "pay now, sue later" clause "enable[d] Equitas to be fully funded immediately," which "would work to the benefit of the names by giving them surer, earlier, and fuller reinsurance." Id. The conclusive evidence clause "extinguishe[d]" claims by the Names. Id. at 480. The Seventh Circuit found that these clauses did not constitute procedural due process offenses. See id. at 479-80. The court also found that the English court's holding that Lloyd's could appoint agents to bind the Names without the Names' permission was not impermissibly unreasonable. See id. at 480-81.

In Turner, as in Ashenden, the Defendants raised many of the same arguments raised by the Defendants here, including a claim that the "pay now, sue later" clause and the "conclusive evidence" clause violated due process. See Turner, 303 F.3d at 327-28; see also Soc'y of Lloyd's v. Webb, 156 F. Supp. 2d at 639 (N.D. Tex. 2001), aff'd sub nom. Soc'y of Lloyd's v.

[4] Although not determinative, the court finds Ashenden, 233 F.3d at 482, and Turner, 303 F.3d at 329-30, to be persuasive. Like the Uniform Act, the operative and often cited language in Hilton, the Supreme Court decision cited with approval by the Utah Supreme Court in Mori, 931 P.2d at 856, emphasizes the soundness of a foreign country's "system of jurisprudence" and "system of laws." Compare Smith, 1999 WL 38160, at *2 (quoting Hilton, 159 U.S. at 202), with Ashenden, 233 F.3d at 476 (emphasizing the Illinois Uniform Act's reference to a foreign country's "system" of courts). Additionally, the Seventh and Fifth Circuits in Ashenden, 233 F.3d at 478-80, and Turner, 303 F.3d at 331 n.22, respectively, analyzed the underlying facts and the foreign proceedings sought to be enforced.

Turner, 303 F.3d at 333. The Fifth Circuit rejected their arguments, noting that "[Defendants] Webb and Turner [had] provided no evidence that the English court proceedings [] were unfair." Turner, 303 F.3d at 331 n.22.

It is also important to recognize that the English courts have considered and rejected the Defendants' claims. In Society of Lloyd's v. Wilkinson & Others, at 17, 21 (Q.B. 1997) (Demery Aff., Ex. J), the court considered and rejected the Names' challenge of the "pay now, sue later" clause. This decision left the Names free to pursue claims of fraud against Lloyd's in a separate proceeding.[5] See id. at 21 (stating that the clause could "[i]n no sense . . . be described as excluding or restricting the remedy by way of damages for fraudulent misrepresentation"). In Society of Lloyd's v. Fraser & Others, at 27 (C.A. 1998) (Demery Aff., Ex. K), the court rejected the Names' challenge of the "conclusive evidence" clause. The court found that the provision was "not an unusual type of clause and [was] in principle appropriate to [the] contract." Id. The court also stated that "[n]o issue ha[d] been raised which [was] sufficient to justify going behind the figures produced under [the "conclusive evidence" clause] nor have the Applicants succeeded in making out a case of manifest error in those figures." Id. at 28. Finally, the court in The Society of Lloyd's v. Dennis Hugh Fitzgerald Leighs and Others, [1997], at 5–10, 31 (Demery Aff., Ex. J), considered and rejected the argument that the Names should not be bound by the Equitas contract.

In sum, Defendants were given a full and fair opportunity to litigate their claims in the

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[5]Many Names did bring fraud claims against Lloyd's in a separate action in England. See Society of Lloyd's v. Jaffray, 2000 WL 1629463 (Q.B. Nov. 2, 2000), aff'd, 2002 WL 1654876 (C.A. July 26, 2002). The English courts determined that the Names had not met their burden of proving that Lloyd's alleged misrepresentations were made fraudulently.

English courts.

2. Public Policy Challenge

The Defendants claim that the English Judgments conflict with Utah public policy. Their arguments in support of this claim are basically the same as those supporting their due process claim. According to the Defendants, (1) the English Judgments violated public policy by binding the Utah Names to an unconscionable contract which was signed by an unauthorized agent; (2) the "pay now, sue later" provision in the Equitas contract violated public policy by not allowing the Names to raise affirmative defenses; and (3) the "conclusive evidence" clause violated public policy by preventing the Names from discovering or presenting evidence to refute the existence or amount of liability. In addition, Mr. Bennett contends that enforcing the Equitas contract would violate the anti-waiver provision of the Utah Uniform Securities Act.[6] See Utah Code Ann. § 61-1-22(9) (2000) (stating that "[a] condition, stipulation, or provision binding a person acquiring a security to waive compliance with this chapter or a rule or order hereunder is void").

The district court in Webb rejected arguments similar to the Defendants' here. See Webb, 256 F. Supp. 2d at 643–44. Although its analysis was based on the Texas Uniform Act, the analysis is helpful here. The court distinguished between the cause of action on which the judgment is based and the judgment itself. The court stated that if *the cause of action* on which the judgment is based is repugnant to public policy, a court could refuse to recognize it. See id. at 643; see also Turner, 303 F.3d at 332. But if the judgment itself offends public policy, that fact, in and of itself, is not grounds for a court to refuse to recognize it. Webb, 156 F. Supp. 2d at

[6]The effect of Utah Code Annotated section 61-1-22 in this case is one of the issues Mr. Bennett urges the court to certify to the Utah Supreme Court. (See Mem. Supp. Mot. for Certification of State Law Questions by Def. Wallace Bennett, at 10–12.)

643. Additionally, the court in Webb noted that to refuse to enforce a foreign country judgment on public policy grounds, "[t]he level of contravention would have to be high," such that the foreign law was "inimical to good morals, natural justice, or the general interests of the citizens [sic] of this state." Id. at 644 (quoting Hunt v. BP Exploration Co., 492 F. Supp. 885, 899 (N.D. Tex. 1980), and Gutierrez v. Collins, 583 S.W.2d 312, 322 (Tex. 1979)); see also Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 F.2d 435, 443 (3rd Cir. 1971); Restatement (Third) of Foreign Relations § 482 cmt. f (1987) (stating that "[c]ourts will not recognize or enforce foreign judgments based on claims perceived to be contrary to fundamental notions of decency and justice").

As in Webb, Lloyd's cause of action in this case --for breach of contract -- is not repugnant to Utah public policy. See Webb, 156 F. Supp. 2d at 643-44; see also Turner, 303 F.3d at 332. Additionally, the Defendants' claims of conflicting public policy, which focus primarily on the "pay now, sue later" and "convincing evidence" provisions in the Equitas contract and the appointment of a substitute agent, do not rise to levels that would require the court to not enforce the foreign judgment. See Webb, 156 F. Supp. 2d at 644; Turner, 303 F.3d at 331-32.

Finally, when the Names signed Lloyd's General Undertaking, they agreed that English law, not Utah law, would govern disputes arising between them and Lloyd's. See Webb, 156 F. Supp. 2d at 643 (rejecting public policy arguments because the Fifth Circuit had upheld the choice of law and choice of forum clause). The Tenth Circuit has upheld the choice of law and choice of forum clauses contained in the General Undertaking. See Riley, 969 F.2d at 958; see also Richards v. Lloyd's of London, 135 F.3d 1289, 1294 (9th Cir. 1998) (following the court's

"six sister circuits that have ruled to enforce the choice clauses"). Implicit in the Tenth Circuit's decision in Riley was an understanding that the resulting English Judgments could differ from decisions rendered in American courts. See Riley, 969 F.2d at 958 (stating that "[t]he fact that an international transaction may be subject to laws and remedies different or less favorable than those of the United States is not a valid basis to deny enforcement, provided that the law of the chosen forum is not inherently unfair").

Based on the above, the court concludes that the Defendants' arguments that enforcement of the Lloyd's judgments would violated Utah public policy are not persuasive.

In addition, authority from both the Tenth Circuit and elsewhere also weighs against Mr. Bennett's claim that enforcing the English Judgments would conflict with Utah Code Annotated section 61-1-22. Section 61-1-22 provides that "[a] condition, stipulation, or provision binding a person acquiring a security to waive compliance with this chapter or a rule or order hereunder is void." Utah Code Ann. § 61-1-22(9). To date, no reported decision appears to have discussed the scope of this anti-waiver provision. It follows that no decision has discussed whether Lloyd's General Undertaking, which calls for the application of English law, and the Lloyd's Act of 1982, which immunizes Lloyd's from many American securities laws, violate the public policy expressed in section 61-1-22. See Richards, 135 F.3d at 1296 (discussing the Lloyd's Act of 1982). There is no reason to believe, however, that Utah law would deal with this question any differently than the Ninth and Tenth Circuits have in recent years. See id.; Riley, 969 F.2d at 959.

In Richards, the Ninth Circuit determined that Lloyd's choice of law and choice of forum clauses did not "contravene a strong public policy embodied in federal and state securities laws."

135 F.3d at 1294- 95. In that case, the Names relied upon Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 634 (1985), to "argue that federal and state securities laws are of 'fundamental importance to American democratic capitalism.'" Richards, 135 F.3d at 1295. Relying on what the Ninth Circuit referred to as "dictum in a footnote regarding antitrust law," id., the Names "claim[ed] that enforcement of the choice clauses [would] deprive them of important remedies provided by our securities laws." Id. The court, however, emphasized that the Supreme Court had recognized "that parties to an international securities transaction may choose law other than that of the United States, . . . yet [had] never suggested that this affected the validity of a forum selection clause." Id. (discussing Scherk v. Alberto-Culver Co., 417 U.S. 506, 508 (1974)).

The court in Richards recognized that "the Lloyd's Act immunizes Lloyd's from many actions possible under our securities laws." 135 F.3d at 1296. It explained, however, that "Lloyd's is not immune from the consequences of actions committed in bad faith, including fraud." Id.; see also Riley, 969 F.2d at 958 (stating that "English law does not preclude Riley from pursuing an action for fraud and we agree with the Defendants that the Lloyd's Act does not grant statutory immunity for such claims"). In part because such remedies were available, the court held that the anti-waiver provisions in the Securities Act of 1933 and the Securities Exchange Act of 1934 did not void the choice clauses in Lloyd's transaction with the Names. See Richards, 135 F.3d at 1296; see also Riley, 969 F.2d at 957 (giving effect to Lloyd's choice provisions and rejecting argument that the defendant was "being deprived of all substantive rights under the federal securities laws").

Mr. Bennett points outs that one California appellate court decision has declined to

dismiss a claim against Lloyd's on the basis of the choice of forum and law clauses. (See Mem. Supp. Mot. to Declare Particular Foreign-Country Writ Unenforceable at 9); West v. Lloyd's, No. B095440, 1997 WL 1114662, at *8 9 (Cal. Ct. App. Oct 23, 1997) (unpublished opinion). The court in West voided Lloyd's choice clauses because the clauses "violat[ed] California's fundamental public policy against waivers of the protections afforded by its securities laws." See 1997 WL 1114662, at *1. This case, however, is not good law. The California appellate court in West relied on the Ninth Circuit's first opinion in Richards v. Lloyd's, 107 F.3d 1422 (9th Cir. 1997). See West, 1997 WL 1114662, at *6 n.8, *8 n.11. The first Richards decision was subsequently withdrawn by the Ninth Circuit sitting *en banc* in Richards v. Lloyd's, 135 F.3d at 1291.

As Lloyd's explains, in Richards, the plaintiffs specifically referenced state securities laws --including Utah's-- in Appendix D to their Amended Complaint, and argued that these laws constituted a public policy against the choice of law and forum clauses. See Richards, 135 F.3d at 1295--96 (discussing the effect of federal and state securities laws on Lloyd's choice clauses). In this case, Mr. Bennett makes the same public policy argument that both the Ninth and Tenth Circuits rejected in Richards and Riley, respectively. See Richards, 135 F.3d at 1295--96; Riley, 969 F.2d at 957- 58. The only apparent difference is that the provision Mr. Bennett relies upon, Utah Code Annotated section 61-1-22, has not been singled out and specifically discussed in either decision. Given the fact that the Richards and Riley decisions dealt with the same underlying transactions at issue here, Mr Bennett's public policy argument should not defeat Lloyd's motion for summary judgment.

Based on the above, the court concludes that all the requirements set forth by the Court in

Hilton have been met and the Lloyd's judgments are entitled to recognition. Accordingly, Lloyd's Motion for Summary Judgment is GRANTED.

II. Related Matters

A. Lloyd's Motion to Dismiss the Harmsens' Counterclaim

The Harmsens' counterclaim alleges fraud in the inducement and negligent misrepresentation by Lloyd's. The Harmsens seek an accounting and a declaratory judgment. These claims concern the underlying transaction involving Lloyd's. Lloyd's argues that the forum selection and choice of law provisions signed by the Harmsens preclude litigation of their counterclaim in this court.

In opposition to Lloyd's motion to dismiss, the Harmsens make the following arguments: (1) the choice clauses should not apply here because Lloyd's availed itself in a United States court to enforce an English judgment; (2) Lloyd's is exempt from fraud claims in England, making any opportunity to bring such a claim in English courts illusory; and (3) the counterclaim is required as a mandatory counterclaim under Utah Rule of Civil Procedure 13(a). But the Harmsens provide no law in support of their arguments.

As discussed in detail above, the agreements between Lloyd's and each of the Defendants, including the Harmsens, contain forum selection and choice of law clauses that obligate the Defendants to litigate any claims they may have against Lloyd's in the courts of England under English law. Section 2.2 of the General Undertakings signed by Mr. and Mrs. Harmsen, respectively, states in part that the parties agreed "that the courts of England shall have exclusive jurisdiction to settle any dispute and/or controversy of whatsoever nature arising out of or relating to the Member's membership of, and/or underwriting of insurance business at,

Lloyd's." (See Demery Aff. Ex. E, Ex. F.) The Tenth Circuit in Riley found these provisions to be valid. See 969 F.2d at 958. In addition, at least seven other circuits have held these same clauses to be valid. See Lipcon v. Underwriters at Lloyd's, London, 148 F.3d 1285 (11th Cir. 1998); Richards, 135 F.3d at 1294; Haynsorth v. The Corporation, a/k/a Lloyd's of London, 121 F.3d 956 (5th Cir. 1997); Allen v. Lloyd's of London, 94 F.3d 923 (4th Cir. 1996); Shell v. R.W. Sturge, Ltd., 55 F.3d 1227 (6th Cir. 1995); Bonny v. Society of Lloyd's, 3 F.3d 156 (7th Cir. 1993); Roby v. Corp. of Lloyd's, 996 F.2d 1353 (2d Cir. 1993). Because no reported case law indicates that the court should disregard the choice clauses merely because Lloyd's is a plaintiff in this enforcement action, the court GRANTS Lloyd's motion to dismiss the Harmsens' counterclaim.

B. Motions for Certification of State Law Questions

Mr. Bennett and the Caldwell Defendants move to certify state law questions. Under Utah Rule of Appellate Procedure 41, a United States court, either on a motion or *sua sponte*, may certify certain questions of Utah law to the Utah Supreme Court. Utah R. App. P. 41(b) (2002).

Certification of legal questions to the state court is appropriate only where there is doubt about the application of state law in a federal case. See Houston v. Hill, 482 U.S. 451, 471 (1987). The Tenth Circuit has stated that "[c]ertification is not to be routinely invoked whenever a federal court is presented with an unsettled question of state law." Copier v. Smith & Wesson Corp., 138 F.3d 833, 838 (10th Cir. 1998) (quoting Armijo v. Ex Cam, Inc., 843 F.2d 406, 407 (10th Cir. 1988)). Instead, certification should be invoked only in "exceptional cases" because the federal courts must "decide questions of state law whenever necessary to the rendition of a

judgment." Copier, 138 F.3d at 838 (quoting Meredith v. City of Winter Haven, 320 U.S. 228, 234 (1943)).

The questions that the Defendants seek to certify are as follows:

1. *Does Utah Substantive Law Apply in a Jurisdictional Diversity of Citizenship Case Seeking Enforcement of an English Judgment?*

Mr. Bennett seeks to certify to the Utah Supreme Court the question of what substantive law applies in this enforcement action. As discussed in detail above, the Utah Supreme Court has stated that, absent a treaty or statute, "principles of comity" determine whether foreign country judgments are enforceable in Utah. See Mori, 931 P.2d at 856. Mori favorably cited Hilton, 159 U.S. at 163-64, one of the Supreme Court's seminal comity decisions. Further, the Tenth Circuit, applying Utah law, recently employed principles of comity with respect to the *res judicata* effect of a Canadian judgment. See Smith, 1999 WL 38160, at **2. This decision applied Utah law with respect to whether the foreign judgments should be given effect, id., but noted that "questions regarding the validity of a foreign judgment 'should be tested by the law of the jurisdiction where the judgment was rendered.'" Id. at **2, n.2 (quoting Rocky Mountain Claim Staking v. Frandsen, 884 P.2d 1299, 1300-01 (Utah Ct. App. 1994)). These decisions provide clear answers to Mr. Bennett's proposed question for certification.

2. *Would Enforcement of Lloyd's English Judgments Against the Utah Names Violate Article 1, Section 11 of the Constitution of Utah (the "Open Courts Provision")?*

Defendants contend that the applicability of the Utah Constitution's open courts provision in the context of enforcing a foreign country judgment presents a question of first impression in Utah. They also claim that this question is potentially dispositive in this case and that

certification is therefore necessary. Although Defendants are correct that this issue has not yet been considered by a Utah court, the court believes that certification is not appropriate..

The Utah Constitution's open courts provision is similar to its due process provisions. Article I, section 11 states that

> [a]ll courts shall be open, and every person, for an injury done to him in his person, property or reputation, shall have remedy by due course of law, which shall be administered without denial or unnecessary delay; and no person shall be barred from prosecuting or defending before any tribunal in this State, by himself or counsel, any civil cause to which he is a party.

Utah Const., art. I, § 11. In Brown v. Wightman, the Utah Supreme Court stated that Utah's open court's provision did not create new rights or remedies. 151 P. 366, 366 67 (1915). Instead, this provision "plac[ed] a limitation upon the Legislature to prevent that branch . . . from closing the doors of the courts against any person who has a legal right which is enforceable in accordance with some known remedy." Id. at 366 -67; see also Laney v. Fairview City, No. 981729, 2002 WL 1822152, at *7 8 (Utah Aug. 9, 2002) (discussing Brown, 151 P. at 366 67); Berry v. Beech Aircraft Corp., 717 P.2d 670, 686 (Utah 1985) (declaring that a products liability statute of repose violated Article I, section 11 of the Utah Constitution).

This case does not involve a legislative limitation on the Names' ability to enforce their legal rights. As such, Article I, section 11 of the Utah Constitution is not relevant, much less potentially dispositive, in this case. Cf. Berry, 717 P.2d at 676 (discussing the open courts provision in the context of a legislative limitation on remedies). Additionally, the Defendants have not been barred from defending Lloyd's claims. Under Mori, the Defendants have been able to challenge the enforcement of the English Judgments under common law principles of comity. See Mori, 931 P.2d at 856.

3. *Would Enforcement of Lloyd's English Judgments Violate Article I, Section 7 of the Utah Constitution, Utah's Due Process Clause?*

The court has considered Defendants' due process challenges in this decision. The same analysis applies to the due process clause contained in Article I, Section 7 of the Utah Constitution.

4. *Would Enforcement of Lloyd's English Judgments Violate Article I, Section 27 of the Utah Constitution?*

Mr. Bennett moves to certify the question of whether Article I, section 27, the "fundamental rights" section, precludes enforcement of the English Judgments. Section 27 of Article I of the Utah Constitution states that "[f]requent recurrence to fundamental principles is essential to the security of individual rights and the perpetuity of free government." Utah Const., art. I, § 27.

As Lloyd's explains, its action is an ancillary proceeding to collect a money judgment. Mr. Bennett has not identified any fundamental rights or principles at issue, other than due process. This is not an appropriate basis for certification.

5. *Does Section 61-1-22(9) of the Utah Code Annotated Override the Forum Selection and Choice of Law Provisions in the General Undertaking?*

The court has dealt with this issue above. As discussed, no Utah case appears to have directly discussed whether section 61-1-22(9) of the Utah Code Annotated would void a choice of law or forum selection clause that precludes application of Utah securities laws. However, substantial case law from both the Tenth Circuit and elsewhere provide adequate guidance for the court on this question.

C. Motion for Discovery Under Federal Rule of Civil Procedure 56(f)

The Defendants move the court to grant the Utah Names the opportunity for discovery under Federal Rule of Civil Procedure 56(f). Under Federal Rule of Civil Procedure 56(f), a court may delay ruling on a motion for summary judgment or refuse summary judgment outright "where the non-moving party has not had the opportunity to discover information that is essential to his opposition." Int'l Surplus Lines Ins. Co. v. Wyoming Coal Refining Sys., Inc., 52 F.3d 901, 905 (10th Cir. 1995); see Fed. R. Civ. P. 56(f). The party opposing a motion for summary judgment must provide affidavits indicating why that party cannot "present by affidavit facts essential to justify the party's opposition" to summary judgment. Lewis v. City of Fort Collins, 903 F.2d 752, 758 (10th Cir. 1990) (quoting Fed. R. Civ. P. 56(f)); Int'l Surplus Lins Ins. Co., 52 F.3d at 905.

The Defendants seek three types of discovery. First, the Defendants seek discovery about the basis and amount of the alleged liability on which the English judgments were based. The Defendants "expect to show that the amounts were completely arbitrary and therefore in violation of due process and public policy." Second, the Defendants seek discovery related to Lloyd's appointment of a substitute agent as well as the facts and circumstances surrounding the formation and execution of the Equitas contract. Third, the Utah Names seek discovery concerning Lloyd's contractual intent in entering into the General Undertaking.

The discovery sought by the Defendants goes to the validity of the underlying Equitas contracts and the appointment of a substituted agent to sign those contracts. The discovery sought by the Defendants is not relevant in light of the limited scope of this enforcement action. The Defendants' motion for discovery under Rule 56(f) is DENIED.

D. Motions to Strike

The parties' have filed various motions to strike materials submitted to the court. Those motions are DENIED AS MOOT.

IT IS SO ORDERED.

DATED this 18 day of November, 2002.

BY THE COURT:

TENA CAMPBELL
United States District Judge

tsi

United States District Court
for the
District of Utah
November 15, 2002

* * CERTIFICATE OF SERVICE OF CLERK * *

Re: 2:02-cv-00204

True and correct copies of the attached were either mailed, faxed or e-mailed by the clerk to the following:

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Index to the judgment

Case Nos: A3/2000/3863A; A3/2000/3863B; A3/2001/2013/A; A3/2002/0069; A3/2002/0069B; A3/2002/0069C; A3/2000/3863; A3/2001/0162; A3/2001/0957; A3/2001/1913; A3/2001/2013; A3/2001/0163

Neutral Citation Number: [2002] EWCA Civ 1101

IN THE SUPREME COURT OF JUDICATURE

COURT OF APPEAL (CIVIL DIVISION)

ON APPEAL FROM THE HIGH COURT OF JUSTICE

QUEEN'S BENCH DIVISION COMMERCIAL COURT

(CRESSWELL J)

Royal Courts of Justice

Strand, London, WC2A 2LL

Date: 26 July 2002

Before :

LORD JUSTICE WALLER

LORD JUSTICE ROBERT WALKER

and

LORD JUSTICE CLARKE

Between :

JAFFRAY & ORS	**Appellants**
- and -	
SOCIETY OF LLOYD'S	**Respondent**

Mr Simon Goldblatt QC and **Mr Vincent Nelson QC** (instructed by **More Fisher Brown**) for certain of the appellants

Mr Gordon Nardell and **Mr Giles Richardson** (instructed by **Grower Freeman**) for others of the appellants

Sir William Jaffray Baronet, Mrs Heather Adams, Mr Sydney Butler, Mr Richard Carter, Mr Cary Harrison and **Mrs Ann Strong** appeared in person

Mr Charles Aldous QC, Mr Richard Jacobs QC and **Mr David Foxton** (instructed by **Freshfields**) for the respondent

Mr Colin Edelman QC (instructed by **Barlow, Lyde & Gilbert**) appeared on behalf of Equitas (intervening)

Hearing dates : 11-15, 18-22, 25-27 March 2002

JUDGMENT : APPROVED BY THE COURT FOR HANDING DOWN (SUBJECT TO EDITORIAL CORRECTIONS)

Lord Justice Waller:

I INTRODUCTORY

Overview

1. This is the judgment of the court (to which we have all made a substantial contribution) on an appeal from an order of Cresswell J made in the commercial court on 3 November 2000. The judge decided what has become known as the threshold fraud issue (described below) adversely to the claimant names. He refused permission to appeal but permission on limited grounds was granted by this court on 8 October 2001, with the rest of the application for permission to appeal being adjourned to the appeal hearing.

2. It is easy to understand the depth of feeling of those names who became members of Lloyd's between 1977 and 1987. They joined Lloyd's at a time when there were many syndicates infected with asbestos-related risks which were persistently underestimated. The procedure at Lloyd's was that each year's accounts were, at the end of a three-year period, closed into the next year's accounts. The effect was that the new names inherited losses of massive proportions.

3. Policies written in the fifties and sixties were coming alive again. Claims were being made in the 1970s and for many years thereafter by persons who suffered from cancer and other diseases caused by inhalation of asbestos during the 1940s and 1950s. Those claims were succeeding against producers and producers were claiming on policies written long before the names ever became members of Lloyd's. Lloyd's syndicates were claiming on reinsurances taken out with other Lloyd's syndicates long before the names became members. Courts in the United States were apparently holding producers liable on any basis that gave the claimant the best prospect of succeeding in his or her claim, and were allowing producers to succeed on claims under their policies on any basis that would lead to insurers or reinsurers having to pay.

4. The names say that by the time they joined Lloyd's it was known by those in the market and at the centre of Lloyd's that there were unquantifiable but potentially massive losses in the pipeline for which proper reserves had never been made, and about which the names were not warned. Indeed they say they were given the impression that all was under control and properly reserved for.

5. Many actions have been brought against members' agents and managing agents, and indeed against auditors. Some have succeeded by compromise or at trial, although not always with full recovery. The thrust of the actions has been to allege that the names were exposed to these losses only because of bad underwriting or poor advice and (so far as both the underwriters and the auditors are concerned) through failures relating to the RITC (reinsurance to close). It is said either that the premiums paid on reinsurances to close were totally inadequate in various years or that the reality was that certain years should never have been closed, leaving the names on those years to suffer the losses but not new names.

6. Attempts have also been made to render the Corporation of Lloyd's itself liable. Previous decisions have established first that there is no room for the imposition on Lloyd's of a duty of care by statute or common law, and second that there is no room for the implication of terms in the contract between Lloyd's and names who became external members of Lloyd's. See

Ashmore v Corporation of Lloyd's [1992] 2 Lloyd's Rep. 620; *Ashmore v Corporation of Lloyd's (No 2)* [1992] 1 WLR 446; and *Society of Lloyd's v Clementson and v Mason* [1994] CLC 71; [1995] CLC 117.

7. In this action what is in issue is whether Lloyd's are liable for making fraudulent misrepresentations. It is a fact to which the judge referred that the major part of the Lloyd's litigation has been settled by the R&R Settlement (see paragraphs 280ff below), and this action is brought by a limited number of names that have refused to accept that offer. We stress that no inference should be drawn against the names who have chosen to continue with this action from any refusal to accept that offer, and indeed we do not understand Lloyd's (through Mr Charles Aldous QC) to be suggesting that it should.

8. What is alleged (putting it shortly) is that in brochures issued by Lloyd's and in global accounts ("globals") issued by Lloyd's certain representations were made as to the quality of the Lloyd's regulatory procedures and in particular the audit procedures described in the brochures as "rigorous". It is alleged that the names relied on those representations in making their decisions to join Lloyd's, and in their decisions to remain members and/or increase their underwriting capacity. It is alleged that those representations were untrue. Lloyd's (it is said) did not have the quality of regulatory procedures, and in particular auditing procedures, which it was asserting it had. Furthermore it is said that those making the representations appreciated that fact.

9. The key to the names' case is a letter, "the Neville Russell letter", written on behalf of a number of panel auditors on 24 February 1982. It will be necessary to look at that letter in detail, but for the present it is enough to set out the penultimate paragraph which said:-

"We consider that the impossibility of determining the liability in respect of asbestosis falls into this category [ie requires to be reported to the Committee] and we accordingly ask for your instructions in this respect."

10. The names say that that letter establishes that it was in 1982 "impossible" to close accounts fairly because of the totally unquantifiable impact of asbestosis. The names say that Lloyd's instead of facing up to that fact (a) sent out to underwriting agents (and then it is asserted only to managing agents) another key document ("the Murray Lawrence letter") together with a letter to auditors signed by Mr Randall (then a senior employee of Lloyd's), which in effect encouraged syndicates and auditors to continue to close their accounts although, as they all knew, no RITC could be fairly estimated; and (b) continued with the representations that the audit procedures were rigorous, thus allowing names to remain in ignorance of the fact that (as the names would allege) the audit procedures were not such as to enable any proper check on the assessment of the RITC.

11. The names' case has some potency when put as starkly as we have so far put it. But many names have gone further, and indeed in this case some names go further. They have suggested a dishonest conspiracy amongst those running Lloyd's to keep quiet about the impact of asbestosis so as to enable the numbers at Lloyd's to be increased so as to bring in more names to share the burden – "recruit to dilute". As part of that dishonest conspiracy it has been suggested first that the cynical response to the Neville Russell letter was to produce the Murray Lawrence letter either as a letter for the file or at least as a letter with limited circulation so that the problem remained as far as possible undiscovered. It was said that members of the Committee of Lloyd's looked after their own interests by reinsuring the liabilities of their own syndicates but left others to suffer. It has been alleged that Lloyd's dishonestly fixed the minimum percentages for reserves so as to enable the syndicates to continue to close their accounts, and continue to declare profits. It has been alleged through Mr Bradley that as early as 1974 individuals at the centre of Lloyd's knew the extent to which the asbestosis losses would rise and set about protecting their own syndicates and deliberately inflicted the losses on new names. This dishonest conspiracy was said to have continued over

eleven years, each group of committee men and members of Council in succession carrying on a scheme designed to keep Lloyd's afloat by disguising the extent of the problem from the individual names. The depth of feeling of the names has been such that almost any conduct of those at the centre has been interpreted by them as having an improper motive. Many of the allegations which were chased down at the trial took time and energy, although none succeeded and many have been abandoned on this appeal.

12. On this appeal the grand conspiracy theory is not alleged. Furthermore although Sir William Jaffray in his submissions clung faintly to the point, it cannot be plausibly asserted that Lloyd's dishonestly recommended low minimum percentages as reserves. The allegation of a limited circulation of the Murray Lawrence letter is persisted in, but in reality it is not a key point in the essential case which the names make.

13. We believe that the other points have detracted and do detract from what is essentially a straightforward case, which (as we should say at the outset) cannot be dismissed lightly. There is no question but that by brochures, and to a lesser extent globals issued by Lloyd's throughout the relevant period, the impression was being given to any reader that Lloyd's was an institution that could be relied on with controls and in particular auditing controls which were of a high order. There is furthermore no question but that history demonstrated that many syndicates were throughout the period under-reserved. The syndicates were in fact under-reserved in the 1950s and 60s when workmen were breathing in the asbestos dust. They were also under-reserved through the 1970s and 1980s, as the building up of claims was to demonstrate. Thus it was that new names were on any view taking on claims for which inadequate premiums had been paid to them by their predecessors on the RITCs. Issues arise as to whether the impressions given by the brochures amount to representations, and as to whether those representations were relied on by the names, but the central question seem to us in reality to be – was it at any time appreciated by those at the centre of Lloyd's that syndicates' accounts were being closed when in fact no fair assessment of the RITC premium could be made? If that was appreciated, and yet a false impression was being created so far as names were concerned, it would be the basis for a strong claim of deceit.

14. To understand the names' case and the Lloyd's answer it is necessary now to go into much more detail. The history needs to be spelt out, and the important characters identified. It is also necessary to address in some detail certain factual issues which underlie consideration of the case that representations were made, that they were relied on, that they were untrue, and that they were known to be untrue.

The threshold fraud issue

15. The trial before the judge was limited to a single issue which was defined in an order made by Colman J on 30 June 1998 as follows:

"The Threshold Fraud Point refers to the issue whether Lloyd's made representations which it knew to be untrue and/or as to which it was reckless whether they were true or false and whether such representations were communicated to the Names and if so, when."

The order of 30 June 1998 further contained directions as to which names should be bound by a determination of the threshold fraud point. Thereafter all concerned proceeded on the basis that the trial would be limited to the threshold fraud point as defined, subject only to some refinement as follows.

16. Paragraph 4 of a further order made by Colman J on 16 March 1999 provided that the trial be limited to three selected individual claimants, namely Sir William Jaffray, who joined Lloyd's in 1982, Mrs Dona Evans, who joined in 1988 and an individual claimant who joined Lloyd's in 1979 to be nominated by Sir William, or perhaps by the names. Captain Hindle was subsequently chosen. There were thus three sample names. By paragraph 4 of a further order

made by Cresswell J, on 1 July 1999, it was directed that the issues to be determined would include, in addition to those ordered by Colman J on 30 June 1998, the question whether each of the sample names relied upon any of the pleaded misrepresentations during the relevant period.

17. The relevant period was defined by paragraph 1 of that order as 1978 to 1988. The order also identified those individuals against whom allegations of fraud were made. As set out in chapter 7(1) of the judgment under the heading the Names' Pleaded Case, they were the following:

"(i) Certain members of the Council and/or Committee of Lloyd's: Sir Peter Green, F Barber, Richard Ballantyne, D J Barham, J R K Beckett, I R Binney, P G Bird, B J Brennan, A H Chester, M H Cockell, D E Coleridge, P T Daniels, R D Hazell, C O Gibb, C D D Gilmour, A W Higgins, V V Hudson, R J Kiln, W N M Lawrence, S R Merrett, Sir Peter Miller, C K Murray, E E Nelson, A Parry, I R Posgate, Sir David Rowland, C H A Skey (including, where relevant, their membership of Audit and Membership Committees and their statements in the Global Reports and Accounts as LUNMA Chairmen respectively during the Relevant Period). The Names say that where any one or more of these persons acted during any year between 1978 and 1988 as Chairman or a Deputy Chairman of the Committee/Council of Lloyd's they carried special responsibilities in the oversight and administration of the Lloyd's market and had particular influence which was likely to be decisive in matters relevant to the problem of asbestos-related claims.

(ii) K E Randall.

(iii) H R Rokeby-Johnson, Robin Jackson, Bryan Kellett and Michael Williams (the other LUNMA Chairmen who contributed to the Global Reports and Accounts in the Relevant Period).

(iv) Certain members of the Asbestos Working Party during the Relevant Period (E E Nelson, H R Rokeby-Johnson, R A G Jackson, D Tayler, C H A Skey). "

18. In these circumstances it was, as we understand it, common ground at the trial that the only cause of action being considered by the judge was the tort of deceit based upon various alleged fraudulent misrepresentations which we identify further below. Both Lloyd's and all relevant names were to be bound by the decision made on the issues determined, which included whether the names had established the ingredients of the tort of deceit on the facts, subject to questions of reliance and loss. Issues of reliance were to be determined only in the case of each of the three sample names. Issues of loss were to be postponed for later decision if necessary.

19. No other issues fell for determination at the trial. It follows that, in the absence of permission being obtained from this court to raise new issues, no other issues fall for decision in this appeal. On 8 October 2001 this court, then consisting of Lord Phillips MR, Waller LJ and Clarke LJ, granted permission to appeal against the decision of the judge on the threshold fraud point, and stood over to the hearing of the full appeal the question whether permission to appeal should be granted on the ground of unfair trial. That is a distinct point which we deal with in Part VII below.

20. The names subsequently sought to include in the appeal for which they had permission a number of points which were not advanced before the judge. However, on 21 January 2002, having heard and read detailed submissions on all sides, we directed that the appeal be limited to an appeal on the threshold fraud point. The reasons for that decision are set out in the judgment of Waller LJ given on that day. As explained in that judgment, it will ultimately be a matter for the judge to decide the extent to which (if at all) further points can be raised by the names in the light of this judgment.

21. It is of great importance to have in mind throughout that we are concerned in this appeal only with the names' case in deceit. It follows that in order to succeed the names must establish the ingredients of the tort of deceit. We are not considering other possible causes of action, including allegations of negligent misrepresentation. That is not only because of the way the threshold fraud issue was formulated as a preliminary issue in these proceedings but also because of the way in which the courts have decided other actions against Lloyd's.

22. For example, the question whether Lloyd's owed names a duty of care was raised in *Ashmore v Corporation of Lloyd's* [1992] 1 WLR 446. In the course of his consideration whether Gatehouse J should have ordered a preliminary issue which included the question whether Lloyd's owed names a duty of care, Lord Templeman said at pp 451H-452A:

"If Lloyd's owe a duty by statute or contract, then the preliminary issue will be decided in favour of the plaintiffs. But if no duty was imposed by statute or contract it does not appear to me that a duty could have arisen in tort. If statute or contract between Lloyd's and a name do not impose an obligation on Lloyd's to convey information to a name concerning his managing agent, an obligation to convey information could not arise just because and whenever information was obtained by Lloyd's."

At the trial of the preliminary issues before Gatehouse J, [1992] 2 Lloyd's Rep 620, the question whether Lloyd's owed a duty of care in tort was not pursued: see p 623.

23. Gatehouse J also considered the question whether certain terms should be implied into the contract or whether duties in similar terms were imposed by statute. The specific duties contended for by the plaintiffs were

"(a) a duty to take reasonable steps to alert the plaintiff names about matters which might seriously affect their underwriting interests and (b) a duty to impose a premium income monitoring system even if it was only an ad hoc system of monthly monitoring of the syndicates managed by an agent in trouble."

24. He concluded against the plaintiffs, and made this observation in relation to good faith at p 631:

"This led to the limited proposition that it is the duty of a regulator to exercise its powers and discretions in good faith and that where the regulator secures for itself contractual powers and discretions it is a necessary legal incident of such contract that (unless expressly excluded) the regulator will exercise its powers and discretions in good faith. A well-known example is *Weinberger v Inglis*, [1919] AC 606, in which this proposition was assumed by the House of Lords. The duty extends no wider, said Mr Simon. Whether an attempt expressly to exclude any duty of good faith could survive the Unfair Contract Terms Act 1977 was not canvassed and, in any case, does not arise; Lloyd's accepted (obviously correctly) an unqualified duty to act in good faith. But I know very little about the self-regulating bodies which, it is claimed, constituted a type or category of contractual relationship and I do not feel able to say that there is such a type, of which Lloyd's contract with a Name is an example. I remain of opinion that the *Lister v Romford* principle has no application."

25. In *Society of Lloyd's v Clementson and v Mason* [1994] CLC 71; [1995] CLC 117 the terms contended for by Mr Clementson and Mr Mason respectively were in the following form:

"*Clementson*

1. that Lloyd's would regulate and direct the business of insurance at Lloyd's with care and diligence and/or lawfully;

2. that Lloyd's would manage and superintend the affairs of the Society with care and diligence;

3. that Lloyd's would advance and protect the interests of members of Lloyd's in connection with the business carried on by them with care and diligence and/or lawfully; and

4. that Lloyd's would collect, publish and diffuse intelligence and information to members of Lloyd's including the defendant in connection with the business carried on by them, with care and diligence and/or lawfully.

Mason

1. that Lloyd's would comply with the provisions of the Lloyd's Acts 1871-1982, any subordinate legislation made thereunder and any direction given or provision or requirements made or imposed by the Council or any person(s) or body acting on its behalf pursuant to such legislative authority;

2. that Lloyd's would regulate the business of insurance at Lloyd's lawfully and/or in good faith and/or with reasonable care and diligence; and

3. that Lloyd's would advance and protect the interests of members of Lloyd's in connection with the business carried on by them as members of Lloyd's lawfully and/or in good faith; and with reasonable care and diligence."

26. The decision of Saville J that no such terms fell to be implied was upheld by the Court of Appeal. Observations in relation to the obligation of Lloyd's to act in good faith were made by Saville J, Steyn LJ and Hoffmann LJ. We do not understand there to be a difference between them, but Hoffmann LJ spelled out the position in this regard at pp 133-134:

"1. Implied terms

Mr Beveridge said that agreements by which members of an organisation agreed to be bound by its rules and regulated by a committee or similar body were a type of contract into which certain obligations on the part of the organisation (if corporate) or its committee were customarily implied. He said that the powers of regulation were regarded as fiduciary and had to be exercised in good faith and for the purpose intended by the rules. From this he said it was a short step to the implication of a duty to members to exercise regulatory powers with reasonable care.

In my view the fallacy of this argument is to confuse the extent of the powers conferred on the organisation or committee with its contractual obligations to its members. The fiduciary nature of the powers means that a purported exercise of those powers in bad faith or for an improper purpose will be invalid. It does not follow that the mere invalid exercise of the power will be a breach of contract for which the organisation is liable in damages, although it may mean that the organisation will be unable to justify an act (such as depriving an expelled member of the benefits of membership) which would be wrongful in the absence of a valid exercise of the power. Once it is appreciated that an improper exercise of the power is not in itself a breach of contract but simply a nullity, the basis for implying a contractual obligation not to act otherwise than in good faith and for a proper purpose disappears. A fortiori, there can be no foundation on which to build an implied term to exercise the power with reasonable care."

27. We shall return below (paragraphs 303ff) to the reasons given by Saville J and this court for rejecting the implied terms proposed in *Clementson* because in chapter 22, where the judge gave his reasons for rejecting the names' case that Lloyd's made a series of fraudulent

representations to names and prospective names, he relied upon some of the reasoning in *Clementson*.

28. It is no doubt because of the decisions and reasoning in some of these cases that we are not concerned with a case which alleges that Lloyd's are liable to the names because of a breach of contract. Nor are we concerned with the breach of an alleged duty of care, whether committed in bad faith or otherwise. In particular, we are not concerned with a case based upon the allegation that Lloyd's fraudulently failed to disclose material facts to prospective names. Any such case is not within the threshold fraud issue.

29. This is important because a significant amount of the argument of the litigants in person, and particularly Sir William Jaffray, sought to advance just such a case. For example it was said that Lloyd's motto is "Fidentia", that Lloyd's owed the names a duty of the utmost good faith and that Lloyd's was in breach of that duty in that it fraudulently failed to give information to prospective names as to the risks associated with asbestos related claims because it knew that, if it did, prospective names would be put off. Submissions along these lines were advanced with great vigour and conviction, but they cannot assist the names in this appeal because in order to establish the tort of deceit the names must establish relevant fraudulent misrepresentations. Mere omissions are not sufficient.

30. It follows that, in so far as it is said that the appeal should be allowed on the ground that the judge reached the wrong decision, we focus in this judgment solely upon the threshold fraud point and thus on the tort of deceit.

The judgment below

31. The trial occupied 64 days between 6 March and 14 July 2000, after the judge (who was already very familiar with the case through his case-management responsibilities) had spent some considerable time pre-reading. There were ten days of oral opening submissions and over 40 days of oral evidence. There was a huge volume of documentary evidence. The parties put in lengthy written closing submissions and produced numerous agreed (or partly agreed) statements of fact on particular topics. In opening this appeal Mr Simon Goldblatt QC referred to the judge having had to assess about two million spoken words, and about twenty million written words.

32. The conduct of a trial of such length, with so great a volume of written material, would in any circumstances have been a heavy burden for any judge. Cresswell J's burden was increased by the number of litigants in person who were appearing before him (in addition to the three teams of counsel) and by the strength of the names' feelings which pressed on the crowded court-room throughout the trial. The judge had to deal with frequent interruptions for 'housekeeping' points and peripheral issues of every sort. Often he had to begin the day by complaining of letters which had been sent to him either by litigants in person or by non-litigating names, and directing (unfortunately to little effect) that names should not attempt to communicate with him otherwise than in open court. On occasions (especially during the oral evidence of Sir Peter Miller) the judge had to give a stern warning that any attempt to intimidate or insult a witness amounted to a serious contempt of court.

33. It will be necessary to return to the course of the trial in more detail in connection with the application for permission to appeal on the ground that the names have not received a fair trial. For the present it is sufficient to say that the complete transcript of the trial conveys a strong first impression that Cresswell J performed a very difficult task with enormous patience and good humour, and sensibly gave the litigants in person a great deal of latitude (while showing firmness on those occasions when it was called for).

34. When he reserved judgment on 14 July 2000 the judge said that he hoped to deliver judgment

in the last week of October or the first week of November. He achieved that aim. On 3 November 2000 he handed down a judgment divided into 25 chapters and four appendices, extending to 635 pages in all.

35. In preparing his judgment the judge had the benefit of five lengthy statements of facts which had been wholly or largely agreed between the parties. These dealt with (i) the administrative structure and governance of Lloyd's and its insurance market; (ii) the regulatory background as regards accounts and auditing; (iii) the rules and procedures governing admission to underwriting membership; (iv) the chronology of information relevant to asbestos-related claims between 1978-88 ("the relevant period"); and (v) cases in the United States concerned with asbestos-related claims during the relevant period. There was also prepared a chronology of matters relevant to Lloyd's treatment of asbestos-related liability during the relevant period (this was not agreed). The first three of these statements were supplemented by numerous appendices and supporting documents.

36. The judge drew on this material in the narrative parts of his judgment, the scheme of which is summarised in chapter 4. The chapters most directly derived from the statements of facts are chapters 10 (administrative structure and governance), 11 (regulatory background for the auditing and accounting regime), 12 (rules and procedures governing membership), 13 (RITC – general principles and the role of the managing agents/underwriter), 14 (RITC – the role of the auditors) and 16 (overview of the nature and development of asbestos-related claims). There is a useful glossary and list of abbreviations and acronyms in chapter 3.

37. This background material is likely to be familiar to most of those who will read this judgment, and so it is unnecessary to reproduce it here at length. As factual material it is largely uncontroversial (although part of the appellants' case is that the judge erred, in deciding that there had been no representations made by Lloyd's, by placing too much weight on the constitutional and regulatory framework and too little on what was actually said in the brochures and global reports on which the appellants relied).

38. For the purposes of this appeal the most important chapters of the judgment are chapter 15 (the witnesses) and chapter 22 (analysis and conclusions on the issue of threshold fraud). It is in those chapters that the reader looks to find the reasons for the judge's conclusions, and it is mainly on what is said (or omitted) in those chapters that the grounds of appeal have focused.

39. In chapter 15 the judge identified all the witnesses who had given evidence orally or by witness statement, and gave an indication (sometimes quite detailed, but in most cases brief) of the topics covered in their evidence. The judge was to some degree critical of several of the witnesses for the names (including Mr Stockwell, Mrs Mackenzie-Smith, Mr Steel and Mr Bradley, of whom the judge was most critical). The judge commented favourably on the evidence of Mr Fredjohn, Sir Eddie Kulukundis and Mr Sturge. In relation to each of the three sample names the judge said that he was not persuaded that he or she relied on any of the alleged fraudulent misrepresentations. He did not enlarge on his reasons beyond saying that Sir William Jaffray probably relied on conversations with his two successive members' agents (and possibly also on conversations with his cousin) and that Mrs Evans probably relied on conversations with her members' agent.

40. The judge did not make any adverse comments on any of the witnesses for Lloyd's, beyond using the word "surprisingly" to describe Sir Peter Miller's evidence that he was not aware that twenty years or more may elapse between exposure to asbestos and the manifestation of serious asbestos-related illness. The judge made favourable comments about the evidence of a number of the Lloyd's witnesses, including Sir Peter ("articulate"), Sir David Rowland ("highly articulate"), Mr Lord ("impressive"), Mr Murray ("a highly professional and skilful underwriter"), Mr Keeling ("a particularly astute underwriter") and Mr Rayment ("a highly conscientious claims man ... I was greatly assisted by his evidence"). In relation to Mr

Lawrence the judge made a clear finding that he accepted as accurate his evidence about the distribution of the Murray Lawrence letter.

41. At the end of chapter 15 the judge added this observation:

"Lloyd's did not call a number of witnesses whose witness statements were exchanged. In reaching the conclusions set out in this judgment I have had regard to the fact that Lloyd's did not call these witnesses and I have considered whether any adverse inferences should be drawn."

The most important uncalled witness in this category was probably Mr Randall. It appears that the judge must have decided not to draw any adverse inference from the failure to call the witnesses, since the judge did not again refer to this point in his judgment.

42. In chapter 22 the judge began by referring to his summaries of the competing cases and the relevant legal principles (chapters 7, 8 and 9). He reminded himself of the names' pleaded case as to the alleged misrepresentations. It was pleaded that the brochures represented that a name joining Lloyd's:

> "(i) Could have confidence in Lloyd's as an institution to safeguard his/her interests;
>
> (ii) Could trust those who were chosen by Lloyd's to regulate the Lloyd's market and manage its affairs;
>
> (iii) Because of the way in which Lloyd's regulated and monitored underwriting accounts year by year:
>
> (a) could rely on syndicate accounts;
>
> (b) could in underwriting and/or deciding whether to remain a member of Lloyd's have confidence in the audited syndicate results, for results of past years;
>
> a. could be sure that Lloyd's as part of its regulatory duties would ensure that when prospective liabilities were reinsured by one syndicate year into another, such liabilities were being fairly assessed and quantified as between the two syndicate years."

43. It was also pleaded that the globals represented to a name who read them:

"(a) that the Lloyd's market was in a sound financial condition;

(b) that Names could safely join Lloyd's and/or continue their membership of Lloyd's and/or increase their Premium Income Limit with confidence that known and projected claims had been prudently and adequately reserved to ultimate."

44. The judge then stated his conclusion that neither the brochures nor the globals made the alleged representations. In relation to the brochures the first five of his stated reasons (elaborated in three further subparagraphs) were as follows:

"(i) The whole of each Brochure must be considered.

(ii) The starting point is the actual words used in the Brochures.

(iii) A useful question is as follows: What would a reasonable applicant for membership of Lloyd's/Name understand when reading the Brochure as a whole?

(iv) The alleged representations are not contained in any of the express words used in the Brochures.

(v) The alleged representations (a) are not necessary to give business efficacy; (b) do not represent the obvious, but unexpressed, intention of the parties; and (c) are inconsistent with the express words used in the Brochures."

In relation to the globals his stated reasons were very similar. In relation to both he summarised his reasoning by observing that the alleged representations were unclear in their terminology, did not accord with the administrative structure and governance of the Lloyd's market and the regulatory background, and were inconsistent with what the documents in question had actually said.

45. The judge then went on, in case he was wrong about the absence of any representations, to find that the other ingredients of the tort of deceit had not been made out: in particular, that fraud (in the relevant sense) had not been made out. He observed that the names' case was limited to the alleged known impossibility of proper reserving for asbestos-related claims, as part of a wider picture which included pollution and other long-tail claims, several catastrophic losses between 1987 and 1990, and the LMX spiral. He also observed (and this is, we think, a dominant and recurring theme of the judgment) that the names' case must be judged against the way the Lloyd's market and the Lloyd's regulatory system operated.

46. He developed this theme by reference to a number of topics as follows: (a) market associations; (b) the role of the DTI; (c) minimum percentage reserves; (d) developments in the Lloyd's regulatory environment for auditing and accounting; (e) managing agents; (f) panel or registered auditors; (g) meetings of panel auditors; (h) members' agents; and (i) the Rota committee. In this and the following sections of the chapter the judge made four important findings of fact (or conclusions representing his assessment of the facts):

(i) "The Committee/Council of Lloyd's was generally entitled to assume that auditors were performing their duties competently."

(ii) At the annual meetings when Mr Lawrence, Mr Nelson, Mr Rokeby-Johnson and Mr Jackson addressed the panel auditors about asbestos-related claims, they "did so (in the case of Mr Nelson probably did so) honestly and responsibly."

(iii) " ... the Murray Lawrence letter and the Randall letter were an honest response to the issues raised by the Neville Russell letter."

(iv) The view that RITC should be left to managing agents and auditors, and should not be second-guessed by the Council, was "representative of the then current thinking of the Committee/Council, and in my judgment reflected the distinction between the role of the Committee/Council and the duties and responsibilities of managing agents/underwriters and auditors of individual syndicates."

47. The judge then considered three particular contentions which had been relied on by the names as part of their case: the allegation that Lloyd's deliberately chose not to make an independent investigation and assessment of the overall exposure of the Lloyd's market to asbestos-related claims (the so-called 'back of an envelope' issue); the allegation that Lloyd's deliberately followed a policy of expanding its membership in order to place part of the burden of under-reserving on new names who were not told of the risks (the so-called 'recruit to dilute' policy); and the allegation that the 1979 year of account should have been left open by syndicates affected by asbestos-related claims. The judge rejected all of these contentions. On

the 'back of an envelope' point he relied on the evidence of Mr Rayment and Mr Lord as to the task being both enormously complicated (as was shown by the Equitas reserving project) and inappropriate to the Lloyd's system. On the 'recruit to dilute' policy he said that it was a matter for agents, not for Lloyd's. On the closure of the 1979 year of account he referred to his own judgment in the Merrett case and also to the Kerr report on syndicate 418/417's closed year.

48. The judge concluded that if he were wrong in his view that no representation had been made, the claim would still fail, especially on the issue of fraud. The judge did not in that part of his judgment add to his brief findings (in chapter 15) as to the failure to prove reliance on the part of the three sample names. Nor did he add to what he had said in chapter 9 (relevant legal principles) as to the representor's intention to convey a false meaning, or as to the issue of attribution of intention to a corporation (he cited, without comment, a passage from *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 506). He did not in terms deal with the reference in the early brochures to a 'rigorous audit', a fact which no doubt reflects the way in which the names' case has developed in this court.

II LEGAL ISSUES

The tort of deceit

49. The names rely upon a number of representations which they say are contained in various Lloyd's brochures and in annual statements known as globals. In the case of each alleged representation, in order to recover damages for deceit a name must establish the following:

i. that Lloyd's made the representation;

ii. that the representation was material;

iii. that the representation was untrue;

iv. that when it made the representation, Lloyd's knew or believed that it was untrue or made it recklessly, careless whether it be true or false;

v. that when it made the representation, Lloyd's intended that the representation should be relied upon by the name;

vi. that the name in fact relied upon the representation; and

vii. that the name has suffered loss as a result.

It is convenient to consider each of those ingredients in turn in the context of a case of this kind.

i) The Representation

50. The names must establish that Lloyd's made the representation alleged, which involves two questions, namely whether a relevant representation was made and, if so, whether Lloyd's made it. As to the second question, since the alleged representations are all contained either in the brochures or in the globals, and since both the brochures and the globals were prepared and published by Lloyd's, we do not think that there can be any doubt that a representation contained in either publication was made by Lloyd's.

51. As to the first question, namely whether a relevant representation was made, the

representation must be a representation as to a past or existing fact and not as to the future: see eg *Yorkshire Insurance Co v Craine* [1922] 2 AC 542 per Lord Atkinson, giving the judgment of the Judicial Committee of the Privy Council, at p 553.

52. Whether any of the alleged representations was made involves a consideration of each brochure or set of globals relied upon in order to see what the words used in the relevant document mean. The particular words used must of course be read in their context, which involves considering them in the context of the particular brochure or set of globals as a whole. Further, just as the words used must not be read in isolation, so the document must itself be considered against the relevant surrounding circumstances. In particular, it is necessary to have regard to the purpose for which the document came into existence, why the statements contained in it were made and by whom they were intended to be read.

53. It follows that the words used may have a meaning other than their literal meaning. They may also have a meaning which is not expressly stated, but which is implicit. However, as we see it, their meaning, whether explicit or implicit, should be arrived at by a process of construction and, subject to one point, not by a process of implication. In particular, whether the relevant document contains a particular representation does not depend upon a process of implication of the kind which is appropriate in answering the question whether a particular term is to be implied into a contract.

54. Mr Goldblatt submitted that the test is simply whether an ordinary person in the position of a prospective or existing name would have understood the document in question, read as a whole, to carry or contain the representation contended for. We agree. There has been some debate as to what attributes should be given to the person reading the brochure as a prospective name. In this regard Mr Goldblatt submitted that the ordinary person of reasonable intelligence in the position of a prospective (or indeed existing) name should not be treated as someone with previous knowledge of the insurance market generally or Lloyd's in particular. Again we agree.

55. The point seems to us to be well demonstrated by the following statement made by Langley J in *Sumitomo Bank Ltd v Banque Bruxelles Lambert SA* [1997] 1 Lloyd's Rep 487 at 515:

> "It is well established in law that the question whether any kind and if so what particular representation was made depends upon an objective assessment of what was said or done and its likely effect on the alleged representee in the context in which the particular parties were concerned. In other words, what would the documents and exchanges relied upon have conveyed to a prudent banker in the position of the plaintiff banks?"
>
> In the instant case we are not concerned with the prudent banker, who is already versed in the world of banking, but with prospective names who may have no previous knowledge of the world of insurance.

56. There is one respect in which the courts have sometimes spoken of implied representations. This can be seen, for example, in the judgment of Bowen LJ in *Smith v Land and House Property Corporation* (1884) 28 Ch D 7, where he said at p 15:

> "... if the facts are not equally known to both sides, then a statement of opinion by one who knows the facts best involves very often a statement of a material fact, for he impliedly states that he knows facts which justifies his opinion."
>
> That principle has recently been considered by Evans-Lombe J in *Barings Plc v Coopers & Lybrand* [2002] EWHC 461 (Ch) at paragraphs 46 to 50.

57. As Evans-Lombe J observed at paragraph 49, in *Brown v Raphael* [1958] Ch 636 Lord

Evershed MR said at p 642:

"... it suffices for the application of the principle if it appears that, between the two parties, one is better equipped with information or the means of information than the other."

In that case it was held that the test was met where the vendor's solicitors expressed an opinion in sale particulars as to an important aspect of the property about which the purchaser could know nothing. Lord Evershed continued at p 643:

"What would be the effect of this language upon the mind of a possible purchaser? Clearly, I should have thought, it would flow from the language used and would be intended to be understood by a reader of the particulars that persons who knew the significance of this matter and who were experienced and competent to look into it were expressing a belief founded upon substantial and reasonable grounds."

58. Those cases were considered by this court in the context of section 20 of the Marine Insurance Act 1906 (applied in a non-marine context) in *Economides v Commercial Assurance Co Plc* [1998] QB 587, where (at p 599B) Simon Brown LJ stressed that in the passage from the judgment of Bowen LJ in the *Smith* case quoted above Bowen LJ had said that in circumstances in which the representor knows the facts a statement of opinion will *very often* amount to a statement of fact "for he impliedly states that he knows facts which justify his opinion". As to *Brown v Raphael*, Simon Brown LJ said (at p 598H to 599A) that the representation there, purporting as it did to come from the vendor's solicitors, would inevitably carry with it the implication that there were reasonable grounds to support the belief.

59. These cases seem to us to show that all depends upon the circumstances. In each case it is necessary to ask the question identified above, namely what would the reasonable person in the position of the representee understand by the words used in the document. In our opinion there is no rule of law that any particular statement carries with it any particular implication. All depends upon the particular statement in its particular context. So, here, as already stated, the question is whether the particular brochure or set of globals relied upon would be reasonably understood by the ordinary applicant for membership of Lloyd's to have the meaning alleged. That meaning might either be explicit in the words used or implicit (and in that sense implied) from the words used. We shall return in Part IV below to the distinction between a representation and an implied term in a contract.

ii) The materiality of the representation

60. Although it is doubted (with some force) in paragraph 6-040 of volume 1 of the 28th edition of Chitty on *Contract* and in paragraph 15-36 of the 18th edition of Clerk & Lindsell on *Torts*, the traditional view is that in order to succeed in the tort of deceit the claimant must prove that the representation was material. Thus, in *Downs v Chappell* [1997] 1 WLR 426 Hobhouse LJ, with whom Roch and Butler Sloss LJJ agreed, said at p.433:

"For a plaintiff to succeed in the tort of deceit it is necessary to prove that (1) the representation was fraudulent, (2) it was material and (3) it induced the plaintiff to act (to his detriment). A representation is material when its tendency, or its natural and probable result, is to induce the representee to act on the faith of it in the kind of way in which he is proved to have in fact acted."

iii) The Truth of the Representation

61. The representation must be untrue or, in other words, false.

iv) Lloyd's knowledge, belief or recklessness

62. If a representation is shown to be untrue or false, it must further be shown that Lloyd's knew or believed it to be false or that Lloyd's made it careless whether it be true or false. As the judge put it, in order to prevent a false statement from being fraudulent, there must be an honest belief in its truth. The position was summarised thus by Lord Herschell in his classic statement in *Derry v Peek* (1889) 14 App Cas 337 at p 374:

"I think the authorities establish the following propositions: First, in order to sustain an action in deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement from being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud is proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made."

63. There is a further principle which may be of relevance here. In the 18th edition of *Clerk & Lindsell* the editors say:

"**15-07 Continuing Representations** The tort is complete only when the representation is acted upon. Where there is an interval between the time when the representation is made and the time when it is acted upon, and the representation relates to an existing state of things, the representation is deemed to be repeated throughout the interval. .... If, during the interval of time between making the representation and the plaintiff acting upon it, the defendant perceives the statement to be false or circumstances change to render it false, liability may be incurred.

15-22 Defendant's later knowledge ... where the defendant does not acquire knowledge of the untruth of his statement until after it has been made, but comes aware of it before the plaintiff has acted upon it, it follows from general principle that he is bound to communicate the truth and will be answerable in damages if he does not.

15-23 Statement becoming untrue *ex post facto* Where the statement complained of was in fact true at the time when made, but before being acted upon by the party to whom it was made had been rendered untrue by reason of a fact coming into existence to the knowledge of the party making it, the balance of authority is in favour of regarding it as deceit."

Those paragraphs seem to us accurately to summarise the relevant principles and are potentially relevant on the facts here because one view of the facts is that some of the representations in the brochures may have been true when they were made but may have become untrue subsequently. We shall return to these principles below, in so far as necessary in the light of our conclusions on the facts.

64. As to the standard of proof, in *Goose v Wilson Sandford & Co (No 2)* [2001] Lloyd's Rep PN 189, Morritt LJ, giving the judgment of the court, said in paragraph 39 at p 198:

"In considering whether the elements in the tort of deceit had been established the judge correctly directed himself as to the relevant standard of proof by reference to the statement of Lord Nicholls of Birkenhead in *Re H (Minors) (Sexual Abuse: Standard of Proof)* [1996] AC 563, 586 that:

"... the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established

on the balance of probability. Fraud is usually less likely than negligence."

See also eg *Hornal v Neuberger* [1957] 1 QB 247 and *The Ikarian Reefer* [1993] 2 Lloyd's Rep 68 per Cresswell J at pp 71-2 and the cases there cited.

65. Where an individual has the relevant knowledge, belief or recklessness, before that knowledge, belief or recklessness could be imputed to Lloyd's it would be necessary to identify the legal basis upon which it could be so imputed to Lloyd's as a corporate body. The names allege fraud against a total of 33 individuals identified above. We shall return, so far as necessary, below to the question whose knowledge, belief or recklessness would be the knowledge, belief or recklessness of Lloyd's, and to the associated question whether Lloyd's is liable in deceit in respect of the deceit of any one or more individuals. It is convenient, before doing so, to consider the facts in detail and to set out the conclusions which we have reached as to the facts relevant to these questions.

v) Lloyd's intention

66. This is an important ingredient of the tort because it is one of the features of the tort which has led to it being considered as involving fraud on the part of the tortfeasor. As the judge observed in chapter 9(2) under the heading the Tort of Deceit, the tortfeasor does not have to be dishonest in the sense in which that word is used in the criminal law. On the other hand it is no defence to a charge of knowingly making a false statement that the person who made it believed that he was justified in doing so or that no harm would come of it or that it would be for the best: see eg *Standard Chartered Bank v Pakistan National Shipping Corporation (No 2)* [2000] 1 Lloyd's Rep 218 per Evans LJ at 221.

67. The tortfeasor must intend the representation to be acted upon: see eg Clerk & Lindsell at paragraph 15-27 but compare Chitty at paragraph 6-42. Moreover, in *Goose v Wilson Sandford & Co (No 2)* Morritt LJ said in paragraph 41 at p 199:

"To establish liability in deceit it is incumbent on the representee to show that the representor intended his statement to be understood by the representee in the sense in which it is false."

The court relied upon *Akerhielm v De Mare* [1959] AC 789, per Lord Jenkins, giving the advice of the Judicial Committee of the Privy Council, at 805 and upon *Gross v Lewis Hillman Ltd* [1970] Ch 189. Thus, if the representor honestly believes the statement to be true in the sense in which he intended it to be understood it he will not be liable in deceit.

vi) Reliance

68. Each of the three particular names must establish that he or she relied upon the representation concerned in the sense that he or she was influenced to become or remain a member of Lloyd's in reliance upon it. It is not necessary for us to discuss here any distinction that there may be between inducement and reliance: cf *Downs v Chappell* per Hobhouse at p.433.

vii) Loss

69. In order to recover damages each name would in the future have to establish that he or she suffered loss as a result. We are not, however, concerned with the question of loss in this appeal.

Corporate knowledge, intention and bad faith

70. The allegation of deceit is made against the Corporation of Lloyd's itself, that is as a body

corporate incorporated under the Lloyd's Act 1982 ("the 1982 Act") and earlier legislation. The names' case does not depend on vicarious liability. That brings into play the 'rules of attribution' as explained by Lord Hoffmann giving the opinion of the Privy Council in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 506:

"Any proposition about a [body corporate] necessarily involves a reference to a set of rules. A [body corporate] exists because there is a rule (usually in a statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a persona ficta to exist unless there were also rules to tell one what acts were to count as acts of the [body corporate]. It is therefore a necessary part of corporate personality that there should be rules by which acts are attributed to the [body corporate]. These may be called "the rules of attribution". "

71. As appears from our analysis of the tort of deceit, the state of mind of a person alleged to have made a fraudulent misrepresentation may arise on more than one point (in addition to the bare fact of whether the defendant was the person who made the representation, on which no issue arises here):

i. Did the defendant intend the representation to be understood in a particular way?

ii. Did the defendant intend the representation to be acted on?

iii. Did the defendant know that it was false, or was the defendant reckless as to its truth or falsity?

72. As indicated in paragraph 65 above, we think it better to reach our conclusions on a number of factual issues before going far into the rules of attribution as they would apply to the allegations made against Lloyd's in this case. But it may be useful to give a brief summary of the opposing submissions. In this context it must be borne in mind that (as explained below in more detail) the governing body of Lloyd's was, until 31 December 1982, the Committee. Thereafter it was the Council, but much of the important decision-making was delegated to the Committee, which consisted of the members of the Council other than the external members (that is Council members who were not working names).

73. Both sides have accepted that the general principles which apply are those stated by the Privy Council in *Meridian Global*, as anticipated, to some extent, by this court in *El Ajou v Dollar Land Holdings plc* [1994] 2 AER 685. But the names have in their submissions put forward alternative tests with the common characteristic (as stated in their skeleton argument, paragraph 153) that

" ... they identify those people with de facto control over the insertion, or not, [in the brochures and the globals] of any health warning or qualification: the people with knowledge of the systemic defects in asbestos reserving, who chose not to disclose that to the members of the Committee and Council who were reliant on them."

The names have criticised the judge for equating the positions of the Council and the (post-1982) Committee because the external members of the Council were in a state of ignorance, since asbestos-related problems were never discussed in Council.

74. Lloyd's on the other hand, have submitted that the names would have to establish the relevant state of mind in a majority of the members of the Committee or Council present when the decision was taken to approve any particular brochure or set of globals. For this they rely on the decision of the House of Lords in *Jones v Swansea City Council* [1990] 3 AER 737 and on *The Ardent* [1997] 2 Lloyd's Rep 547. In *Jones* the claimant brought an action for misfeasance in public office (a tort involving dishonesty) against the Swansea City Council, alleging bad

faith against every member of the Labour group on the council. This court (by a majority) reversed the trial judge and the House of Lords restored his judgment. The case turned ultimately on a pleading point and the assistance which it gives is therefore limited. If it were necessary to go further into this point we would start from a position of some scepticism as to whether a process of counting heads would be the right approach.

Approach of the Court of Appeal

75. In this case the judge acquitted of fraud both Lloyd's and all the individuals against whom allegations of fraud had been made. The names say that he was wrong to do so. They invite us to say that, contrary to the conclusions of the judge, who had the advantage of seeing many witnesses give evidence over a number of days, many of the individuals were guilty and so was Lloyd's as an institution.

76. The correct approach of the Court of Appeal to this kind of case has been considered many times in the past. It is, we think, sufficient to refer to the way in which this court identified the approach in *The Ikarian Reefer* [1995] 1 Lloyd's Rep 455, where in the event the court reversed the decision of the trial judge that the plaintiff insured shipowners had not deliberately scuttled their vessel or cast her away. Giving the judgment of the court, Stuart-Smith LJ addressed the correct approach as follows (at pp 458-9):

"(1) The burden of showing that the trial Judge was wrong lies on the appellant. ...

(2) When questions of the credibility of witnesses who have given oral evidence arise the appellant must establish that the trial Judge was plainly wrong. Once again there is a long line of authority emphasizing the restricted nature of the Court of Appeal's power to interfere with a Judge's decision in these circumstances though in describing that power different expressions have been used. In *SS Hontestroom v SS Sagaporak* ... [1927] AC 37 at p 47 Lord Sumner said:

"None the less not to have seen the witnesses puts appellate Judges in a permanent position of disadvantage as against the trial Judge and unless it can be shown that he has failed to use or has palpably misused his advantage, the higher Court ought not to take the responsibility of reversing conclusions so arrived at merely on the results of their own comparisons and criticisms of the witnesses and of their own view of the probabilities of the case."

....

Finally in *Mersey Docks and Harbour Board v Proctor* [1923] AC 253 at p 258, Viscount Cave LC said:

"In such a case ... it is the duty of the Court of Appeal to make up its own mind not disregarding the judgment appealed from and giving special weight to that judgment in cases where the credibility of witnesses comes into question, but with full liability to draw its own inferences from the facts proved or admitted and to decide accordingly."

(3) When a party has been acquitted of fraud the decision in his favour should not be displaced except on the clearest grounds. This proposition is not in contest and is supported by the House of Lords in *Akerhielm v De Mare* [1959] AC 789 at p 806, where the earlier authority of *Glasier v Rolb* (1889) 42 ChD 436 is cited."

77. Another way of putting essentially the same approach is to say, as was said in *Gross v Lewis Hillmann* [1970] Ch 445 at 459C-460B, that the Court of Appeal must be completely satisfied that the judge was wrong. It follows that the names have a difficult task in front of them, but that does not mean that in an appropriate case it is not the duty of this court to reverse a trial judge who has acquitted a party of fraud. As already stated, it did so in *The Ikarian Reefer*.

Another example of a well-known case in which this court reversed the conclusions of the trial judge based on the credibility of the witnesses is *Armagas Ltd v Mundogas SA, The Ocean Frost*, [1985] 1 Lloyd's Rep 1.

78. We recognise that all those cases were decided when the Rules of the Supreme Court were in force, which provided by RSC Order 59 rule 3 that "an appeal to the Court of Appeal shall be by way of rehearing". The present appeal is governed by the CPR, which by rule 52.11(1) provides:

"Every appeal will be limited to a review of the decision of the lower court unless –

(a) a practice direction makes different provision for a particular category of appeal; or

(b) the court considers that in the circumstances of an individual appeal it would be in the interests of justice to hold a re-hearing."

Neither party invited the court to say that it should hold a re-hearing within the meaning of rule 52.11(1)(b) (and not a review).

79. Equally neither party submitted that the traditional principles stated above should not apply, or that the approach should be different depending on whether the appeal were treated as a review or a re-hearing. We are inclined to think that in this class of case the position should be the same. In any event we shall follow the principles stated above in our approach to this appeal.

III THE FACTS

80. In the following sections of this judgment we identify the individual protagonists and other important witnesses on both sides, and proceed to a chronological summary of the development of asbestos-related claims and losses. Changes in the governance of Lloyd's, and other important events, are noted as they occurred. The chronological summary starts before the beginning of the relevant period and continues (with some digressions and deviations from strict chronological sequence) until the inception of this litigation. It is largely drawn from undisputed documentary material, although there are many disputed issues as to the inferences which the judge did or did not draw from the documents. Parts of the summary are covered again, in more detail, in Parts IV, V and VI of this judgment. But some degree of repetition is unavoidable in such a complex case.

The claimants and their witnesses

81. There were 216 claimants (almost all of whom were in fact counterclaimants in actions commenced by Lloyd's) concerned in the threshold fraud issue. Under the case-management orders directing that issue three individuals – Captain Donald Hindle, Sir William Jaffray Baronet and Mrs Dona Evans – were selected as sample cases for the issue of reliance. Sir William has appeared as a litigant in person and so have some other appellants who were not selected as sample cases: Mrs Heather Adams (appearing by her husband), Mr Sydney Butler, Mr Richard Carter, Mr Cary Harrison and Mrs Ann Strong. We summarise the circumstances in which these persons became names, and then identify the most important non-party witnesses who gave evidence for the claimants.

82. Mrs Adams was admitted as a name in 1977 and started underwriting in 1978. She did not give evidence at trial but according to her husband she asked to be put on low-risk syndicates but found herself on the Merrett and Outhwaite syndicates. Mr Adams made well-structured and moderate submissions to the court.

83. Captain Hindle had a distinguished career as a sea captain, commanding the two biggest ships in the world. He stopped going to sea in 1979 but continued working as an expert consultant, based in Malaysia. He was admitted as a name in 1978 with an initial premium limit of £100,000 spread equally between three marine and two non-marine syndicates. The judge doubted whether he was ever an appropriate candidate for membership of Lloyd's. Captain Hindle frequently increased his premium limit, ultimately (in 1989) to £1.5m. He made profits for every year until 1986 for which he had records (those for 1981 and 1982 were lost).

84. Sir William Jaffray, Baronet (who was born in 1951 and succeeded his father in 1953) was admitted as an external name late in 1981. He began underwriting in 1982 with a premium limit of £200,000 (increased to £300,000 in 1985 and later further increased). Initially he made some profits but he suffered substantial losses in numerous years from 1983, particularly on Gooda Walker syndicates. He made submissions which were carefully prepared and eloquently delivered, but not always relevant to the issues before the court.

85. Mr Butler became a name in 1986 and began underwriting in 1987 on a Poland syndicate which had no E & O cover. He did not give evidence at trial but he made clear and forceful submissions in this court.

86. Mrs Evans became a name in 1987 and began underwriting in 1988, with R W Sturge as her members' agent. She was then married but she has since divorced. She has been a prominent member of names' action groups. She gave evidence at trial. The judge doubted whether she was ever an appropriate candidate for membership of Lloyd's.

87. Mr Carter is a chartered surveyor and property consultant. He became a name in 1988 and began underwriting in 1989. His first and worst losses arose in his first year of underwriting from his participation in the parallel marine and non-marine Feltrim syndicates. He made clear submissions which were no less effective for being moderately expressed.

88. Mr Harrison is an American resident in London. He is retired. He has a liability to a bank which guaranteed, and has discharged, his liability to Lloyd's. He forcefully submitted that he would have preferred to conduct his own case separately rather than being what he called a 'free rider' in the group litigation.

89. Having identified the sample names and the litigants in person who appeared in this court we will mention briefly some of the most important witnesses for the names. Mr Christopher Stockwell became a Lloyd's underwriter in 1979 and joined the Outhwaite (Combined) Agency. He was the first-named claimant in the action against Mr Richard Outhwaite which Saville J tried in 1991 (and which was settled before judgment). He was a prominent campaigner throughout the Lloyd's litigation. The judge had serious reservations about his evidence and gave substantial reasons for his reservations.

90. Mrs Catherine Mackenzie-Smith became a name in 1974. She is a member of the bar and has also been prominent in Lloyd's action groups. Her evidence was directed mainly to her contact with, and information which she derived from, another barrister who was also a name, Mr John Osbrey-Taylor (who died in 1999). The judge said that Mrs Mackenzie-Smith found it difficult to distinguish between the role of a witness and that of an advocate.

91. Mr Roger Bradley was a working name who joined Janson Green in 1967. In 1977 he became an equal partner and joint underwriter in the Bryan P Barrie Underwriting Agency, on syndicates 901 (marine) and 921 (non-marine). From 1993 he began to work (after some years of hardship) for the Names Defence Association. The judge found his evidence unsatisfactory (for reasons set out at some length in the judgment).

92. Mr Colin Mackinnon was the active underwriter on marine syndicate 927 and was also underwriter on two specialist stop-loss syndicates. Mr Mackinnon's witness statement was quite short (relating to his having no recollection of seeing the Murray Lawrence letter before 1995) but he did in the course of his cross-examination answer many questions about practice and procedures at Lloyd's. The judge described him as an articulate witness.

93. Mr Robin Kingsley became a working name in 1959. In 1976 or 1977 he became founder chairman of three members' agencies. He was also from 1977 to 1989 a director of Hardcastle Underwriting Agencies Ltd, a managing agency later renamed Cutler. One of his members' agencies arranged for Sir William Jaffray's underwriting between 1982 and 1987, when Sir William changed his members' agent. Mr Kingsley was cross-examined on various topics. He stated in his witness statement that he did not see the Murray Lawrence letter until the early 1990's.

94. Mr Anthony (generally known as Charles) Sturge left A L Sturge & Co in 1972 and formed Chatset (a specialised information service about Lloyd's syndicates) in 1981. He gave evidence about the market's perception at different times of asbestos-related problems. The judge described him as a careful witness who gave a reasonably balanced account.

95. There were numerous other witnesses for the names including two individuals who were the first external names to serve on the Council of Lloyd's after the coming into force of the Lloyd's Act 1982. They were Mr Dennis Fredjohn, whom the judge described as a distinguished industrialist and a generally reliable witness, and Sir Eddie Kulukundis, a well-known philanthropist whom the judge described as an impressive witness.

Working members of the Lloyd's community

96. The reamended defence and counterclaim (quoted in paragraph 17 above) names 33 individuals, all working members of the Lloyd's community at some time during the relevant period, whose knowledge ought (it is pleaded) to be imputed to the Society of Lloyd's so as to arrive at a finding of bad faith against the corporation itself. Nine of these individuals are dead. All but five of them were at some time members of the Committee or (after its institution in 1983) the Council of Lloyd's and some served as Chairman or as one of the two Deputy Chairmen (after 1983 the Chief Executive was also designated as a third Deputy Chairman). Six of them gave oral evidence at trial (and the witness statement of Mr Rokeby-Johnson was admitted under CPR 33.2). Others had made witness statements which were exchanged (and were, it seems, read by the judge) but they were not in the event called to give evidence. In the following paragraphs we identify, in alphabetical order, some of the working members of the Lloyd's community who appear most frequently in our chronological summary. Those who are impugned in the pleadings are denoted by an asterisk. The specialised committees established by Lloyd's at different periods are summarised in paragraph 188 below.

97. Mr Frank Barber* was on the Committee of Lloyd's in 1978-80 and 1982 and on the Council and Committee in 1983-5 and 1987. He was Deputy Chairman in 1983-4. He was a member of the Membership Committee in 1978. He was on the Committee of LUNMA (Lloyd's Underwriters Non-Marine Association) in 1978-80.

98. Mr Arthur Chester* (deceased) was on the Committee of Lloyd's in 1978 and 1980-2 and on the Council and Committee in 1983. He was on the Audit Committee in 1980-3, chairing it in 1980, 1982 and 1983.

99. Mr Michael Cockell* was on the Council and Committee of Lloyd's in 1984-7 being Deputy Chairman in 1986. He was on the Audit Committee in 1984. He was on the Committee of

LUNMA in 1978-85 and 1987, being Deputy Chairman of LUNMA in 1982 and Chairman in 1983.

100. Mr David Coleridge* was on the Council and Committee of Lloyd's in 1983-6 and 1988, being Deputy Chairman in 1985 and Chairman in 1988. He was on the Committee of LUNMA in 1978-85 and 1987, being Deputy Chairman in 1982 and Chairman in 1983.

101. Mr Ian Hay Davison was appointed as the first Chief Executive of Lloyd's in 1983, the year in which the Lloyd's Act 1982 came into force. He was an accountant who had had a distinguished business career. His appointment was widely believed to have been influenced by the Bank of England, which was concerned to improve and modernise the regulation of the Lloyd's market. Relations between Mr Davison and the Council of Lloyd's were not entirely harmonious and he resigned early in 1986 (being succeeded by Mr Alan Lord). Mr Davison subsequently wrote a book entitled 'A View of the Room' about his time at Lloyd's. A copy of this book was provided to the court (as it had been provided to the judge) but (like the judge) we have not read it (except for a few excerpts which were actually put to witnesses in cross-examination, and so appear on the transcript).

102. Mr Charles Gibb* (deceased) was on the Committee of Lloyd's in 1978-81, being Deputy Chairman in 1978-80. He was on the Membership Committee in 1978.

103. Sir Peter Green* (deceased) was on the Committee of Lloyd's in 1979-82, being Deputy Chairman in 1979 and Chairman in 1980-2. He was then the first Chairman of the newly-instituted Council and Committee in 1983. He was therefore very closely involved in the promotion of the Bill which became the Lloyd's Act 1982. He was knighted in 1982. Subsequently disciplinary proceedings were taken against him over a matter in which he had a serious conflict of interest and he was censured and resigned from Lloyd's.

104. Mr Robin Jackson* was never on the Council or Committee of Lloyd's but he was between 1980 and 1988 a leading member of LUNMA (of which he was Chairman in 1986) and of the AWP (Asbestosis Working Party) of which he was Chairman from 1984 to 1988. He began his career in 1956 with C T Bowring Group, a firm of Lloyd's brokers. He worked in the United States from 1960 to 1971 underwriting reinsurance of liability business (referred to in the United States as casualty business). He returned to England in 1971 as chief underwriter for an American insurer. In 1976 he became the active underwriter for the Merrett non-marine syndicate (later called syndicate 799). He stopped full-time underwriting in 1988 but remained as a consultant until 1990. During the relevant period he was very closely involved in the problems of asbestos-related claims, and from 1994-6 he worked on the Equitas Project. It was suggested to the court, without contradiction, that he and Mr Rayment (see paragraph 117 below) were probably as knowledgeable about asbestos-related claims as anyone at Lloyd's. Mr Jackson gave evidence which the judge summarised without any comment (whether favourable or adverse).

105. Mr Richard Keeling was during the 1970's deputy underwriter to Mr Lawrence (see paragraph 108 below) on syndicate 360 (a composite syndicate which later split, the non-marine element becoming syndicate 362). As Mr Lawrence took on other commitments Mr Keeling assumed more responsibility and was formally appointed active underwriter of syndicate 362 in 1984, a position he occupied until the end of 1996. Mr Keeling gave evidence and the judge described him as a particularly astute underwriter. His evidence covered, among other topics, the allegations made against Mr Lawrence, including the reinsurance which Mr Lawrence effected with the Outhwaite and Meacock syndicates and disputes which arose over that reinsurance cover.

106. Mr Bryan Kellett* was a member of the Members' Solvency and Security Committee ("MSSC" – the successor of the Audit Committee) of Lloyd's in 1985-6. He was a leading member of the

Committee of LUNMA in 1983-88, being Chairman in 1987. He was on the Council and Committee after the end of the relevant period. He had set up his own non-marine syndicate 993/994 in 1973 and he was an active underwriter until the end of 1989. He gave evidence about his own underwriting activities (which included writing run-off policies) and about a meeting with the Inland Revenue in 1984. The judge made no particular comment on his evidence except to say that his remarks to the Inland Revenue ("we are under-reserved") had to be seen in the context in which they were made.

107. Mr Robert Kiln* (deceased) was on the Committee of Lloyd's in 1978, 1979 and 1981. He was on its Audit Committee in 1979, 1981 and 1982, being Chairman of that committee in 1979 and 1981. He had set up syndicate 510/511 in 1963 and was its active underwriter until 1974, with Mr Murray as his deputy. In his witness statement Mr Murray described Mr Kiln as a man of the highest integrity and 'the least greedy of men', a view supported by a statement of Mr Holman put in by Mr Harrison.

108. Mr Murray Lawrence* is of central importance in this matter, since it was he who as Deputy Chairman wrote the 'Murray Lawrence letter' dated 18 March 1982 in indirect response to the 'Neville Russell letter' dated 24 February 1982. Mr Lawrence was on the Committee of Lloyd's in 1979-82 (being Deputy Chairman in 1982) and on the Council and Committee of Lloyd's in 1984-8, being Deputy Chairman in 1984-7 and Chairman in 1988. He was also on the committee of LUNMA in 1978-83, being Chairman in 1978. He had become active underwriter on composite syndicate 360 in 1970 and from 1980 (after syndicate 360 split) he was active underwriter of syndicate 362. In 1979 Mr Lawrence became Chairman of the Computer Leasing Working Party. In 1982 he placed an unlimited liability run-off policy (with an excess of $55m) with the Outhwaite and Meacock syndicates (which underwrote two-thirds and one-third respectively). This later led to disputes and arbitrations. In 1985 Mr Lawrence set up his own managing agency, Murray Lawrence and Partners, which was incorporated in 1989. Mr Lawrence gave evidence and was cross-examined over four days. The judge summarised his evidence and expressly accepted his evidence as to the distribution of the Murray Lawrence letter but did not otherwise comment on its quality.

109. Mr Alan Lord became Chief Executive of Lloyd's in March 1986 in succession to Mr Davison. He held that position until 1992. He had (as the judge said) previously had a distinguished career with the Inland Revenue, the Treasury, the Department of Trade and Industry and Dunlop, as well as serving on the Court of the Bank of England. The judge described Mr Lord as an impressive witness.

110. Mr Stephen Merrett* was a leading underwriter whose agency was successfully sued for negligence by names who were on his syndicate. He was on the Committee of Lloyd's in 1981-2 and on the Council and the Committee in 1983-4 and 1987-8. He was on the Audit Committee (or its successor the MSSC) in 1982-5 and 1988 (being Chairman in 1985 and 1988) and on the Membership Committee in 1981. He was on the committee of LUNMA in 1981-3.

111. Sir Peter Miller* began work with Thomas R Miller & Son, a Lloyd's broking firm concerned with marine business, in 1954. Throughout his career he was mainly concerned with marine liability broking, and he became Chairman of the Committee of Lloyd's Insurance Brokers in 1976. He was on the Committee of Lloyd's in 1978-80 and 1982 and (after the Lloyd's Act 1982 came into force) on the Council and Committee of Lloyd's in 1983-88. He succeeded Sir Peter Green as Chairman and held that office in 1984-7. He was on the Membership Committee in 1979-80. He gave evidence at trial and the judge described him as an articulate witness.

112. Mr Colin Murray* was with C T Bowring from 1953 to 1963 and then joined Mr Kiln's agency as deputy underwriter to syndicate 510/511 (set up by Mr Kiln). Mr Murray became active underwriter in 1974. He was on the Committee of LUNMA from 1979 to 1984. He was on the

Council and Committee of Lloyd's in 1983-6, and on the MSSC in 1985-6 (being Chairman in 1986). He gave evidence at trial. The judge described him as a highly professional and skilled underwriter and said that he was assisted by his evidence. He attached particular importance to Mr Murray's evidence about the influential character of the Conning Report (a report produced in 1982 on the impact of asbestos-related diseases on the insurance industry).

113. Mr Edward Nelson* was closely involved in the problems of asbestos-related diseases between 1978 and 1983. He was on the Committee of Lloyd's in 1980-2 and on the Council and Committee in 1983. He was on the Audit Committee in 1982-3 and on the Membership Committee in 1980-3 (being Chairman in 1983). He was a founder member of the AWP (1980-3) and its first chairman (1980-1). He was on the committee of LUNMA in 1978-83 being Deputy Chairman in 1978 and Chairman in 1979. Later a disciplinary committee of Lloyd's found him guilty of discreditable conduct.

114. Mr Alan Parry* was on the Committee of Lloyd's in 1979-82 and on the Council and Committee in 1987-8, being Deputy Chairman in 1987-8.

115. Mr Ian Posgate* was a controversial figure who was implicated in some of the more serious scandals at Lloyd's. He was on the Committee of Lloyd's in 1982 and on the Council and Committee in 1983-4.

116. Mr Kenneth Randall* was a senior employee of Lloyd's who was in that capacity in attendance at the Audit Committee in 1980-4 and the Membership Committee in 1984. He was closely involved in the preparation of the Murray Lawrence letter in March 1982. He was perhaps the most surprising of those whose witness statements were exchanged but who were not in the event called to give evidence.

117. Mr Keith Rayment worked in the claims department of R W Sturge, a Lloyd's underwriting agency, from 1969 to 1990. He was concerned with non-maritime business, primarily that of syndicate 210, and in 1979 he became claims director of that syndicate. From 1980 he was concerned almost exclusively with long-tail United States casualty business. He was a member of the AWP from 1983 (having joined its claims sub-committee in 1981) and he also sat on its reinsurance sub-committee. He was a director of Topliss & Harding (Asbestos Services) Ltd, a service company established by the AWP. He was involved (between 1982 and 1985) in negotiations for the Wellington Agreement which was finally concluded in June 1985. He had an exceptional knowledge of the insurance implications of asbestos-related diseases. He was himself a name from 1980 to 1990. The judge spoke most highly of his evidence:

"Mr Rayment struck me as a highly conscientious claims man who worked tirelessly to assist the market in relation to the handling of asbestos-related and other long-tail claims. I was greatly assisted by his evidence."

118. Mr Ralph Rokeby-Johnson* was a leading underwriter who was active underwriter of Sturge syndicate 210 from 1974 to 1987. He was a member of the AWP from its inception in 1980, being Deputy Chairman in 1981-2 and 1983-8 and Chairman in 1982-3. He was on the committee of LUNMA from 1978 to 1987, being Deputy Chairman in 1983 and Chairman in 1984.

119. Sir David Rowland* began working at Lloyd's with Matthews Wrightson, insurance brokers, in 1956. From 1964 he was involved in the management of Matthews Wrightson and other companies with which that company merged. He was on the Council and Committee of Lloyd's in 1987-90, and then served on the task force investigating the future capital structure of Lloyd's. He was Chairman from 1993 to 1997. In the early part of 1995, as Chairman, he gave evidence to the House of Commons Select Committee which in May 1995 produced a report

entitled 'Financial Services Regulation: Self-Regulation at Lloyd's of London'. It was under his chairmanship and guidance that R&R took place. Sir David Rowland gave evidence at trial and the judge described him as a highly articulate witness.

120. Mr Charles Skey* was a member of the Committee of Lloyds in 1978-81. He was a founder member of the AWP and was on the committee of LUNMA from 1978-85.

121. Mr Don Tayler* (deceased) was a member of the AWP from 1980 to 1983. He was its first deputy chairman (1980-1) and its second chairman (1982). He was the active underwriter of Pulbrook syndicate 90 and as such he effected reinsurance (early in 1982) for the syndicate's old years. It was suggested that he used 'inside' information for this purpose. Sir David Rowland (who was chairman of the holding company of the Pulbrook managing agency) described him as a sensible, serious and cautious underwriter. Mr Tayler died in 1983.

122. The other individuals impugned in the pleadings were Mr Richard Ballantyne, Mr David Barham, Mr Richard Beckett (deceased), Mr Ivor Binney, Mr Patrick Bird, Mr Brian Brennan (deceased), Mr Peter Daniels, Mr Charles Gilmour, Mr Richard Hazell, Mr Alec Higgins (deceased) and Mr Michael Williams.

Chronological summary: before 1982

123. Asbestos is (as the judge stated in chapter 3),

"A fibrous silicate material which achieved wide usage by reason of its physical properties such as the ability to withstand fierce heat, corrosion and decay under almost every condition of temperature and moisture. Its uses included roofing, plasterboard and fireproof wallboard, floor tiles, an ingredient in paints and sealants, car brake linings and clutch facings."

Exposure to asbestos is a causative factor in many diseases, including mesothelioma, lung cancer, gastric cancer and asbestosis. These diseases are typically contracted by workmen who have been exposed to asbestos at their workplace, especially in shipbuilding and the construction, insulation and demolition of buildings of all sorts. Some conditions developed only after prolonged exposure but the most serious (mesothelioma) could result from even a single brief exposure. An important epidemiological study was published in the United States by Dr Selikoff and others in 1964.

124. Claims by workers against their employers for asbestos-related injury were covered by Lloyd's under third party general liability policies extending to cover product liability. Until the advent of asbestos-related claims, such policies had been profitable for underwriters. That changed dramatically with the rapid growth in the manifestation of asbestos-related diseases and changes in tort law in the United States. The first landmark case establishing strict liability was *Borel v Fibreboard* 493 F2d 1076, decided by the Federal Court of Appeals for the Fifth Circuit in 1973. But during the 1970s the number of claims was still relatively small and most were settled for modest sums. Rather under 1000 had been filed in US Federal Courts by 1980 (that figure must be compared with about 100,000 claims by the end of the relevant period in 1988, and about 450,000 claims by 2000).

125. Mr Bradley gave evidence of a conversation at a golf match in 1973 at which Mr Rokeby-Johnson spoke of asbestos as "going to change the wealth of nations" but the judge found his evidence to be unreliable. Mr Rokeby-Johnson's own evidence (given in 1996 to the Syndicate 210 Loss Review Committee) about his perception in 1974 was as follows:

"Q Do you remember whether pollution was one of the concerns that you had when you were arranging the run-off reinsurance in 1974, or were you worried about particular types of liabilities or at that stage were you thinking that you wanted to deal with the whole of the back

years?

A I think my – I cannot call them "doubts" – certainties about the likely run-off of casualty underwriting in the United States overall more than any specific thing. I do not believe that we were aware of the depths and heights and horrors of asbestos, for instance, back then. The potential in this new law was there so it would have been part of it, but I think you were thinking about medical malpractice, trains, cars, all the contractors, all the stuff that had been written quite gaily for all these years, I was thinking much more of that. The overall rather than the particular."

126. Not all experienced lead underwriters took a pessimistic view during the 1970s. Between 1974 and 1982 three well-known underwriters, Mr Outhwaite, Mr Merrett and Mr Meacock wrote run-off contracts which involved heavy exposure to asbestos-related risks. In consequence several syndicates including Outhwaite syndicates 317 and 661 incurred very heavy losses which were the subject of an inquiry conducted by Freshfields. Claims in respect of run-off losses featured largely in litigation brought by names against managing agents and members' agents. The first case which went to trial was *Stockwell v Outhwaite*, which went to trial in October 1991 but was settled in January 1992 before judgment. Three of the cases went together to the House of Lords and have contributed to the development of the English law of tort (*Henderson v Merrett Syndicates* [1995] 2 AC 145).

127. The run-off contracts (and in particular those written by Outhwaite syndicates 317 and 661) are covered in chapter 17 of the judgment. They are an important strand in this tangled story, because as well as producing very large losses they led to suspicions of malpractice by insiders, including those who had special knowledge of asbestos-related problems from their work on the Asbestos Working Party (see paragraph 138 below). These suspicions were raised by a working member of Lloyd's, Mr John Donner, and were investigated by Lloyd's during November and December 1989. (Mr Donner was to have been called by the names but his ill-health prevented that. His witness statement was put in evidence but Lloyd's attacked its credibility.)

128. The investigators appointed by Lloyd's did not find the suspicions substantiated but the interviews which were conducted are a valuable source of evidence which can be tested against the contemporary documents. At a meeting on 20 December 1989 Mr Donner said that his real concern was not to suggest conspiracy:

"He had been concerned for some time, having known Mr Outhwaite, Mr Merrett and Mr Meacock as intelligent underwriters, that he could find no answer to the question of why they wrote the run-off policies. He could only conclude that they had written those policies on the basis of certain information, which raised the question of whether all information that was in the hands of those that ceded the run-offs was made available to Mr Outhwaite. This was one of the specific questions raised in the early days of Mr Donner's enquiries. He emphasised that the doctrine of caveat emptor was not relevant in the context of insurance, although it had been suggested to him at a previous meeting that it did apply. Mr Donner said that he believed that he now knew approximately what had happened and that he would explain this to Mr Lord and would be able to produce corroborative evidence. Focusing on the period of 1981 and 1982, Mr Donner recalled that the insurance market worldwide faced an unparalleled series of losses from asbestos-related diseases. Some American insurance companies talked openly of going into liquidation and Lloyd's also faced a difficult position. At the time that the 1979 account was being closed at December 1981, there were two practical alternatives available to underwriters with an asbestos involvement. The first was to make full provision for the losses in line with information then available which would have resulted in many syndicates remaining open and some going out of business. The alternative was to roll the losses forward so that claims arose in the future and future Names had to pay. This involved massaging the audit at December 1981. The Lloyd's panel of auditors made clear their view of the gravity of the situation to some individuals in senior positions of authority at Lloyd's and there was

general talk of these losses breaking Lloyd's. Senior people in the Market concluded that they could not face this and there was a considered decision by some of those in authority, underwriters and auditors to view the 1979 account as far as asbestos claims were concerned in the most favourable light possible. The result of this would have been to roll forward the losses to later years."

This passage gives the general flavour of actual and alleged events (especially during 1981 and 1982) which this court, like the judge, has had to look at in some detail.

129. On 28 October 1977 the active underwriters of over fifty syndicates initialled a memorandum of agreement as to the negotiation of a settlement of claims in respect of asbestosis made against Bell Asbestos. This document was relied on as showing that in 1977 the market already had general knowledge of asbestos-related risks. In February 1979 there was produced the first edition of the Asbestos Litigation Report, a publication which subsequently appeared at monthly intervals.

130. The growth in asbestos-related claims gave rise to acute differences of legal opinion as to whether liability under general liability policies was related to the period of exposure or to the time when the disease manifested itself (after a time lapse which could be as long as 20 years). The impact of these developments was discussed at an important meeting held on 19 June 1979 at the offices of US attorneys (referred to for reasons of confidentiality as H) instructed on behalf of Lloyd's underwriters. Representatives of attorneys G, K and I were also present. The attorneys made a joint recommendation of a gross reserve of $75,000 for every claim. Their summary stated:

"The one certain fact about the asbestos litigation is that at present we cannot estimate the number of claims that will eventually be brought against your assureds. We do know that the number of lawsuits has increased dramatically each year since 1973. While some experts believe the number and severity of claims will peak within the next year or two, there are others such as The National Cancer Institute who estimate more than two million people will die from asbestos-related cancer. It should be noted that anticipated claims were taken into account to some extent in arriving at the figures recommended above."

131. By the end of 1979 (the year in which Captain Hindle began underwriting) there were several declaratory actions on foot seeking to clarify the basis of liability. A letter dated 10 December 1979 to Mr Nelson (as chairman of LUNMA) referred to

" ... the Market split into two camps; one supporting the manifestation approach and the other that of exposure."

This letter may reflect the genesis of the Asbestos Working Party ("AWP") which was formed in 1980 (see paragraph 135) and of which Mr Nelson was a leading member.

132. At a meeting of the Committee of Lloyd's on 14 December 1979 Mr Lawrence (who later became a Deputy Chairman and in 1988 Chairman) drew attention to the problem of long-tail business being aggregated with other types of business under the rubric of "All other" business. The minutes record that

"He suggested that consideration should be given to breaking down the "All Other" Account in order to extract the very Long Tail business and that premium income was not the appropriate yardstick upon which to base the reserves for the older Accounts."

133. In the five years spanning the start of the relevant period the results of general liability insurance at Lloyd's were in striking contrast to the general profitability of all classes of business combined. That appears from the five-year summary set out in Lloyd's global

accounts 1982, the first to appear in the new format. (In considering these and other tabulated figures it is necessary to keep constantly in mind the built-in time-lag resulting from the Lloyd's system of keeping every accounting year open for a further two years, followed normally by RITC into the next open year. So when new names were shown the results for the last seven closed years the figures would be between four and ten years old.)

	overall		general lia
	underwriting profit	investment income & gains	underwriting loss
	£000	£000	£000
1976	96.5	83.2	(27.7)
1977	99.9	110.9	(13.2)
1978	110.8	169.3	(1.7)
1979	37.1	233.6	(35.8)
1980	21.7	374.4	(118.8)

These figures also show how far the overall profit was coming to depend on investment income and gains. Sir Peter Green (who was Chairman from 1980 to 1983 inclusive and was knighted in June 1982) wrote in his statement preceding the accounts:

"To those whose business is insurance these figures are something of a paradox. While satisfactory enough as a return on capital they are, from a professional point of view, a cause for some concern. It is a sobering thought that pure underwriting profit in 1980 accounted for only £22 million or 8.25% of the overall profit and did not cover the management expenses. "

134. The documentary evidence shows that during the 1970s the problems on the general liability side were identified primarily with computer leasing rather than asbestos-related risks. A Computer Leasing Working Party (chaired by Mr Lawrence) was formed in 1978. But by 1980 that had changed. Computer leasing problems were mostly in the past by about 1982. Mr Rokeby-Johnson's evidence in 1996 put it as follows:

"Q: Can I ask you one thing linked to that. At the time when the placing was taking place the ultimate position on the 1969 and previous liabilities looked very much more like a banking operation for a payment of, say, I think it was in the region of $20 to 25 million, there was an ultimate liability of $35 million ----

A: A perceived ultimate liability, not an ultimate liability.

Q: Yes. A projected ultimate of $25 million [?$35 million] and that was projected to be reached by about 1980. Then by 1977 or 1978 that ultimate position had been projected to reach $90 million. There was a sort of sea change in the projection within a reasonably short time of its placement. Do you recall any underlying reason for that dramatic change?

A: It is called asbestos.

Q: Had that just come into a -----

A: I think if you look, as I recall, at Hady Wakefield's projections, take out asbestos and they were about right. They were remarkably accurate. The thing that turned the coracle upside-down was asbestos, which was enormous."

135. The appellants have drawn attention to numerous documents dating from 1980 and 1981 (including both internal Lloyd's documents and letters from attorney G, attorney H and other attorneys) showing that asbestos-related claims were by then being recognised as a very serious and unpredictable problem. At the end of 1980 claims were being filed in the United States at the rate of about 100 a month (although a letter dated 24 December 1980 from attorney H to Mr Nelson reported that 286 claims had been filed so far that month, and by 1982 the monthly average was about 400; the letter identified three categories of claim and suggested settlements of up to $50,000, $100,000 to $250,000 and up to $450,000 for the three categories).

136. On 27 March 1980 Mr Jim Ayliffe of Merrett-Dixey syndicates (who was very knowledgeable about asbestos-related risks and later was on the claims subcommittee of the AWP) wrote to Mr Jackson reporting on his visit, shortly before Christmas 1979, to a meeting of the Non-Marine Association. He stated that it became apparent that that association's committee did not fully appreciate the impact which asbestos-related disease would have. Mr Ayliffe wrote that so far reserve recommendations had been based on known cases only. American attorneys were seeking guidance and support from the market to

" ... their putting up reserves which do take into account a projection of something in the region of four years. Not unnaturally the size of the figures that would then be recommended would be very large and if indeed the Market wishes that the matter be dealt with in this manner it is also necessary that people such as [attorneys H and I] and others also approach the problem in the same way. Inevitably the impact of projected reserves on our Market will be substantial and I feel that it would be extremely difficult for the leads to make this type of determination by reason of the implications which it carries."

137. On 1 April 1980 the Manager of Lloyd's Underwriting Agents and Audit Department wrote to panel auditors in the following terms:

"The Deputy Chairman, Mr Gibb, has requested that Auditors be informed of the following "facility" which has been offered to certain Syndicates in Lloyd's and which was intended as a form of reinsurance when a Syndicate was closing its Accounts, particularly those with a long tail element where the settlement in respect of the year-end provision might not be made for many years.

The following is an example of how the reinsurance would operate:-

"A Syndicate had known outstandings of £100,000 and an IBNR Load of the same amount – total provision £200,000. On the basis that the top 10% slice of the reserve (£20,000) would not be needed for (say) 10 years £10,000 the Syndicate would be indemnified for £20,000 in excess of £180,000 aggregate losses after 10 years. The anticipated reinsurance recoveries of £20,000 would be deduced from the total audit provision for an outlay of £10,000. Payment of the recovery would be guaranteed by a Letter of Credit for £20,000 payable in 10 years time."

I am to advise you that the Audit Committee does not consider such a reinsurance recovery can be used to reduce a Syndicate's Audit provision because all anticipated recoveries brought into account at the end of the third year must be immediately available."

The appellants' case is that this letter was describing so-called 'time and distance' ("T and D") policies and was expressing disapproval of their use for the stated purpose; nevertheless, the appellants say, they continued to be used for that purpose to the knowledge of members of

Lloyd's Committee and (after 1982) Council.

138. In August 1980 some leading non-marine underwriters formed the AWP. This was an unofficial but influential group whose primary function was to collect and disseminate information about asbestos-related claims and problems. Another function was to work towards a common market view on problems about coverage (these problems included, but were not limited to, the exposure/manifestation debate). The AWP had no agency or other formal relationship with Lloyd's and its membership was not limited to those working in the Lloyd's market (although its chairman regularly wrote, as he was entitled to do, on Lloyd's headed writing paper) and some members of the Lloyd's community appeared to think that it had official status. It continued in existence until 1996. Most of its early meetings were attended and minuted by Mr Stephen Mitchell, a solicitor and partner in Elborne Mitchell. Much of the work was carried out by the claims subcommittee (later called the direct claims subcommittee) and the reinsurance subcommittee; these met more frequently than the full AWP committee.

139. The AWP was not a secret body – indeed its purpose was to provide information – but it had to respect the confidentiality of much of the information which it obtained. That is illustrated by a letter dated 16 February 1982 written to all interested underwriters by Mr Tayler, the chairman of AWP. The last three paragraphs of the letter were as follows:

"As matters continue to develop, and indemnity payments are claimed from the levels of coverage underwritten in London, a record will be maintained by the LUNCO [Lloyd's Underwriters' Non-Marine Claims Office] of the transactions that take place.

It will be apparent to you that there is a need to observe confidentiality in respect of the information which is available, and for this reason when your representative visits the LUNCO office, it will be necessary for that person to identify the accounts in which you participate. Your auditors may also want to see the information, however, in view of the need for confidentiality, it will be necessary for them to be accompanied by your own representative.

It was emphasised to you in the circulation of year end reserves that, in view of the uncertainties of the future, it is difficult at this stage to provide the Market with any meaningful projection of the developments that are likely to take place over the coming years in regard to this problem. However, the number of claims is likely to escalate and for this reason I must emphasise that future deterioration is inevitable."

140. On 30 September 1980 Mr Skey (who was on the Committee of Lloyd's and the AWP) wrote in an internal memorandum (after stating other concerns)

"3) On top of all this we have to absorb the impact of 'DES' 'Agent Orange' and most important of all "Asbestosis". We do not wish to go into the question of coverage and how it may or may not apply in this memorandum but suffice it to say that collectively they must make a major impact on the enclosed loss ratios – and indeed probably on the pre-1966 figures as well.

4) The original premium base is being severely affected by competition and/or rate cutting.

5) If the 'exposure' theory is upheld in "Asbestos" cases we fear it will be impossible ever to close our books with any certainty.

The problem therefore is obvious – how to rate contracts of this nature when you don't know the record for, say, 10 or even 20 years and on a reducing P.I. to boot. The easy (and maybe correct) answer is to say you can't and stop writing the class. If we did others in the London Market could follow suit to the detriment of the market place as a whole."

141. The minutes of an AWP meeting on 28 November 1980, chaired by Mr Nelson, record:

"The Chairman proposed that the Meeting should discuss the desirability of circulating the Market with a report for the valuation of outstanding claims for audit purposes at year end. Mr Ayliffe believed that Attorneys should make recommendations for year end purposes but it was for the individual Underwriters to determine the figures used when closing the account. He was concerned that reserves currently carried on files, were lower than would have been the case under normal circumstances. Those concerned were looking for recommendations from the Working Party before final decisions were made. This view was supported by Mr Jackson, who thought that a figure of US$125,000 per average claim was more realistic than the present figure of US$75,000 currently used as a yardstick."

and at the end of the meeting

"In summary, the Chairman stated: -

a) The Audit Committee were reluctant to identify individual situations for audit purposes. The Asbestosis situation was well known in the Market and they believe that the Underwriters were aware of the potential problems.

b) Attorneys should be invited to give a view on the present valuation of an average, individual claim and should indicate an additional expense allowance. They should also provide information on the likely eventual number of claims which could develop."

142. The minutes of the first meeting of the AWP in 1981 are (for reasons which we need not go into here) available only in a severely redacted form. The parts which the court has been permitted to see show a general agreement that asbestos-related risks were quite different from those of computer leasing: "when the floodgates open the syndicates would not be able to cope" (Mr W W Maitland). It was thought appropriate for a member of the Committee of Lloyd's to serve on the AWP; this had been agreed by the Audit Committee. Mr Ayliffe was recorded as thinking that there should be a "bland report" informing the market that all the information received from attorneys was available for inspection (but Mr Ayliffe is also recorded as taking the view, contrary to the majority, that figures should be published).

143. On 2 February 1981 Mr Randall (the manager of what was then the Underwriting Agents and Audit Department, and the only individual accused of bad faith who was at one stage an employee of Lloyd's) wrote to all the members of the panel of auditors sending their formal instructions in respect of the accounts for 1980. In the covering letter he stated,

"ii) Very Long Tail Business

Where a Syndicate underwrites a very long tail business such as product liability and excess casualty reinsurance business, Auditors are asked to pay particular attention to the effect that such business will have on the reserves to be created bearing in mind the greatly increased cost of claims on older years of account due to inflation etc."

This letter is significant because it marks the beginning of exchanges between the panel and the Committee which are of central importance to the case. (There had been comparable exchanges the year before in respect of the 1979 accounts, but there was a growing sense of concern which reached a peak by the time of the 1981 accounts.)

144. On 20 April 1981 attorney G wrote a long letter of advice to Mr Ayliffe. The letter is remarkable for suggesting what appears (by comparison with attorney H's advice) a very low average cost per claim of $2,500. This appears to reflect the position of the particular insured (as one only of multiple defendants). But the letter also contained a dire warning about the scale of the problem:

"There are numerous well informed people who profess to believe that claims filed to date

represent only the beginning of a potential flood of asbestos litigation. The Secretary of Health, Education and Welfare of the United States recently stated that 67,000 people each year will die from exposure to asbestos products during the next thirty years. We know that between 8,000,000 and 11,000,000 workers have variously been exposed to asbestos in the United States since the beginning of World War II and of this group 4.5 million have worked in shipyards. Most of the shipyard workers have been exposed to asbestos and it is estimated by the United States Government that one third of all those heavily exposed to asbestos have died or are likely to die of asbestos-related diseases. Although the assured's involvement with products containing asbestos does not appear to be as substantial as other defendants in these matters, it may be that in the future the assured regularly will be included among the growing group of frequently named defendants."

145. In June 1981 the AWP sent out to over 150 syndicates (and also to over 50 insurance companies outside the Lloyd's market) a form of general authority conferring on the AWP a limited power to handle and agree claims. By 22 June 1981 68 underwriters had signed unconditionally. Another 6 had signed conditionally and 8 had declined to sign.

146. In September and December 1981 two discussion documents on asbestos-related problems were produced. They were referred to at trial as the 'White Papers'. Each was signed by ten leading members of Lloyd's, including Mr Lawrence, Mr Murray and Mr Skey. They discussed the difficulties of key concepts (such as 'causative agency', 'common origin' and 'common cause') in the context of reinsurance in respect of latent risks. In that context the second paper observed,

"Obviously claims from the asbestos-related diseases are catastrophic and disastrous so far as the whole Insurance Industry is concerned but this fact alone does not automatically qualify them to be treated as 'a catastrophe' ..."

147. On 10 November 1981 there was an important meeting between members of the Committee of Lloyd's (including Mr Kiln, in the chair, and Mr Lawrence, with Mr Randall also present) and representatives of 15 different firms of chartered accountants who were panel auditors. There are several sets of minutes of this meeting prepared by different participants. The Lloyd's minutes record under the heading 'Any Other Business – Asbestosis':

"Mr Kiln reported that claims were being made on notices as far back as 1947 where underwriters had been involved in direct insurances or reinsurances of companies covering liabilities of companies subject to Asbestosis claims.

Mr Lawrence reported that a databank was being produced which would contain details in respect of the 10 or 12 major assureds with all years of cover. The loss adjusters would then be able to make some estimate of underwriters' lines on such risks. Projections of claims for 3 or 5 years hence would be made, and also loss expenses for 2 or 3 years ahead; both such items would be in respect of direct business only. From the databank it would be possible to obtain a list of major companies and look at their reinsurers, to give a rough estimate as to the exposure in respect of reinsurance business.

Mr Kiln pointed out that he did not wish to see mention of these specific claims in the Audit Instructions.

Mr Holland [of Ernst & Whinney] requested that an indication should be given to Auditors as to how the databank report was fragmented, so that they may know what to look for. Mr Lawrence replied by stating that a Market Meeting would be held soon enabling all to be appraised of the situation.

It was agreed that there would be a further meeting of the Panel early next year to consider asbestosis and any other business not concluded at this meeting."

Another note of the meeting began this section

"The potential claims in connection with asbestosis make computer leasing appear insignificant by comparison."

148. The databank referred to in these minutes was known as the Claims Information System. It was developed in 1981 by Alexander Grant & Co on instructions from the Claims Committee of the AWP. It stored information on US claims under more than 40 different heads, as described in chapter 16 of the judgment.

Chronological summary: 1982

149. 1982 was the year in which Sir William Jaffray began underwriting. It is also of central importance in this case. The first three months call for particularly close attention. Counsel for the appellants, and several of the litigants in person, referred to it as the pivotal period, and counsel for Lloyd's did not dissent from this description. It was common ground that if at any stage there was a decision (for which Lloyd's must bear responsibility) to mislead external names and prospective names about the unquantifiable risks of asbestos-related claims, or if there was ever a moment at which those at the centre of Lloyd's should have appreciated that the audit system might not involve making reasonable estimates of outstanding liabilities, it must have occurred during the early months of 1982 when the Neville Russell letter and the Murray Lawrence letter were written.

150. In paragraphs 143 and 147 above we have noted exchanges between responsible officers and officials of Lloyd's and the panel of auditors. At the meeting held on 10 November 1981 it had been agreed to hold a further meeting in the new year in order to consider (among other topics) asbestosis. The further meeting took place on 15 January 1982. Again, there are several different minutes of the meeting prepared by different participants.

151. One note (made on 25 January 1982 by Mr P B Milne of Littlejohn Fraser) recorded Mr Nelson as having advised the auditors in terms which the judge summarised as follows:

"There are to be no specific audit instructions other than a reference to the incidence of late claims arising from product and disease insurance. There have been some 15,000 claims notified (increasing at the rate of 400 per month). By mid to end 1980s it is expected there will be some 25,000 claims in total. E E Nelson thought that the estimate by the Prudential of 2 million claims was well wide of the mark. The Committee of Lloyd's has set up a database whereby the full details of all known syndicates liable are stated. At present loss reserves have been based on an average cost per claim of $125,000 plus expenses of £10,000 per claimant. Currently this means a total claim of $2.025 billion. On an exposure basis 40% is with the London companies and Lloyd's, on a manifestation basis it is 10%. E E Nelson also reminded the Panel Auditors of three other product claims requiring consideration; Agent Orange; Love Canal; and DES."

152. The note also referred to three important legal decisions in the United States. These were the decision of the Court of Appeals for the Sixth Circuit in *INA v Forty-Eight Insulations Inc* (5 March 1981, 633 F 2d 1212) upholding the exposure basis of liability; *Eagle-Picher Industries Inc v Liberty Mutual Insurance Company* (14 August 1981, 523 F Suppl. 110) in which the District Court applied the manifestation basis; and *Keene Corporation v INA* (1 October 1981, 513 F Suppl 47) in which the Court of Appeals for the District of Columbia Circuit adopted the so-called 'triple trigger' basis of liability, which was more favourable to claimants than either the simple exposure test or the simple manifestation test. The note commented,

"Clearly, the foregoing decisions are a bit of a nonsense and the London Market is currently in

the process of appealing to the US Supreme Court to obtain a sensible ruling."

But in the event the United States Supreme Court refused petitions in all three cases (an appeal to the Court of Appeals for the First Circuit in *Eagle-Picher* having been largely unsuccessful in June 1982).

153. By 3 February Neville Russell and three other firms of panel auditors had agreed a form of questionnaire which was distributed to underwriters. It should be noted that there were in all fifteen panel firms, but Neville Russell and the other firms who joined in the Neville Russell letter (mentioned below) had between them over four-fifths of the syndicate audit work. The questionnaire asked for information under five heads: (i) direct writing or reinsurance of main carriers; (ii) other exposure to asbestosis; (iii) IBNR (Incurred but not reported); (iv) reinsurances; and (v) other latent disease claims.

154. The general nature of the responses to the questionnaire appears from a memorandum sent by Mr A M Blake, the senior partner of Neville Russell to his syndicate partners:

"ASBESTOSIS

From the replies that are coming in from our clients certain facts are emerging with great consistency:

1 A very few clients have probably very little exposure.

2 The remainder are unable to quantify their ultimate liability with even a remote degree of accuracy for the following reasons:

(i) Advices so far are 15,000 – maximum would be 11,000,000.

(ii) Courts have not decided on whether exposure or manifestation basis is applicable.

(iii) The losses are being apportioned over carriers on an "industry" basis. If one of the carriers has losses going right through its insurance cover (as is highly likely) then it could well go into bankruptcy. That company's share of the industry loss would then be apportioned over the remaining companies.

(iv) Although many insurers are covered by reinsurance, I don't get the impression that many have been able to get very far with this.

(v) Similarly, Syndicates will pick up the losses on their own reinsurance writings, which are likely to fly round the market with some speed. None of these appear to be notified so far. One particular Syndicate has been mentioned more than once as being involved in writing the reinsurance of other people's run-offs.

(vi) The data bank established has very little value so far.

Very early in March we will need to meet again with the other auditors to agree our approach."

155. Two days later Mr Blake wrote another memorandum to his partners:

"Further to my memo of 17 February I think that we should pay immediate attention to the instructions contained within the document "Instruction for the guidance of Lloyd's auditors".

We never strictly follow this clause to the letter because if we did we would never get our audits complete, but in view of the Asbestosis problem I think we should follow the letter of the paragraph absolutely."

What I have in mind particularly is the instruction "if there are any other factors which affect or may affect the adequacy of the reserves, then the auditor must report to the Committee and obtain their instructions before issuing his Syndicate Solvency Report".

This seems the obvious course of action in this particular case and I think we should proceed as soon as possible."

156. On 22 February Mr Randall sent a memorandum to Mr Lawrence headed "1982 Audit". The second item was:

"Reserves for Asbestosis and other latent diseases

I have arranged for the item to be put on the Agenda of both the Membership Committee and the Audit Committee when further consideration will be given to the basis of reserving and whether new Names should be warned that specific syndicates are carrying a liability for such risks.

I will advise you of the outcome of these discussions."

157. That was the immediate background to the Neville Russell letter dated 24 February 1982 which Mr Blake wrote in his firm's name to Mr Randall as manager of Lloyd's audit department. Neville Russell stated that they were writing on behalf of five other firms of panel auditors. The main part of the letter was as follows:

"A substantial proportion of our Syndicate clients have losses, or potential losses, arising from asbestosis and related diseases.

It appears that although, in respect of direct insurance of the main carriers and reinsurance of American insurers, Syndicates have received some notification of outstanding claims, they are unable to quantify their final liability with a reasonable degree of accuracy for the following reasons:

(i) You have informed us that there have been approximately 15,000 individual claimants. Total exposure to the problem appears to be considerably in excess of this figure.

(ii) The Courts have not yet finally decided on whether the exposure or manifestation basis is applicable.

(iii) The losses are being apportioned over carriers on an "industry" basis. If one of the carriers has losses in excess of its insurance cover (as seems likely) then it could go bankrupt. It appears that its share of the industry loss could be apportioned over the remaining companies.

(iv) Most Syndicates are not very certain of their reinsurance recoveries.

(v) Most Syndicates will incur losses on their own writings of reinsurance business. Very little of this has been advised so far.

The Audit Instructions (Clause 3) require that if there are any factors which may affect the adequacy of the reserves, then the auditor must report to the Committee and obtain their instructions before issuing his Syndicate Solvency Report.

We consider that the impossibility of determining the liability in respect of asbestosis falls into this category and we accordingly ask for your instructions in this respect."

158. This letter provoked a good deal of discussion, both formal and informal, and various views

were expressed. The eventual consequence was the despatch of another important letter, the Murray Lawrence letter dated 18 March 1982, written by Mr Lawrence, then the Deputy Chairman of Lloyd's. There was an issue at trial of who were the intended recipients of the letter, and whether it was in fact sent to them. It is also necessary to look closely at what happened in the period of about three weeks between these two letters.

159. On 1 March there was a meeting of the AWP chaired by Mr Tayler. The minutes record:

"The Chairman raised the question of the letters which had recently been circulated to Underwriters by the Panel Auditors. He believed the Auditors appreciated that it was not possible for Underwriters to be precise in their reply although he was disturbed at the ignorance displayed by certain syndicates on the question of Asbestosis generally."

160. On the following day there was a meeting of Lloyd's Audit Committee, chaired by Mr Chester, with Mr Randall present. The Neville Russell letter was at the top of the agenda. The minutes record the discussion as follows:

"Mr Chester said that he had spoken to Mr Nelson with regard to this matter who had put forward the following suggestion:

a) with regard to direct business, underwriters should reserve their known claims plus a margin of 30% and their expenses.

b) with regard to reinsurance assumed they should allow for one loss per assured per each year of account.

c) on Underwriters own reinsurances it was suggested that they approach the matter on the same basis as (b) above; Mr Nelson thought that this would be the basis on which the excess of loss market would settle any claims.

With regard to the question of whether claims should be reserved on an exposure or manifestation basis it was considered that whichever basis produced the worst result should be adopted.

d) the letter from the auditors also stated that the losses were being apportioned over carriers on an "industry basis". If one of the carriers had losses in excess of its insurance cover then it could go bankrupt. It appeared to auditors that its share of the industry loss might then be apportioned over the remaining companies.

e) the auditors' letter also stated that many syndicates lacked information regarding their reinsurance recoveries. Mr Nelson considered that recoveries might be determined on the formula for reinsurance assumed business as set out above.

Having discussed Mr Nelson's views, the Audit Committee considered that it would not be possible or desirable for them to give a definite answer as to the amount or basis of reserves syndicates should carry. It was a matter for the underwriter of each syndicate to determine his potential liability and agree this with his auditor. It was, however, necessary for a full discussion to take place with Panel Auditors so that where possible general guidance could be given and it was agreed that a meeting should be arranged in this regard at the earliest opportunity.

Mr Chester then raised the question of the reinsurance of underwriters' asbestosis liability in the Lloyd's Market (ie effectively amounting to reinsurance of the Asbestosis "tail") and expressed concern that such liabilities could fall on comparatively few syndicates. Mr Merrett considered that it would be inappropriate for such reinsurances to go unnoted and unreserved by Panel Auditors and that it would be improper for a syndicate taking such reinsurances

without telling its own Names. It was stressed that auditors should make any enquiries they deemed necessary with regard to the open years and that they should ensure that whatever position they consider is necessary should be created over and above the minimum percentage reserves.

It was agreed that this matter should also be raised with Panel Auditors at next week's meeting."

The appellants have suggested that Mr Merrett's contribution, as recorded in the minutes, can now be seen to have been highly questionable.

161. On 9 March 1982 members of the Audit Committee (Mr Chester and Mr Nelson, accompanied by Mr Randall and his assistant) met with representatives of the six firms of panel auditors on whose behalf the Neville Russell letter had been written. The Audit Committee minutes record that Mr Nelson explained that the problem had three aspects:

> "(i) Business written direct by Lloyd's
>
> (ii) Reinsurance of asbestosis risks written by companies
>
> i. Where Lloyd's syndicates had reinsured their liability with outside companies."

Mr Nelson explained the controversy as between manifestation, exposure or a combination of the two. The minutes record the auditors' views and the subsequent discussion:

> "The main worry raised by auditors was the widely differing views taken by syndicates and that the real purpose of their letter was an attempt to seek some uniformity in the Lloyd's Market for dealing with this matter. They considered that it would be grossly unfair for syndicates on basically the same risk to treat their reserves on an entirely different basis. Auditors were also concerned that not only may they reserve too little but that they may ask the closing year to carry too great a reserve. Part of the auditors' job was to ensure that there was equity between the account accepting the reinsurance and the closing account.
>
> Mr Chester asked auditors for their opinion on leaving the 1979 account open. Auditors thought that although this would solve the problem of equity between years of account it would still leave the problem of quantification in that Names could still be asked to put up substantial sums of money.
>
> Mr Nelson then said that in his view a figure of 50,000 new claims over the next 10 years would seem to be realistic and that the reports of up to 2,000,000 new claims could well be an exaggeration.
>
> Mr Randall then said that perhaps Lloyd's could consider issuing guidelines on the basis of the 50,000 figure and that where asbestosis formed a material part of a syndicates accounts (say 10%) then consideration should be given to leaving the account open.
>
> Auditors said that they would be reassured with guidance of this sort. It was, however, suggested that in those cases where consideration was being given to leaving the account open applications should in any case be made to the Committee for instructions."

162. During the next few days Mr Randall had at least one further meeting with representatives of the six firms of panel auditors. On 12 March Mr Nelson produced an eight-page memorandum

(headed 'Strictly Private and Confidential – Implications of Asbestosis Involvement for the Audit of Lloyd's Syndicates at 31.12.81'). This document was considered and annotated by Mr Randall and then passed by him (on 15 March) to Mr Lawrence (then one of the two Deputy Chairmen of Lloyd's) for a meeting of the 'O' Group (see paragraph 189 below) held on 15 or 16 March.

163. The opening paragraphs of Mr Nelson's memorandum were as follows:

"The following is a personal appraisal and opinion regarding the Asbestosis problem and is based on my own experience as Chairman of the Asbestosis Committee in 1981, two formal meetings with the Panel Auditors and various private conversations which I have had with individuals in the Market. There is little doubt now that this problem is every bit as serious as was expected by the Asbestosis Committee, and the information on claims involvement which has been made available in the LUNCO office has identified the extent of Lloyd's involvement.

There is no doubt in my mind that Panel Auditors are extremely nervous of their position regarding the audit at 31st December 1981. They consider the situation to be unique and not one where they alone should bear the responsibility of deciding the amounts which should be reserved at year end.

Whilst they would agree that most Underwriters are co-operating fully, there are some who by design or ignorance are not complying. Auditors are going so far as to suggest that all Syndicate accounts must be qualified and some seek an instruction that all accounts must be left open at this year end. To my mind, neither of these should be acceptable to the Committee [of Lloyd's].

If this view is supported, then I believe it is incumbent upon us to give clear and concise instructions as to how the audit should be conducted in certain areas and thus bear a share of the responsibility to Names for which they are entitled."

164. The appeal bundles contain a copy of Mr Nelson's memorandum annotated by Mr Randall. Mr Randall's manuscript comments show some of his thinking at the time. He agreed with Mr Nelson that the final decision to leave a year open must be the underwriting agent's. He wrote 'Expand?' against Mr Nelson's proposal,

"Managing and Members' Agents must advise their Names at year end of their Asbestosis position overall and the manner in which the claim has been handled by them."

At the end of Mr Nelson's proposals Mr Randall wrote,

"+ ? Position of New Names."

165. On 15 March 1982 Mr Lawrence initialled a memorandum for consideration by 'O' Group. This is one of the very few documents in the appeal bundles which refer to 'O' Group as such. Its terms suggest that Mr Randall's comments on Mr Nelson's memorandum were approved by Mr Lawrence.

166. On the same day Mr Murray (then the active underwriter of the Kiln syndicates) wrote a letter headed '1979 Reinsurance to Close'. The letter was formally addressed to the Chairman of the Audit Committee (who was Mr Chester) but it begins 'Dear Murray' (Mr Lawrence being in 1982 the Deputy Chairman with responsibility for auditing matters). The letter began,

> "There has obviously been much discussion within the market regarding asbestosis and other potential loss developments on old years. These problems obviously present difficulties to the Underwriter closing the account, and to the

Managing Agent and Panel Auditor. I have, however, heard that one or more Panel Auditors have approached the Lloyd's Audit Committee for specific guidance with regard to the figures which should be allocated to asbestosis claims, and I am sufficiently disturbed by the possibility that this should be true for me to write this letter.

I am concerned because a request for your guidance in this matter seems to suggest:

a) that it is possible to set a figure to close an account that will be proved closely accurate in the future;

a. that one or more Panel Auditors may have lost confidence in their own abilities."

The letter strongly urged that RITC was ultimately a matter for the experience and judgment of the active underwriter,

" ... but regardless of this all of us should surely acknowledge that even our best endeavours may be found to be far too much or far too little at some later date."

This letter has been referred to as the 'Bannockburn' letter from a postscript whose casual anti-semitism may or may not reflect the tone of Lloyd's in the 1980s.

167. We have been shown no written record of what happened at the meetings of 'O' Group on 15 and 16 March. On 16 March there was a meeting of the Membership Committee, chaired by Mr Bird, which considered the topic (brought forward from a previous cancelled meeting) of what changes (if any) should be made to the standard questions put to candidates at Rota meetings. The minutes record two small changes which were agreed and then state,

"The decision was taken not to refer specifically to Asbestosis risks in the Rota brief."

168. On 17 March there was a formal meeting of the Committee of Lloyd's with Mr Peter Green in the chair. Committee members present included Mr Brennan and Mr Lawrence (the Deputy Chairmen) Mr Barber, Mr Barham, Mr Bird, Mr Chester, Mr A W Higgins, Mr Miller, Mr Nelson and Mr Posgate. The Committee had a memorandum and a draft letter prepared by Mr Randall, who was present for the relevant part of the meeting. The Committee did not, it seems, have copies of the Neville Russell letter itself. The final paragraphs of the memorandum stated,

"The attached draft will, it is believed, assist Auditors in agreeing the reserves to be created at 31st December 1981, although it is still possible that a few individual syndicates may feel it necessary to approach the Committee for further instructions. It is also likely that a number of syndicate accounts will be left open at the discretion of the Managing Agent concerned.

The letter also covers the position with regard to the open years.

In all cases it is felt that Agents must advise Names regarding the basis of reserving and also advise Names on the open years which will assume the liability.

The Committee is asked to agree that a letter along the lines of the attached may be issued to Agents. Before publishing the letter, however, it is recommended that there should be further informal discussion with Auditors to confirm that the letter provides an adequate degree of "comfort" to enable them to complete their Audit discussions."

169. The minutes of the discussion and the Committee's decision must be set out in full:

"The Committee was advised that six firms on the Lloyd's Panel of Auditors covering the large majority of syndicates had requested instructions, in accordance with Clause 3 of the Audit Regulations, as to the basis on which syndicates should provide for Asbestosis liabilities as at 31st December 1981.

The main area of concern centred around the need for syndicates to make searching enquiries regarding their potential exposure, both direct and by way of reinsurance written, to enable them to make adequate provision in their accounts at 31st December 1981. There appeared to be substantial differences in approach both as to the amount of research carried out and the intended IBNR loadings as at 31st December.

Without guidelines from the Committee, Auditors believe that there was a real danger that Managing Agents and Auditors would not be able to agree the closing reserves and that some syndicate results may be qualified by Auditors. It was also pointed out that there could be wide discrepancies regarding the approach adopted by individual syndicates.

A draft letter had been prepared for the Committee's agreement and discussion ensued on its content.

It was pointed out that the draft had already been discussed with three of the Auditors concerned and that in the case of two firms it was regarded as of vital importance that the Committee should stipulate a minimum percentage for the IBNR loading. They also considered that the Committee should issue some guidance to Agents with regard to whether syndicates should close at the end of the third year or remain open. It was felt that the term "a material proportion" was too vague and that a specific percentage should be quoted.

In discussing this matter the Committee felt that it was in no position to stipulate a minimum percentage for the IBNR loading as this could vary from syndicate to syndicate depending on the cover given to insurers and its own reinsurance programme. Mr Nelson said that in respect of at least one large manufacturer syndicates had already reserved up to the policy limits and that no further IBNR would be necessary in this case.

Certain Members of the Committee were unhappy that the Committee was instructing Agents that they must tell their Names of their syndicate's involvement in Asbestosis. It was therefore decided that the wording in this regard should be amended so that Agents would be strongly advised to inform their Names of their involvement in Asbestosis.

It was also pointed out to the Committee that certain syndicates had indicated their intention to discount the reserve for Asbestosis to reflect possible future investment earnings and that Auditors had requested a statement in any letter from the Committee specifically banning this practice. The Committee whilst agreeing that such practice should not be allowed in the case of Asbestosis decided that to refer to one particular part of the reserve might lead underwriters to take the view that such a practice of discounting was being encouraged or condoned by the Committee.

With the exception of the points mentioned above the Committee agreed that the draft letter should be forwarded as soon as possible to the Market but that a separate letter from the Manager of the Underwriting Agents & Audit Department should be sent to Auditors in reply to their letter requesting guidance. This would set out more fully the Committee's reasons for the approach it had adopted to the problem."

170. The draft letter, which was approved with few amendments, became known as the Murray Lawrence letter, sent out signed by Mr Lawrence on 18 March 1982. It too must be set out in full:

"Asbestosis – Lloyd's Audit at 31st December 1981

Potential claims arising in connection with Asbestosis represent a major problem for insurers and reinsurers. It is therefore all the more important that the reserves created in the Lloyd's Audit at the 31st December 1981, fairly reflect the current and foreseeable liabilities of all syndicates.

I should stress that the responsibility for the creation of adequate reserves rests with Managing Agents who will need to liaise closely with their Auditors. Clearly, individual circumstances will vary, but it is felt that the following broad guidelines may be helpful to Underwriters, Managing Agents and Auditors in agreeing equitable reserves as at 31st December 1981, and ensuring, so far as possible, a reasonably consistent approach to this problem.

1. Reserves for Asbestosis liabilities should be separately identified and disclosed to Auditors. This applies for both the closing and open years.

2. Substantial information has been built up in the LUNCO Office regarding direct business and all Underwriters should check the information available to ensure that their own records are as complete as possible. This information should also be made available to the syndicate auditors.

3. It is in the area of reinsurance writings that the information available may be least complete. Nevertheless, the Committee believes that some information is now available within the Market and Underwriters and Managing Agents should discuss with their Auditors the steps they have taken to quantify and reserve for losses which may arise on an Excess of Loss or Pro Rata basis as a reinsurance of American or other insurers. In this connection, Underwriters should attempt to identify reinsureds on whom Asbestosis claims are likely to fall and to seek their opinion as to the basis on which they intend to submit claims on their reinsurance contracts together with the reserves which they are carrying at the present time and an estimate of possible future liabilities.

4. The Committee is aware of the legal argument whether liability arises on the basis of "exposure" or "manifestation". It is not, however, for the Committee to express an opinion as to which is correct. For the purpose of reserves at 31st December 1981 Managing Agents are strongly advised to carry a reserve which is the higher of the alternatives.

5. An IBNR "loading" should be carried for those claims not specifically advised but which could come to light in the years ahead. The decision regarding the appropriate IBNR percentage is a matter for the Agent and his Auditor to resolve dependent upon the circumstances of each case. It would be inappropriate for the Committee to lay down a minimum loading but, it appears that this loading should be substantial to reflect unreported cases on the direct account and incomplete information on the reinsurance account. Credit may, of course, be taken in respect of reinsurance recoveries, but Agents should verify, so far as possible, that reinsurers have been identified and have agreed to accept claims on the basis submitted. In the event that there are any disagreements with reinsurers these should be discussed with Auditors. (The normal guidelines regarding the admissibility of reinsurance recoveries obviously will apply).

6. A syndicate which has written a run-off or stop loss in respect of an Asbestosis account which has been signed into an open year, should advise the details to its Auditors and where appropriate, the open year reserves should be increased.

7. A syndicate underwriting London Market Excess of Loss business should make particular and comprehensive efforts to ascertain the extent of its possible liability going beyond those claims which have been advised at 31st December 1981, and these should be fully disclosed to and discussed with Syndicate Auditors. The same requirement should apply to specialist Personal

Stop Loss syndicates.

8. Where the reserve for Asbestosis represents a material proportion of the total reserves of the syndicate, Agents should consider whether or not to leave the account open. It is the Agent's responsibility to ensure that the reserves provided for Asbestosis are sufficient to meet the Syndicate's liabilities regardless of whether the account is closed or left open.

9. Managing and Members Agents are strongly advised to inform their Names of their involvement with Asbestosis claims and the manner in which their syndicates' current and potential liabilities have been covered.

I would urge you to discuss the contents of this letter with your Auditor before deciding what further action, if any, is necessary for you to take.

If you should have any enquiries with regard to this matter would you please contact Mr M Bowmer (Extension 3299) or Mr K E Randall (Extension 3124).

This letter has been sent to all Underwriting Agents and Active Underwriters, with copies for information to all Panel Auditors."

171. Mr Randall's accompanying letter of 18 March (sent to panel auditors only) was as follows:

"Asbestosis – Lloyd's Audit at 31st December 1981

Several Panel Auditors have approached the Committee for instructions under Clause 3 of the Instructions for the Guidance of Lloyd's Auditors regarding the basis on which syndicates should provide for Asbestosis liabilities in their accounts at 31 st December 1981.

I attach a copy of a letter which is being circulated to all Active Underwriters and Underwriting Agents setting out broad guidelines which should be followed in this regard.

The Committee has decided that it is inappropriate to specify a minimum IBNR loading to apply across the Market; the IBNR loading is regarded as a matter for Managing Agents to resolve depending upon the particular circumstances of each syndicate. Nevertheless the Committee wishes me to stress that, unless there are sound reasons to the contrary regarding any specific case, the loading should be very substantial to reflect unreported cases on the direct account and, possibly, incomplete information on the reinsurance account. The Committee also believes that the reserve (including the IBNR loading) should be maintained in full and not discounted to reflect possible future investment earnings.

One of the main reasons why the Committee does not feel it is appropriate to lay down a specific IBNR loading factor is that in a number of cases syndicates will have reserved up to the maximum of policy limits and a substantial IBNR loading, in addition to this figure, might be regarded as excessive.

Auditors will no doubt give special attention to the question of whether or not the Agent has decided to leave an account open in cases where the reserve for Asbestosis represents a material proportion of the total reserves of the syndicate or where there is a wide margin for error in the basis of calculation of the closing reserves due to a lack of current information.

Where it is decided that an account should be left open, your attention is particularly drawn to Clause 6 Note 1 of the Instructions for the Guidance of Lloyd's Auditors regarding the reserves which are being created for the purposes of assessing Members' solvency.

If you should have any queries with regard to this matter would you please contact Mr M Bowmer (Extension 3299) or myself (Extension 3124).

The names' case (summary and discussion)

391. The names rely on the matters summarised in this and the following paragraphs. In summarising them it is convenient to add some discussion and to reach some conclusions, although our main conclusions on this period are at paragraphs 427ff below. In the first place the names rely on the wording of the Neville Russell letter itself – *the impossibility of determining the liability in respect of asbestosis.* The names say that Mr Lawrence's attempt to explain in evidence what auditors were concerned about (i.e. that the concern was over the lack of uniformity in the ways in which syndicates were dealing with the matter) simply should not be accepted, and should discredit him as a witness.

392. In mid-February 1982 Mr Tayler in his role as chairman of the AWP wrote to underwriters stating "it is difficult at this stage to provide the market with any meaningful projection". No projections were done by the attorneys; how then were underwriters to be able to calculate IBNRs with any degree of accuracy? The only method would be by reference to how years had progressed historically.

393. Mr Randall, according to a note of his evidence at the Donner Inquiry in December 1989, recalled discussing the auditors' concerns with Mr Murray Lawrence, and that there was great concern that full reserving could bankrupt many syndicates, that many syndicates might have to leave their accounts open and that losses could bust the market; and (although this may be more relevant to consideration of the position after March 1982), he had been unable to understand how the results reported in 1982 were not as bad as he had expected in the light of the views expressed by the auditors. Mr Randall in a signed statement dated 25 August 1993 said this:

> "The Panel Auditors expressed grave concerns regarding the question of reserving for asbestos related claims. They commented that if a proper view was taken of reserves needed by syndicates at December 1981 auditors would not be able to sign off the reinsurance to close for the 1979 account of many syndicates which would have to be left open. Alternatively there would need to be such large provisions for future asbestos claims that the market would effectively be bankrupt. They said they wanted to give me advance notice of a formal approach to Lloyd's for guidance under Lloyd's audit instructions. I reported on the issues raised by Panel Auditors to Mr Robert Kiln who was or had just ceased to be the chairman of the Lloyd's Audit Committee, and to Murray Lawrence, who was then the Deputy Chairman of Lloyd's with responsibility for matters concerning the annual solvency test of Names."

The suggestion is that these passages support the view that the letter was sent to underwriters and auditors (1) appreciating that they would understand that if insolvency was to be avoided a calculation would have to be done (even though actually impossible) and (2) that if some calculation had to be done anyway, then accounts may as well be closed even though no-one could tell whether the RITC premium was fair.

394. The names rely on the decision not to refer in the Rota briefs specifically to asbestosis risks. We have already referred to and dealt with the decision not to refer to asbestosis as such in the audit instructions (see paragraph 383 above), but the decision not to refer to asbestosis in the Rota brief is clearly of much greater concern. The judge found "that this was an honest decision" (chapter 19, page 328). It is said by Lloyd's that the background to this decision was the letter from Mr Langton (Chairman of the LUAA) on 5 March 1980 in relation to the fact that "computer leasing" was a matter to which reference was made in the Rota brief. He hoped that questions about "computer leasing or any other specific claims would be avoided at Rota". The thinking behind such a request was explained by Mr Colin Murray, "if we had mentioned some issues and not others this might have been misleading and the subject of criticism".

395. At the time of the decision not to refer to computer leasing at Rota a letter (dated 26 March

1980) was sent to underwriting agents reminding them of their duties to keep names informed of past and future matters which might affect their underwriting. That recommendation was then incorporated into the manual for underwriting agents. The thinking was that it was for members' and managing agents to advise about the risks and about which syndicates to join. This view was supported by Sir Peter Miller, Mr Lawrence, Sir David Rowland, Mr Bird, Mr Lord and Mr Pollard. Indeed it was, and is, a significant aspect of Lloyd's case that the names' case ignored the fundamental importance of the role of the members' and managing agents in advising and informing the prospective name on issues such as whether to join Lloyd's, what portfolio of syndicates to join, and what the risks and advantages of particular types of business and particular types of syndicates were.

396. This may well accord with any relevant legal duties i.e. no duty of disclosure on the regulator but duties on the members' agents. But it is not easy to see why some check at Rota that the duties of agents were being complied with would have conflicted with that thinking. Time and again the names forcefully made the point about the lack of any warning emanating from the centre, and we have found it compelling. Sir William Jaffray made the point in his response to Lloyd's skeleton of 4 March 2002. Mrs Ann Strong made the point that her Rota interview was in August 1982 without any questions being raised on asbestos. Mr Sydney Butler, who joined Lloyd's in 1986, put the argument in favour of disclosure most forcefully and eloquently in paragraphs 5 and 14 of his written submissions. Mr Adams and Mr Richard Carter also made the same point.

397. But the question for the court is whether the decision not to refer to asbestos in the Rota brief in March 1982 supports the case that those who sent out the Murray Lawrence letter believed that despite its terms the result would be a suppression of the asbestos problem, and that consistent with that suppression, nothing should be said to new names at Rota. There is the note by Mr Randall on the Nelson memorandum (paragraph 164 above) at about this time "? Position of new names" and before then (indeed, even before the Neville Russell letter had arrived) Mr Randall had on 22 February 1982 (paragraph 152 above) written to Mr Lawrence:

"I have arranged for the item to be put on the Agenda of both the Membership Committee and the Audit Committee when further consideration will be given to the basis of reserving and whether new Names should be warned that specific syndicates are carrying a liability for such risks."

398. This would seem to indicate that the decision not to raise the matter with new names at Rota was taken in conjunction with the sending of the Murray Lawrence letter, and not simply coincidentally. Neither Mr Randall nor Mr Nelson gave evidence at the trial and thus their explanations are unknown. The matter was explored shortly with Mr Lawrence on day 39 pages 6014-5 where he explained that computer leasing was a very easy subject to address and that in any event the problem there was the premium transfer. We are of the strong view that the decision not to refer to asbestosis at the Rota meetings was misguided, and so misguided as to have given rise to suspicion as well as resentment in many names. But it does not follow that the decision was dishonest nor does it necessarily lead to the conclusion that Lloyd's was guilty of any dishonest representation.

399. The names further suggest that it is necessary to examine the knowledge of those responsible for sending the Murray Lawrence letter, and any evidence relating to their credibility. In this regard it is convenient to identify those present at the Committee meeting on 17 March 1982. Thirteen members of the Committee were present, and Mr Randall and Mr Bowmer attended for the discussion of the draft letter. Of the thirteen, eleven are within the 33 charged with dishonesty, and Mr Randall is also so charged.

400. Of the eleven, the names suggest that there are reasons to doubt the integrity of certain of them in any event. Sir Peter Green was ultimately censured, being found guilty of serious professional misconduct. Mr Posgate was involved in the Alexander Howden scandal. Mr Nelson

was found guilty of discreditable conduct.

401. The names further suggest that there was evidence to support the view that Mr Lawrence had not been frank in February 1990 (during the Donner Inquiry), when questioned about the reinsurance his syndicate took out around the time that the Murray Lawrence letter was sent. The notes of the Inquiry record the following interchange:

"Mr Lord asked when a decision in principle to accept the policy had been reached. The Chairman said that he could not be precise about this but referred to the schedule of dates that had recently been prepared for him by Winchester Bowring and which showed that this must have occurred in the period between about 19 February and 1 March.

Mr Lord referred to concerns that had been expressed to Lloyd's by the panel auditors at about that time concerning reserves for the 1979 account and asked whether the Chairman's decision had been affected in any way by knowing of these concerns. The Chairman said that their decision to take the cover under the run-off policy was purely as a precaution against some development that could not possibly be foreseen at the time, for example the possibility that fluorescent bulbs might suddenly be found to cause eye damage or something of that sort."

402. The names suggest that the reality was that the reinsurance was being taken out because of a fear that the asbestos problem might explode and the failure even to mention asbestos demonstrates a guilty mind. At the trial Mr Lawrence was taken to his note prepared in 1989 where he suggested that the policy was to cover an "Armageddon situation" and asked what he meant. His answer was as follows:

"Well, I regarded the fact that if, when we bought this contract in 1982 that if it was ever going to get affected - we bought it as a catastrophe contract, if I can use that in general terms, something quite catastrophic had to happen to make that contract be effective and that catastrophic happening could be one of two things. It could be some new situation coming to light which no-one could have foreseen and I use somewhere else, just to show the sort of stupidity of it; I think it could have been light bulbs that would blind us or it could have been mobile phones, it could have been anything; I want to make the point it could have been something unheard of at that time. The other way it could have been affected would be a catastrophic deterioration of something that was already over the parapet that we didn't expect. Those were therefore the two things I thought could have affected this contract and, as it happened, we got affected by both. Asbestos catastrophically deteriorated and we had pollution."

403. It was put to him that he in fact always had in mind "at the time of entering into the run-off contract, that asbestos might explode", and his answer was that he did not "otherwise I would have bought the first quote excess of $37.6" and "why would I have left $18m in the middle" (day 42 page 6383). Mr Adams, in a written submission received after the appeal hearing, has referred to a quotation from an annual statement of the syndicate and has also supplied a letter from Bowring Reinsurance to Fireman's Fund Insurance Co dated 20 October 1981. They demonstrate that asbestos was in mind when the cover was negotiated and that it did in fact cover asbestos losses. But that is not really the point. What is sought to be extracted from the above is (1) that Mr Lawrence felt guilty that he had taken out the reinsurance at all at the time of the Murray Lawrence letter and that he was prepared to be economical with the truth at the Donner Inquiry, and (2) the reason he felt guilty was (so the names allege) because he appreciated that such reinsurance was the only basis on which a syndicate could protect itself because in reality there was no way of calculating IBNRs.

404. The suggestion has to be that Mr Lawrence was also not telling the truth at the Donner Inquiry in the following interchange:

"Mr Lord asked whether the Chairman could recall discussions that took place early in 1982 with Mr Nelson and Mr Randall about how the market might react to the concerns expressed by panel auditors. The Chairman said that he could barely recall the meetings at all, though he had recently refreshed his memory by seeing documents that Mr Hewes had listed for him.

Mr Lord asked whether in any sense the letter of 18 March 1982 which the Chairman had signed in his then capacity as Deputy Chairman had been "for the record" with the expectation that the market might still fail to reserve adequately. The Chairman said that this was not the case. At the time there was great uncertainty within the market as to which syndicates and reinsured companies would be affected by asbestosis claims, for which years and on which basis, given that the Keene decision had not yet been finalised. In no sense was the letter written for the record. He could not speak for the view that individual underwriters in the market might have taken. He simply recalled that the market was advised to take especial care in the matter. Mr Lord noted that it had been suggested that Lloyd's could not face the losses that might have been involved and that there was a decision to let the future pay. The Chairman said that he could not speak for what views individual underwriters in the market might have taken. He could speak for his own position. He had taken over the syndicate in 1968 and had concluded that the syndicate was severely under-reserved for the past. He had cancelled a lot of contracts with effect from 1 January 1969 and thereafter the syndicate was not heavily involved in US liability business until the 1970's when they had some involvement in relation to medical malpractice insurance. He had not been in close touch with the way that American casualty business had developed in the intervening period as others in the market might have been."

405. It is also suggested that he was not telling the truth at the trial when cross examined on that passage (day 42 page 6384). The judge summarised Mr Lawrence's evidence and referred to the reinsurance that his syndicate took out (chapter 15, pages 226-229). He did not however make any findings about the nature of Mr Lawrence's evidence to the Donner Inquiry, and why he appeared reluctant to mention asbestos at that inquiry when dealing with the reinsurance. The judge did not in fact make any express finding about the credibility of Mr Lawrence (although by his conclusions he must have accepted that the letter was written in the honest belief that underwriters and auditors could make an assessment of syndicates' reserves). We have serious reservations about the veracity of Mr Lawrence's evidence to the Donner Inquiry in so far as it was seeking to give the impression that asbestos and its uncertainty was not a factor in the mind in arranging the reinsurance. It is fair to say that in addition to Mr Lawrence's evidence, there was the evidence of Mr Keeling and Mr Archard which supported the view (a) that the policy was not primarily a guard against the syndicate's asbestos exposure and (b) that Mr Lawrence was not himself the key influence in the taking out of the policy and thus it was not taken out because of some 'insider knowledge' on the part of Mr Lawrence.

406. Mr Randall was not called to give evidence. It was somewhat unsatisfactory that a statement by him had been prepared and placed before the judge for his pre-reading. This case had many problems for the judge in terms of simply managing the case and, as explained in Part VIII below, he held that he had no power to compel Lloyd's to call those witnesses whose statements had been read by him and that the appropriate course was to put the statements out of his mind, and treat the witnesses as uncalled. There was no challenge to his ruling on this aspect by the names represented by Mr Goldblatt. Certain of the names in person have drawn attention to this aspect in their contention that the trial was unfair. We will deal with the ruling under that section of the judgment. But that still leaves the question of whether the judge should have drawn an adverse inference against Lloyd's. It seems to us that on aspects where the evidence points in a direction against Lloyd's in an area which could have been dealt with by Mr Randall the judge should have drawn an adverse inference from Lloyd's failure to call Mr Randall to deal with it. This does not mean that any allegation that the names make against Mr Randall must be accepted because he did not give evidence. It simply means that where the evidence points in a certain direction an adverse inference can be drawn from a

failure to call the witness to deal with it.

407. This conclusion seems to us to be in accord with the principles as to the drawing of adverse inferences summarised by Brooke LJ, after an extensive review of the authorities, in *Wisniewski v Central Manchester Health Authority* [1998] PIQR 324:

"From this line of authority I derive the following principles in the context of the present case:

(1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.

(2) If a court is willing to draw such inferences they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.

(3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.

(4) If the reason for the witness's absence or silence satisfies the court then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified."

408. As to the knowledge of the eleven and Mr Randall, the position is as follows:-

a. Mr Murray Lawrence certainly had knowledge of asbestos as a problem; the "white papers" dated September 1981 and 4 December 1981 signed by him (see paragraph 146 above) record "Obviously claims from the asbestos related diseases are catastrophic and disastrous so far as the whole insurance industry is concerned....". There is then the series of meetings with panel auditors, the Neville Russell letter, the Nelson memorandum, and possible discussions with Mr Randall as recorded by Mr Randall.

b. Sir Peter Miller – as far as we can see it is not suggested that Peter Miller had knowledge of anything of relevance as at this stage. He was a marine broker.

c. Mr Frank Barber- he would have the circular letter establishing the AWP, and was at the meeting at which a decision was taken not to mention asbestosis in the audit instructions on 7 December 1981. He must have been generally aware of asbestosis as a market problem.

d. Mr David Barham – from Cuthbert Heath who had a long acquaintance with US casualty business.

e. Mr Patrick Bird – a director of the Kiln Agency, and likely to be aware of the extent to which the Kiln syndicate was affected by asbestos. He was a member of the Membership Committee which decided that asbestosis should not be on the Rota brief.

f. Mr Edward Nelson – he was member of the AWP; he addressed the auditors in March 1981, and 1982; he wrote the Nelson memorandum; there can be no doubt about his in-depth knowledge of the asbestos problem as it appeared in 1981, and his influence as to how to deal with the anxieties of the auditors is clear.

g. Mr Ian Posgate – he must have had some awareness of asbestos as a problem, and it was his evidence given in 1994 which is referred to above.

h. Mr Brian Brennan – he was deceased by the time of the trial; he was on the Audit Committee in 1980 and 1981; he would have been aware of asbestos as a problem since he was a party to the decision (at the meeting on 7 December 1981) that it should not be referred specifically to in the audit instructions.

i. Mr Harry Chester- deceased by the time of the trial; he was on the Audit Committee 1980 - 1983. He was at the meeting of that Committee when the Neville Russell letter was discussed on 2 March 1982; he attended the Auditors' Panel meeting on 9 March 1982, and he asked the opinion of the auditors on leaving the 1979 account open.

j. Sir Peter Green – deceased by the time of the trial; he was Chairman; Mr Posgate in his 1994 evidence suggested that he had spoken to Sir Peter Green about dealing with the asbestosis problem gently; Mr Lawrence gave evidence that Janson Green was a leader in US casualty business; and Mr Lawrence in evidence suggested that in December 1982 Sir Peter wished to be "up-dated on the whole question of asbestosis" indicating a degree of knowledge prior to that time.

k. Mr Alfred Higgins – deceased by the time of the trial; he was very senior and thus likely to know of problems with US long-tail casualty business.

l. Finally there is Mr Kenneth Randall – as drafter of the Murray Lawrence letter and author of his own, the position of Mr Randall is central. He was recipient of all material documents during the relevant period, and it is unnecessary to recite them again at this juncture.

409. Sir William Jaffray and other litigants in person relied on a speech of Miss Plumptree made on 5 December 1990 in which she was highly critical of the way in which the RITC was calculated and in which she posed this question : " ... with the advent of ever increasing and ever more unquantifiable long-tail risks, can any underwriter today honestly and fairly quantify his outstanding liabilities with any degree of accuracy?" Miss Plumptree, we were told, was a solicitor who had worked in the legal department in Lloyd's from 1978 to 1988. She was at Titmus Sainer and Webb at the time that she made her speech. Sir William sought to suggest that her words could be imputed to Lloyd's and that what she said in December 1990 could be taken to be the view of Lloyd's during the whole of the relevant period, including 1982. The views expressed by Miss Plumptree are of some interest but it cannot be said that they reflect the view of Lloyd's and it cannot be said that they reflect the views of Lloyd's throughout the relevant period.

Lloyd's case

410. Lloyd's submit that the evidence points to those at the centre (and particularly those on the Committee who approved the sending of the Murray Lawrence letter) believing that the system was working and believing that it could work. The following factors they suggest support that view.

411. In the first place they rely on the terms of the interchanges between auditors and Lloyd's at this time and the terms of the letters themselves. It is submitted that the documents show that what was concerning auditors was the attitude, and indeed the difference in attitude, of different underwriters to their exposure to asbestosis. The following question and answer between Mr Goldblatt and Mr Lawrence provides the flavour:

"Q It is saying, isn't it, "we consider it impossible to determine the liability in respect of asbestos; this is a factor which may affect the adequacy of the reserves. Please, Committee, tell us what to do." It is as simple as that, isn't it?

A No. My reading, Mr Goldblatt, is: they summarise on the first page, points that have been made to them in previous meetings with the representatives of the Audit Committee. They have said that those are difficult to do because they had certainly indicated to either the Corporation people, people concerned, that what was worrying them was the complete difference, different ways that syndicates were approaching the sort of problems that had been set out on page 1, and that if they didn't have guidance on those points – how to deal with them – then they would have an impossible task in finding the right results for the syndicates, because they found syndicates on the same risks dealing with them in totally different ways. So this was the guidance that they were seeking under Clause 3.

Q That is a gloss which you put on the letter, maybe from subsequent talks, but it is not what the letter says is it?

A Well, in my memory, Mr Goldblatt, it was made clear to us by either Mr Randall or somebody else, that having talked with the auditors this was the problem; it was the total lack of common approach across the market to these problems that made their task impossible."

412. That inconsistency was a concern is reflected in the contemporaneous notes. The minute of 9 March 1981 contains the following:

"The main worry raised by the auditors was the widely differing views taken by syndicates and that the real purpose of their letter was an attempt to seek some uniformity in the Lloyd's market for dealing with the matter."

In any event it is said the Audit Committee were not prepared to accept it was "impossible" to calculate reserves. The Murray Lawrence letter stressed asbestosis as a "major problem for insurers and reinsurers"; the importance of reserves "fairly reflecting the current and foreseeable liabilities of all syndicates"; that an "IBNR loading should be carried for those claims not specifically advised but which could come to light in the years ahead"; the decision for the IBNR percentage was for the agent and his auditor to resolve; "where the reserve for asbestosis represents a material proportion of total reserves of the syndicates, Agents should consider whether or not to leave the account open". The Randall letter to the auditors drew attention to the guidelines of the Murray Lawrence letter; stressed that "the [IBNR] loading should be very substantial to reflect unreported cases on the direct account and, possibly incomplete information on the reinsurance account"; it should not be discounted to reflect possible future investment earnings; special attention would have to be paid to the assessment of reserves in the situation in which an account was left open, and where they were being created for the purposes of assessing a member's solvency. Taken together, the letters read as if it was believed that there was a system that could be applied and would work provided people realised the seriousness of the problem, and the letters did not read as if accounts must be closed at all costs nor as though certificates of solvency must be produced at all costs. Further, they gave clear instructions that names should be informed.

413. That they did believe that the system worked is supported by the fact that following receipt of the Murray Lawrence letter and the Randall letter, no auditor or underwriter suggested that dealing with the 1979 year and its exposure to asbestosis was impossible. The auditors who had been parties to the Neville Russell letter were themselves approving the premiums for RITCs as fair and certifying solvency. Cresswell J found no negligence on the part of Mr Merrett or his auditor in closing the 1979 account in 1982; the Kerr Committee's view was that either everyone was negligent or no-one was negligent in closing the 1979 accounts in 1982, and preferred the view that no-one was.

414. If those responsible for sending the Murray Lawrence letter were of the view that the system no longer worked and that reserves for asbestosis were unquantifiable, the expectation would be that they would not continue to underwrite on syndicates exposed to asbestosis, certainly would not increase their exposure, and would take out stop-loss policies to protect themselves. In fact 13 of the 33 were on the Merrett syndicate which ultimately was forced to leave its 1985 year open (those 13 included Mr Lawrence, Mr Nelson, and Sir Peter Miller who were on the Committee that approved the sending of the letter, and also Mr Rokeby-Johnson, Mr Skey, and Mr Jackson); and 5 were on the Outhwaite syndicate that left its 1982 year open (including Mr Nelson, Sir Peter Miller, Mr Rokeby-Johnson, and Mr Skey). Mr Lawrence increased his underwriting from £265,000 to £1.3m over the relevant period; Mr Rokeby-Johnson increased his from £468,000 to £1.3m; Mr Colin Murray increased his; Sir Peter Miller increased his lines and his family increased their lines; and Mr Kellett, Mr Jackson, Sir David Rowland, and Mr Bird all increased theirs. Twenty one of those accused of being dishonest did not have a stop-loss policy in relation to their own underwriting, including Mr Lawrence. A note prepared by those representing Lloyd's provides the complete picture. Sir William Jaffray contended that Lloyd's misled the court over the underwriting losses suffered by the 33. This submission was particularly aimed at Sir Peter Miller, a point to which we will return hereafter.

415. Insurance companies were managing to calculate reserves including IBNRs. They, as history shows, were getting it as wrong as the syndicates at Lloyd's, but it is only hindsight that demonstrates that fact.

416. Many underwriters, whether or not on the full Committee or any of the sub-committees at Lloyd's, thought that the figures on which the names now rely (taken from the Califano statement, Dr Selikoff's research, and the Commercial Union), as the forecast of the number of possible victims, were exaggerated. Mr Nelson for example is recorded as expressing the view at the Audit Committee Meeting of 9 March 1982, that "in his view a figure of 50,000 new claims over the next 10 years would seem to be realistic and that the reports of up to 2,000,000 new claims could well be an exaggeration." The names' case is that Mr Nelson was dishonest, and he was one of those witnesses not called against whom it is said the judge should have drawn adverse inferences. The names place some reliance on the fact that Mr Nelson was ultimately found guilty of discreditable conduct by a disciplinary committee. That finding was not a finding of dishonesty, but even if it had been it would have related to one matter – the writing of policies to confer benefit on himself and his family. That would not establish dishonesty of any other kind. Mr Nelson as previously indicated was on both Outhwaite and Merrett syndicates that reinsured the run-offs of other syndicates with long-tail US liabilities. He increased his underwriting from £202,500 on 10 syndicates in 1979 to £312,500 on 11 syndicates from the 1982 to 1987 years. He was caught on the Outhwaite 1982 open year and the Merrett 1985 open year. Lloyd's submit that that is simply inconsistent with dishonesty on the part of Mr Nelson, and in particular inconsistent with him having deliberately scaled down his predictions.

417. Lloyd's also rely on the fact that other experienced underwriters gave evidence that they could calculate reserves; for example the names called Mr Mackinnon who wrote stop-loss policies during the relevant period. He had all the information from attorneys' reports and the AWP. He thought he had his reserving right; took out a limited run-off policy and declined greater protection in 1982. He did not think the market was under-reserved, otherwise he would not have gone on writing stop-loss policies until 1988. Mr Jackson (underwriter for syndicate 799), and Mr Rayment (claims manager for Sturge), accepted by the judge as being amongst the most knowledgeable in relation to asbestos, also gave evidence as to how the problem developed in unexpected ways.

418. Mr Aldous also relied on passages from the evidence of Mr Keeling and Sir David Rowland. One passage from Mr Keeling's evidence relating to the Commercial Union report is worth quoting:-

"There are several of these reports out there that were certainly written - the one I can remember is the Commercial Union one - was really, I think, written to try and accelerate tort reform in the United States of America. I think you had some agenda setting out there other than actually finding out what the ultimate figure was. It is quite interesting that the Commercial Union figures ... You see the figures out of the Commercial Union report. I am not sure there were 11 million, but there were quite lurid figures out there - that was not the figures Commercial Union reserved on. They were not the figures Commercial Union reported to their reinsurers."

419. Reference was also made by Mr Aldous to the Conning & Co report produced in September 1982 which put the range of successful claimants as between 40,000 and 90,000. Furthermore, there were other estimates being made outside Lloyd's. Even in 1984 a projection was being made for the purpose of the Johns Manville reorganisation of 44,000 claims; that was revised in 1986 to between 83,000 and 100,000 claims, and approved by the US bankruptcy court in those terms. In the event 240,000 claims had been received by 1995 and over 400,000 claims by 2000. Sir William Jaffray suggested that Lloyd's gave a misleading impression to the court of the effect of asbestos being worse than expected. Lloyd's may have sought to underplay how serious the problem was perceived to be in 1982, but there is no doubt that there were two views as to how serious the problem was likely to become and there is no doubt that the problem became more serious than many persons at the centre contemplated.

420. In any event sheer numbers of claimants generally could not ultimately assist in assessing how individual syndicates would be affected. What they do not tell you is firstly who will bring a claim; secondly whether that will be a product liability claim or a workman's compensation claim; thirdly who they will be bringing a claim against; fourthly the defences available to those insureds; fifthly how much insurance those insureds may have, for what years and on what terms; sixthly the defences that may be available to their insurers; seventhly what reinsurance those insureds have; and eighthly what proportion of the insurers' total reserves concern exposure to this type of claim (which may be important when a determination is being made of the impact of the possible adverse development in one type of claim to its whole book of account).

421. Mr Aldous submitted that there had never been any suggestion by names that syndicates were under-reserving for pollution. He submitted that if syndicates were deliberately under-reserving for asbestos there was no logic in their taking a different approach to pollution. The Inland Revenue, even in 1984, were suggesting that syndicates were over-reserving, and were unconvinced that the large sums which were being set aside in the RITC process could be justified. A settlement was ultimately negotiated with the Inland Revenue at the beginning of 1985 under which Lloyd's paid £42.5m.

422. Mr Aldous also referred to the run-off policies written by Outhwaite, Merrett and Meacock. In essence Mr Aldous made three points in relation to these policies. First, they demonstrated a different view being taken by those underwriters towards long-tail business. Second, when their view turned out to be wrong and when claims far exceeded the premiums received they made allegations of non-disclosure and those allegations failed. They failed in the case of Cockell, Hampton and Hiscox so far as Outhwaite was concerned. They failed in the case of Pulbrook so far as Meacock was concerned and in Judd and Gooda Walker so far as Merrett was concerned. Third, although at one time an allegation was maintained that it was insiders who were placing these run-off policies e.g. Cockell and Lawrence, the truth was that many policies were placed by persons who could in no way be described as insiders. The information that was available to those at the centre was also available to underwriters and claims staff generally.

423. It was not possible for anyone at the centre of Lloyd's to carry out a global calculation at the

beginning of 1982. There were far too many unknowns. For the purpose of the R&R in the 1990s it took three years and cost many millions. The matter had to be dealt with at syndicate level, each syndicate having all the relevant information available (including such reinsurance as it possessed) in order to assess its own position. It was reasonable to send the Murray Lawrence letter and the Randall letter in order to make syndicates and auditors deal with their individual positions. That might have led to syndicates leaving their accounts open or auditors being unable to approve RITCs or certify solvency. Those possibilities were left open.

424. Mr Rayment (a witness who much impressed the judge) gave powerful evidence in relation to calculating an equitable RITC. Certain questions and answers (on day 38 page 5792) are worth quoting:

"Q. Did you feel - I know you were not involved in the exercise, but did you feel that Mr Rokeby-Johnson in conjunction with his auditors, was in a position to set an equitable RITC in order to close the accounts of that syndicate?

A. I would spend a considerable amount of my time leading up to the end of the year in conjunction with the auditors, almost permanently based in our office, and I believe we did a very thorough and exhaustive job in, I believe, putting all the facts before Mr Rokeby-Johnson and the auditors for the purpose of the RITC.

Q. I understand that. Following that exercise, were you aware that Mr Rokeby-Johnson is closing the year of account in conjunction with the auditors having set an IBNR?

A. Yes.

Q. Did you personally feel that although you were not involved in the exercise Mr Rokeby-Johnson in conjunction with the auditors could arrive at an equitable RITC?

A. I believe so, yes."

Mr Aldous also referred us to the evidence of Mr Murray, Mr Jackson, Mr Keeling and Mr Archard.

425. Mr Aldous also relied on the fact that auditors were amongst those who supported the reform which brought about the obligation to certify accounts as showing a "true and fair view". That, he submitted, was inconsistent with the notion that there was already something impossible in the calculation of outstanding liabilities. Panel auditors, including for example Mr Blake of Messrs Neville Russell who had signed the Neville Russell letter, gave evidence to Sir Patrick Neill in relation to the preparation of his report and did not suggest that there was any impossibility in calculating or certifying reserves.

426. Mr Lawrence (and Mr Rayment and Mr Jackson) gave evidence and refuted the suggestion that they had been dishonest. Mr Jackson concluded his statement powerfully in the following way:-

"I would like to conclude this statement on a personal note. I fully understand and can appreciate the upset felt by the names in this action. Like them, I too joined Lloyd's after the majority of the insurances and reinsurances which caused losses had been underwritten. For me, it was made worse in that I had spent nearly twenty years attempting to sort out the problems we had or inherited, rather than enjoying the results of the business. Like the names I also lost a lot of money.

When I gave up the chairmanship of LMCS in October 1988 I decided I would have no further involvement in past problems. I was therefore very reluctant to become involved in this action. However, I did not feel I could allow the appalling allegations against me and others to go

unchallenged. It is difficult, in a matter of pages, to explain just how much time and effort I gave to the problem of asbestos, writing to and talking to the market and its insureds and reinsureds about asbestos problems, to make sure that as many people as possible understood the seriousness of the issues at stake.

To be involved in this action after these efforts is insulting. I categorically deny that I made any efforts or took any actions to withhold information from anybody on this subject, nor did anybody suggest I should do so, to allege otherwise is outrageous.

As I have said, like others in the insurance industry, we at Lloyd's in good faith, underestimated the ultimate cost of asbestos losses. Nobody denies that. What I do strongly deny is any wrongdoing in any of my dealings in asbestos matters."

Mr Aldous also relied on the evidence of Mr Lord, ultimately Chief Executive of Lloyd's and not charged with dishonesty, and the evidence of Mr Fredjohn called by the names, who gave evidence of the integrity of the persons at the centre of Lloyd's with whom they were involved.

Conclusions as to the position in 1982, and the Murray Lawrence letter

427. Some justified criticism can be made of the judge in relation to his assessment of the witnesses. For example, in relation to Mr Lawrence the names attacked his credibility in relation to his syndicate's run-off and his reluctance to accept that asbestos was in his mind. The judge did not say expressly what view he formed about that, and, as indicated, we have our reservations about it. Furthermore, having summarised his evidence, the judge made no comment whatever about it. In addition some witnesses were not called who could have assisted the judge in building up an accurate picture of the period just prior to the sending of the Murray Lawrence letter. Mr Randall is the prime example, but there is also Mr Nelson. If the evidence demonstrated that there were matters pointing to dishonesty, which those witnesses might have dealt with if they had been called, then clearly, as it seems to us, an adverse inference should have been drawn by the judge from the decision not to call them, and it is a legitimate criticism of the judge that he did not deal with this aspect. But that said, it must be stressed that (a) if an adverse inference is to be drawn, there must be some evidence which required dealing with before that adverse inference can be drawn; and (b) the task set for this judge was enormous, and it would be astonishing if some errors could not be detected in his judgment; any such errors must be viewed in the context of the whole.

428. We have also already expressed our anxiety about the decision taken by the Membership Committee, two days before the Murray Lawrence letter was sent, not to mention asbestosis in the Rota brief. Furthermore we do not find convincing the explanation as to what it was that the auditors were saying about their concerns in the Neville Russell letter i.e. the lack of uniformity in the ways in which different syndicates were reserving. Could the Murray Lawrence letter have spelt out more clearly the obligation to reserve to "ultimate", including for example an instruction not simply to load the estimates of known claims but to make some estimates of future claims and assess their likely worth as Sir William would suggest? (See paragraph 18 of Sir William's reply). Do these factors demonstrate a guilty mind? Was the position that Mr Lawrence and others believed (i) that reserving for the IBNR element of asbestosis losses was actually impossible; (ii) that whatever the terms of the letters both to underwriters and auditors, underwriters would continue to make assessments which would enable them to close their accounts with auditors being satisfied of the RITCs and auditors certifying solvency; and (iii) that as long as Lloyd's continued to represent all was well, the market would be kept afloat, names would not resign and new members would not be put off joining provided they were not told? Does the fact that Mr Randall in particular was not called to deal with the discussions at the time, add support for that scenario?

429. We have found these questions worrying. We can well understand the names' suspicions. But we have come to the clear conclusion that the names' case at trial fell far short of the heavy

burden of proof required to establish dishonesty. The submissions made by Mr Aldous (summarised at paragraphs 410 to 426 above) are very powerful.

430. The terms of the Murray Lawrence letter and the Randall letter themselves are the starting point. There is no vestige of a suggestion that underwriters and auditors should do otherwise than make a proper attempt at assessing RITCs. It is made clear that syndicates may have to leave their year open. The underwriters are being told that they must inform their names. The reports of the syndicates quoted in section W of Lloyd's closing submissions at the trial consistently refer to asbestosis and to reserving for asbestosis. Of course (as one finds in the internal documents, and as is supported by what Mr Randall was apparently saying at the time of the Donner Inquiry), there was anxiety as to what might follow if many years were left open and if (of even more importance) certification of solvency could not take place. But the letters were in clear terms, and if auditors and underwriters had taken the view that they could not make an assessment of outstanding liabilities, the outcome would have been the very result about which anxiety was being expressed. That is inconsistent with the sending of the letters being dishonest.

431. Furthermore, the conduct of persons such as Mr Lawrence and Mr Nelson in relation to their own underwriting, after the letters were sent, supports the view that they did believe that the system was working and that liabilities were being properly assessed. They must have thought that the RITC premium which was being received by the years in which they were still underwriting or increasing their share was being assessed fairly. If no case of dishonesty can be made against Mr Lawrence (or Mr Nelson), then it is difficult to see how any case could be made against others on the Committee at that time.

432. We have to remind ourselves that the judge did see Mr Lawrence in the witness box over a period of days. If the letter he wrote was dishonest, then (as we have said) he must be the key person against whom that charge must succeed. We have had anxieties (and as it would seem more anxieties than the judge), but the names have not succeeded in establishing that the Murray Lawrence letter and the Randall letter were sent out without an honest belief that the audit system could assess reserves, and have not succeeded in demonstrating as at March 1982 that they did not believe what was being represented in the brochures at that time, let alone that they knew that the representations were untrue or were reckless as to their truth.

Evidence as to 1983-8

433. We now go on to consider whether there came a point during the period following the sending of the Murray Lawrence letter when any one of those charged with dishonesty appreciated that the representation that the system was producing reasonable estimates for reserves was untrue. We repeat what we have said in paragraph 379 above as to the need to read this part of the judgment in conjunction with the chronological summary in Part III.

434. Having regard to the view which we have just expressed, our starting point must be that the representation was believed to be true when the Murray Lawrence letter was sent out, in other words, that it and the Randall letter were honest letters. What followed the sending of the Murray Lawrence letter and the Randall letter was the finalisation of syndicate accounts in April and May 1982. No underwriter or auditor suggested that reserving was impossible. Furthermore, the reports to the names, set out in section W of Lloyd's closing submissions, consistently refer to asbestosis and to the reserves made for asbestosis. The open year file would indicate that 5 or 6 1979 accounts containing latent disease risks were left open (as at 31 December 1981, but reported on in 1982) but the vast majority were closed (see paragraph 200 above). That would not provide an indication that the system was not working, if anything it would suggest that it was. Furthermore, pursuant to Clause 3 of the Audit Instructions, auditors were bound to report on inadequacies as between premiums paid to close the 1978 accounts and those paid to close the 1979 accounts.

435. At the end of the year the Audit Committee reviewed Instructions for 31 December 1982 and recommended once again that reports on inadequacies in the premiums to close accounts should be provided by the auditors. It recommended as follows:

"Reports on Inadequate Reinsurance

Auditors are required to report all cases where the reinsurance to close an Account (or the reserves created at the end of the third year of an Account) has appeared, after 12 months, to have been inadequate.

As at the 31 December, 1981 Audit, there was an increase in the number of cases reported, there being 63 cases where the reinsurance premium charged to close the 1978 and previous years' Accounts appeared to be inadequate after 12 months; this compared with 48 cases reported at the Audit as at 31st December, 1980. Of the 63 reported cases 19 revealed an inadequacy of 15% or over and it is intended that these be followed up to ascertain the reason for the inadequacy."

436. On 9 December 1982 the Committee is recorded as resolving:

"REPORT ON INADEQUATE REINSURANCES

THE COMMITTEE CONFIRMED the recommendation of the Audit Committee that, as soon as possible after the 31.12.82 Solvency Test had been completed, a review should be carried out of all those Syndicates where a report had been received in respect of an inadequacy in the reinsurance to close from the previous year, 31.12.81. It was expected that this review would commence at the end of June and, having first been considered by the Audit Committee, would be submitted to the Committee of Lloyd's."

At that Committee were present 15 persons including eleven against whom charges of dishonesty are made. At first sight it may seem strange that the review was not to take place until June 1983, but it would seem that that was dictated by the fact that the Solvency Test and RITC for the current year should be completed first.

437. During 1983 the Minutes of the Audit Committee indicate concern over the calculation of the RITC. At a meeting in September 1983 Mr Nelson pointed out that LUNMA "at the request of the Audit Committee, was looking into the question of long-tail reserving, and that a Sub-Committee had been set up...". At a Special Meeting on 26 September 1983 a Report on the Inadequate Reinsurances was considered. The note of the meeting records:

"REPORT ON INADEQUATE REINSURANCES (CLAUSE 3)

At a previous meeting of the Audit Committee, a report was circulated setting out those Syndicates which appeared to have created inadequate audit reserves on the Accounts which had closed at the previous 31st December. The Audit Committee had requested that for those Syndicates which had reported a figure of 15% or over, the inadequacy should be looked at in relation to the capacity and premium income of the Syndicate concerned.

The information was then laid before the Committee.

On consideration of the figures, the Audit Committee felt that although in some cases the figures appeared to be extremely high, it was, in general, felt that the circumstances and reasons for these figures had to be taken into account. One of the main reasons for the high apparent inadequacies was the asbestosis increase on closing reinsurance. The MSS Committee did, however, feel that where an apparent inadequacy arose and the Syndicate had also an overwriting situation, this should be followed up."

438. Furthermore, on 22 December 1983 the DTI wrote to Mr Parkington, Members' Solvency and Security Department. Amongst many other matters he said this (in the context of the MPRs being set):

"NON MARINE "ALL OTHER" U.S. DOLLAR

The reserves for this exceptionally long-tailed account look very weak indeed, particularly at the end of years 1 to 4 but also throughout the tail. There is prima facie evidence in Table 3 that the minimum reserves have not been shown to be adequate, and the full picture is yet to emerge, as the estimated ultimate cost as at years 7, 8, 9 etc based on the minimum audit reserves will probably be shown to be too optimistic. GAD believe that strengthening is needed in the tail, and also in the first four years. Objections to minimum reserves of more than 100 per cent of premiums received would need to be resisted: the premium rates and the actual experience are both relevant. To the extent that there is implied discounting for future income (as was discussed at your meeting with Vernon Lane) we think it better to face this openly and declare the underlying assumptions.

. . . . . .

I should however be grateful if you would confirm that the comments in this letter will be taken into account in reviewing the reserving system. I understand from our conversation that Lloyd's has commissioned a report from a consulting actuary on this subject. As the Secretary of State has a statutory duty to approve the basis of the calculation of general business liabilities at Lloyd's, I think it would be desirable for the Department to be consulted about the proposals at an early stage, as you have done in respect of the Premium Trust Deed."

439. The response to the above on 16 April 1984 was as follows:

"Non-Marine "All Other" U.S. Dollar

It is agreed that the scale of audit reserves looks weak compared with the run-off date in the Tables and the observations made by G.A.D. have been noted. As you know, it has been argued that it is reasonable to keep the reserves at or around their present level, having regard to the future earnings on the retained fund. It is acknowledged that this avoids declaring the underlying assumptions and does not deal with the problem of the wide mix of business comprised in this category. We are continuing to examine the means by which this account may be subdivided, but it has not yet been possible to agree appropriate groupings of the sub-classes to which separate scales of audit reserves might be applied. It is also hoped that the studies which are being conducted under the guidance of Mr Sidney Benjamin (consulting Actuary) will help to overcome the problem of those Syndicates whose accounts do not follow the pattern of the overall settlement figures for the Market.

I confirm that the comments in your letter will be further considered when the reserves to be applied to Underwriters' accounts as at 31st December 1984 are reviewed. As you know, we carried out the review last year at an earlier stage than in previous years. It is very important for the Market that this exercise is carried out at the earliest possible stage and I think you should be aware that we are aiming for an even earlier review this year. The prompt attention your Department has given this matter has been greatly appreciated and I trust it will be possible for this to continue.

I have mentioned above the review that is being carried out by the Working Party under the chairmanship of Mr Sidney Benjamin into possible alternate methods for determining the minimum audit reserves. The initial report of the Working Party has been presented to the members of the Members' Solvency & Security Committee who have decided that the proposals should be further tested before any recommendation is made with regard to their implementation."

440. In February 1984 there was the usual meeting between the auditors and what had by now become the Members' Solvency and Security Department where the auditors were brought up to date with the position on asbestosis by Mr Jackson, Chairman of the AWP. During 1984 there were serious problems with the Inland Revenue who were challenging the use of roll-over policies, and the size of RITC premiums. It was in this context that Mr Barber is quoted as saying in relation to asbestos liabilities, "These losses are coming in at a frightening rate and for many syndicates a full reserve would bring massive losses to names in 1981/82 Accounts. This loss may settle very slowly if every case is contested through the courts or may settle very quickly as underwriters attempt to reach a compromise. In the former case, the reinsurer will make profits, in the latter there exists the probability of severe losses."

441. The difficulty so far as roll-over policies were concerned was that, as one document put it, they "parade[d] as ordinary reinsurance policies" (see paragraph 209 above) whereas in many cases they were not, in that they were placed with captive entities, and represented no more than funds, placed usually overseas, which could be called on at any time to pay losses. There were instances where these policies were used to the detriment of names but the Inland Revenue's attack was on the use of such policies taken out for the benefit of names. So far as the RITC was concerned the Inland Revenue's attack was that syndicates were simply building up reserves rather than paying out profits on which names would otherwise have had to pay tax.

442. It was in this context that Lloyd's made its presentation to the Inland Revenue in November 1984. The papers presented contained a detailed description by Mr Parkington of how the RITC was intended to be calculated and carried out. There was a paper from Mr Stephen Merrett describing the RITC as "the largest single risk in most cases". There was a paper from Mr Kellett, much relied on by the names, in which he explained why syndicates could not simply use the MPRs recommended by Lloyd's; how year on year the Committee at Lloyd's had found it necessary to increase the MPRs providing "conclusive evidence of the unreliability of using past statistics to estimate future development"; and how in his view "we are under reserved, what concerns us is how the industry can survive its under reserving".

443. We have already quoted part of this paper (paragraph 218 above) but it is worth adding a further passage:

"Despite the difficulties, the underwriter will eventually, after detailed study of the figures and in consultation with his staff, arrive at a figure, which I can only describe as being his assessment of the real worth of the reinsurance he is to effect. As with any other reinsurance, he must know what he thinks its worth, in order to know what he is prepared to pay for it. Performing, as I have said, his last duty for the Members of the closing year's syndicate, he must endeavour to pay no more than this price, and if possible less. If he could effect a reinsurance to close with another party, for less than his assessment of its worth, he should do so and will be in breach of his duty if he pays more to any other party, including the following year's syndicate.

The reality, however, is that any third party would inevitably want more. It is in the nature of one underwriter, looking at another's account, to take a hard view of all the evidence that points to deteriorating results, and to pay scant regard to factors seeming to show improvement.

I have, myself, written the run-off of other syndicates where they have been unable for various reasons to effect it with a following year. Free from the normal constraints I have taken a commercial view and loaded on every bit I could before setting the premium. In all cases the original underwriters have thought mine a very high price, but these run-offs cost me dearly, before I in turn reinsured them with yet another syndicate at what I thought was a very high price, paid only because there was no alternative market. The losses are now costing

them dearly.

And the underwriter certainly won't be doing his duty to the assuming year's members, if he, as their underwriter, takes on the liability at less than his assessment of its worth.

Thus the reinsurance to close, would, in most cases continue to be placed with the following year of account. At what the underwriter believes to be its true worth, and what history will more probably show to be too little."

444. With the above in mind it is relevant to quote the speech of Mr Peter Miller at the General Meeting of Members on 28 June 1984:

". . . . we are working, through our Accounting and Auditing Standards Committee . . . . towards a comprehensive and more stringent approach to the auditing of Syndicates. The number of underwriting Members at 1st January 1984 was 23,438 and the signs are that more than 4,500 will come forward for Membership in 1985. At the same time, approximately 5,500 existing Members increased their underwriting commitments with effect from 1st January 1984, at which date the total of Members' deposits and Special Reserve Funds amounted to £1,289m. This amounted to 38% of overall Premium Income Limits and may be compared favourably with the figures ten years ago when the corresponding amount represented 17.1% of Premium Income Limits. As the Market turns, Lloyd's is therefore well placed to take proper commercial advantage of that turn. I ask you to remember who will be responsible for that success which lies within our grasp. It will not be the Council, it is not the activity of regulation which creates wealth but rather the activity which is being regulated .... I cannot end this section of my address without a mention of reinsurance to close. The Revenue has a right and duty to satisfy itself as to the validity of the sums of money involved. The Underwriter has a right and duty to try to ensure that an adequate premium is charged for the transfer of obligations from one set of Names to another. The problem of adequate reserves for past liabilities is critical for the whole insurance industry. This is an age when no mere extrapolation of past claims experience has validity .... the reinsurance to close is fundamental .... and in these circumstances, Underwriters must pursue a prudent reserving policy. At the same time Underwriters must not use purely arbitrary or speculative judgments and I welcome the increased sophistication of the calculations leading to the final figure for the reinsurance to close."

445. We have already referred (paragraph 216 above) to the Johns Manville settlement reached in July 1984. Although the London market paid US$ 94 million, Mr Rayment in his witness statement said "The settlement has proved to be a good deal, such was the explosion in claims in the latter part of the 1980s."

446. On 15 October 1984 at an MSSC Meeting chaired by Mr Lawrence and attended by Mr Cockell, Mr Coleridge, Mr Merrett and Mr Randall (who was by then employed by Merrett syndicates) but with Mr Parkington, Mr Bowmer, Mr Tovey and Mr Mehta in attendance, there was considered the report on inadequacies of the RITC as at 31 December 1983 for those accounts closed the previous year. The Committee agreed that:

"a) where satisfactory explanations had not been given, letters should be sent to the Managing Agents of the Syndicates where the inadequacies exceeded 15%, requesting a full explanation of why the inadequacies had occurred and what steps had been taken to avoid a recurrence.

b) in all cases where the inadequacies were greater than 30%, and for Syndicate 702, the active Underwriter and a Director of the Managing Agency should be interviewed by the Chairman of the M.S.S. Committee."

447. On 12 November 1984 by the letter to auditors, their attention was drawn to the following:

"Scales of Percentage Reserves

a) The scales represent the absolute minimum requirement for any Syndicate.

a. The percentages must be regarded as the base to which additional provision must be made to take cognisance of a Syndicate's own experience, its estimated outstanding (included I.B.N.R.), the mix of the account between the longer and shorter tail elements, changes in portfolio, etc.

b. In view of this position it is proposed to add the following to Note 1 of Clause 6 of the "Instructions for the Guidance of Lloyd's Auditors":-

"The Auditor must also have regard to the fact that the scales of percentage reserves set out in this Clause represent the absolute minimum requirement for any Syndicate and have been compiled on this basis. Where professional judgment and statistical evidence so suggest, provision must be made over and above the minimum percentage reserves to take account of the particular circumstances of individual Syndicates."

c. As a result of the above factors some Syndicates will be required to reserve sums greatly in excess of the percentages.

d. Any syndicate reserving at or near the minimum percentage will need to demonstrate to their Auditors that this represents an adequate provision."

448. On 17 December 1984 there was a meeting of the MSSC, at which were present not only Mr Lawrence the Chairman and Mr Coleridge of those charged with dishonesty, but also others including the permanent staff, Mr Parkington, Mr Bowmer, Mr Tovey and Mr Mehta. There was considerable discussion on the RITC and whether the Council should have to approve an RITC closing below the MPRs. Mr Lawrence stated "Lloyd's should avoid having to pass judgment on syndicates' reinsurance to close". On the same day a letter was sent by Mr Frank Barber (as Deputy Chairman) to underwriters warning them that if their RITCs were to survive a challenge by the Inland Revenue the calculation must be supported by full records "of the historical data taken into account, with supporting graphs and charts, and of the statistical or actuarial techniques employed ... "

449. On 5 February 1985 it was proposed and approved that the AU 38 Clause 3 reports should refer to inadequate "reserves created for the 1981 and prior accounts" instead of the "reinsurance to close". Somewhat prophetically Mr Merrett protested at the word "inadequate" as implying that it should have been recognised previously, but Mr Tovey explained that it was apparent inadequacies the Committee was interested in, and that such were only followed up where explanations for the inadequacy were unconvincing.

450. On 12 April 1985 there was a meeting between Mr Randall and Mr Tovey (of MSSD) described by the judge at chapter 19, page 349 of his judgment. Mr Randall was reporting a serious problem for syndicates 418/417. A calculation of the IBNRs had been carried out since the previous Solvency Test; the claims were unlikely to come in for many years and Mr Randall was seeking assistance for his names in relation to the solvency requirement. He said that the 1982 year would not be closed until a more certain outcome could be established. In the event this year was closed into the 1983 year and Cresswell J in his *Merrett* judgment found that this should not have happened. Mr Merrett was Chairman of the MSSC at this time.

451. Mr Outhwaite was also in trouble. The run-offs had mostly been written for the 1982 year of account. Initially he wished to close the 1982 year into the 1983 year in May 1985, but if he had done so then Ernst & Whinney would have put a qualification on their audit report. That

qualification would have related to the RITC only. They were satisfied so far as solvency was concerned. Following meetings between Mr Tovey and Mrs Shorthouse, two accountants from Ernst & Whinney and Mr Gilkes and Mr Hussey representing the Outhwaite syndicate, Outhwaite ultimately decided to leave his 1982 year open at this stage although when he wrote to his names on 1 July 1985 explaining the decision he expressed "our considered view that ... the 1982 year will prove to be profitable". Many other syndicates exposed to latent liability claims including asbestos (at least 20 and probably more) left their 1982 years open in April/May 1985. There is however no suggestion that auditors could not sign solvency certificates.

452. On 19 March 1985 Mr Jackson as Chairman of the AWP gave testimony to Senator Nickles in which he referred to the problems being created for both producers and insurers in relation to asbestos. He further referred to the considerable liberalisation and wide divergence in judicial interpretations in relation to policy wordings. We have already quoted from his testimony but one passage bears repetition:

"Against this background of judicial uncertainty, already catastrophic losses, and the reality of massive property damage claims yet to come, the task of fixing meaningful reserves and managing cash flow to pay claims will continue to demand virtual clairvoyance and a near reckless courage from executives involved at primary level, as well as from their reinsurer counter-parts. You might well ask if we are getting it right. I will show you how we propose to do just that."

453. The signature of the Wellington Agreement followed in June 1985 (see paragraphs 230-2 above). The evidence indicates a strong belief, at the time, that it marked the beginning of the end of the problem. In fact incurred claims were just at the beginning of their steep rise, as appears from the graphs for the various accounts for which Outhwaite reinsured the run-off.

454. It is clear that during this period Lloyd's was encouraging new membership. At a Council Meeting of 13 May 1985, the new Chairman Mr Peter Miller referred to a paper to be circulated to Chairs "indicating the line which would be taken ... in forthcoming speeches which will encourage applications for membership ... This will take account of the need for increased membership as a result of a shortage of capacity and the conflicting adverse publicity arising from reported underwriting losses for recent years." On 5 July 1985 Sir Peter Green wrote his "fishing trip letter" quoted at paragraph 233 above. The letter is much relied by the names because of its reference to the "overpayment of past profits is falling for recoupment from a far larger number of current names" and the reference to it being critical if old names were to resign or new names would not join. But the letter also reflects the difficulty with the Revenue and states that that "there are plenty of horrors in the pipeline and they must be reserved for even if the figures are not available. The "true and fair" requirement should assist in this".

455. Mr Peter Miller delivered his speech on 26 June 1985 to the General Meeting of Members. He referred in detail to the PCW problem, the way Lloyd's had dealt with it and the further problem which had occurred in relation to the syndicate that took over the run-off of Richard Beckett Underwriting Agency when further losses were discovered in April 1985. Richard Beckett Non-Marine syndicate 986 left its 1982 year open, this being an account affected by the asbestos and latent disease problem. In that context he stressed that insurance was a risk business but he also stressed that the Council had now "evolved a regulatory system ... in which the current members of Lloyd's and those seeking membership can fully place their trust."

456. He then went on to explain the reasons for confidence:

"The 1982 Act gave us new and sufficient powers, so we must look at what we have achieved by passing byelaws in relation to the underwriting agency system.

Firstly, we are insisting upon improvements in the auditing of syndicate accounts and in the reporting thereof. This will ensure that any improper behaviour or other problem are identified and, therefore, dealt with much more rapidly.

Secondly, by insisting upon very full disclosure, we have highlighted the accountability enshrined in the law of agency, which requires the agent to respond to his principal for his care over the principal's interests. A central file of syndicate results is now available for inspection.

Thirdly, we have introduced a new standard agency agreement which must be used throughout the market from 1st January 1987.

Fourthly, we have codified and immensely strengthened our processes for the approval of underwriting agents. I believe that the impact and importance of the "fit and proper test" for directors and underwriters and Boards of directors cannot be over-estimated.

Next, we are insisting that each managing agent has a system to monitor his premium income and we review the results produced.

In all these matters, I consider that it is important to realise the essential difference between regulators like the Council of Lloyd's or the Department of Trade, for that matter, and a monitor. There is and there must be a limit to what regulators can do. Neither the Department of Trade nor Lloyd's set out to monitor the day to day activities of the market. A regulator generally works on a post-facto basis. Therefore the objectives of good regulation must surely be to try to ensure that the right controls are in place and functioning correctly and to see as far as possible that the individual syndicates and their managing agents are run by fit and proper people, fully accountable to the members for whom they are undertaking.

The measures I have listed and many other reforms add up, in my view, to a modern and efficient system of regulation in which Names may readily put their trust. The events of the pasty few months will have affected some peoples decision to become members of Lloyd's. The current turn in the market and our new regulatory regime, however, will be seen by many as compelling reasons for participating in this market. Indeed, it seems that this is how most perceive the matter. The latest figures show that new applications for membership for 1986 continue to run 20 per cent above the numbers for 1985. At the same time, about 9,000 existing members are asking to increase their premium income limits for next year. It is, as we all know, almost impossible to speak of the "right time to join the market." That said, I believe that this is one of those times."

The transcript of the questions and answers after the speech shows that many names raised concerns, especially in regard to PCW.

457. In the report from Mr Richard Hazell (Chairman of LUNMA) in Lloyd's Global Report and Accounts 1984 which was distributed to all names during 1985 appeared the following (which we have quoted in paragraph 335 above, but repeat because of its importance):

"The figures produced for the close of the 1982 Account do not make happy reading from the non-marine market's viewpoint, producing an overall loss of £219m after taking into account substantial investment earnings. It must be remembered when reviewing these figures that they relate to the experience of the insurance market of three years ago when the insurance industry generally was at its lowest ebb for very many years, if not in its entire history.

Undoubtedly, much of the blame for these poor results can be attributed to the need for underwriters to increase reserves for outstanding losses in the light of the more liberal attitudes adopted by the American courts, very often in pursuit of the deep pocket theory. This is particularly apparent, but is not unique, in relation to those claims affecting asbestosis and

pharmaceutical products. New laws regarding liability following pollution and other forms of environmental impairment could also produce problems for underwriters as these new laws appear to apply retroactively, thus making it very difficult to underwrite against such circumstances. It is to be hoped that the newly formed asbestosis facility, which after many years of being discussed has now been established, will enable settlement of claims to be made at a faster rate with a consequent saving of legal expenses."

458. A memorandum for the MSSC dated 16 December 1985 reported on inadequacies as at 31 December 1984, and set out a table comparing the previous years. It analysed the reasons for inadequacies (there being 24 with significant inadequacies). The report concluded as follows:

"In the main the syndicates identified were reasonably predictable, including syndicate 895, five former PCW managed syndicates (plus the two stoploss syndicates impacted by PCW losses) and two Robert Napier syndicates formerly managed by Oakeley Vaughan. Fifteen of the twenty-four syndicates affected no longer underwrite.

Of the non-marine syndicates, many explain the inadequacies as being due to under reserving in respect of latent disease, product and environmental liability and pollution claims. Furthermore, three of the six marine syndicates attribute the deficiencies in reserving to the same type of problems. Interestingly, three syndicates refer to a specific reinsurance contract with Transit Casualty Insurance Company of California.

It is intended that letters will be sent, where appropriate, to those agents whose syndicate returns indicated apparent deficiencies greater than 15%.

These letters should express concern at the apparent deficiency and seek further, more detailed, explanations of the circumstances. Additionally the letter should request detail of what steps are being taken to improve reserving techniques in future years."

459. During 1986 evidence was taken by Sir Patrick Neill in connection with the Report he would produce in January 1998. In April/May 1986 Mr Merrett left his 1983 year open. Many continued to leave their 1982 years open and some (about 15 or so) did not close their 1983 years. On 1 December 1986 the Solvency & Security Committee considered the report on syndicate returns made by syndicate auditors in connection with the 1985 Solvency Test.

"Mr Kellett drew attention to the section of the paper dealing with inadequacies of reserves and asked the SSC what further action should be taken in respect of those syndicates with large inadequacies. The secretary explained that the Department had written to the managing agents concerned and in some cases this would result in an interview with a Deputy Chairman"

The Chairman of that Committee at this time was Mr Murray.

460. At the beginning of 1987 Lloyd's reviewed the solvency of the 1982 year of Outhwaite syndicate 317. On 29 January 1987 Mr Outhwaite wrote to all his names informing them that "We are obliged to question the basis on which certain of the run-off policies written by 317/661 were placed ... "

461. Several syndicates again left 1984 years open including Warrilow Syndicate 553, and inadequacies on the RITC or reserves for solvency purposes were showing a number of serious deficiencies as between 1983 and 1984. The deficiency for Mr Outhwaite for example was over £14m, and Mr Pulbrook over £7.5m. According to the schedule with our papers (S1) the total inadequacy was about £79m.

462. The Committee of Lloyd's further considered how time and distance policies should be treated in the annual report. In March 1987 the Report to the Panel of Auditors indicates that Mr Jackson reported on the asbestos position including the following:

"NON-MARINE - ROBIN JACKSON

GENERAL COMMENTS

It had been hoped that there would be a drop in claims in 1986 but this has not been evident; nine hundred new cases per month were reported in 1985, while fifteen hundred new cases per month were reported in November and December 1986."

463. On 19 August 1987 the Committee of Lloyd's was requested to approve the Global Report and Accounts as at 31 December 1986, and it was in relation to the draft Chairman's account that Mr Merrett is recorded as saying that it was important to avoid the risk of alarming names as regards the US casualty scene. The statement ultimately read in this way:

". . .

the overall results for 1984, constitute a record profit for the Lloyd's market of almost exactly £300 million, excluding PCW, while the outlook for 1985, at least overall, looks likely to improve on that figure and 1986 is spoken of, almost reverently, as a vintage year . . .

However, there is one factor which continues to dominate the whole Lloyd's market and indeed it is perhaps no exaggeration to say it continues to dominate the whole world insurance scene. I refer, of course, to the general liability account. I have in previous years drawn attention to the enormous losses made in this area and I must do so again. The overall loss on this account shows a welcome reduction from last year's figure. However, I have to say that the problems facing those underwriting this account, while perhaps reduced as a result of the reforms in the law of tort in the United States, are nevertheless far from solved. Two facts seem to me to stand out; first, that this account produces 12 per cent of Lloyd's premium income and almost 100 per cent of our losses. Second, almost exactly 50 per cent of our reinsurance to close (£2,000 million out of £4,000 million in round figures) has to be devoted to the claims outstanding within this account; on a premium income base of some £400 million any under-reserving must have a sharply disadvantageous effect. In spite of all the efforts that have been made, quite extraordinary court awards and judicial interpretations continue to come from in particular, the American scene.

There are two quite different problems in the whole of this area. First, whether the amounts put aside to meet these claims will be sufficient, a problem of the past which underwriters must do their best to solve. Second, how far it is prudent to commit underwriting resources in the future to a class of business hedged about with such dangers and uncertainties ..."

We have already quoted from Mr Kellett's statement in these globals (paragraph 251 above).

464. In August 1987 an attorney's report drew attention to the total asbestos universe as it existed in 1986 – 54,058, and as at 1987, 80,003. In both instances the figures included a projection for further claims between June and December based on the number of filings over 6 months. The lines on the graph relating to Fireman's Fund (reinsured by Mr Outhwaite) were continuing to rise in 1987 although they were to rise even more dramatically between 1987 and 1990.

465. In September 1987 Memorandum for Consideration by the MSSC reviewed the inadequacies of the previous years' reserves and concludes as follows:

"A large proportion of the "over 15%" inadequacies relate to the non-marine syndicates and 4 of the 7 marine syndicates relate to pollution and asbestosis claims. Once again the difficulty of providing the right level of reserves for longer tail business is highlighted. While syndicates must be careful not to over-provide for long-tail due to revenue investigations, under-reserving must be avoided to retain parity between Names where an account is closed

to a more recent year of account.

Although the number of syndicates whose reserves appear inadequate has remained reasonably stable over the last three years including those greater than 15% (24, 26 and 22 in 1984, 1985 and 1986 respectively), the level of the inadequacies is worrying, particularly those greater than 40%. Approximately one-third of the syndicates with inadequate reserves last year greater than 15% have recurred in 1986. MSSD intends to write to the agents and their auditors and, if considered appropriate, request that a meeting is arranged with the Senior Deputy Chairman to discuss their reserving."

466. Minutes of a 27 January 1988 meeting of the Committee report as follows:

"Mr Merrett expressed concern that substantial increases in asbestosis/pollution claims were being notified by the Asbestosis Working Party and Environmental Claims Group. However, the Solvency and Security Committee did not have access to figures showing the overall position but had to rely upon the reports of individual syndicates. The level of reserving could be anticipated to require significant increases for next year and future years and Lloyd's needed greater comfort than at present that Agents were adopting adequate figures in their accounts. In Mr Merrett's view this was a problem that needed to be addressed centrally..... In the ensuing discussion the following points were made: ..... (v) The level of reserving was a matter for the Managing Agents and should not become a matter of instructions from Lloyd's centrally. (vi) The political aspects of the matter should not be ignored and pressure should be maintained on Washington, on the basis of the basic question of "Who should clean up America". ..... At the conclusion of the discussion it was AGREED that:- ..... (iii) The Chairman, Mr Merrett and Mr Hazell would ..... discuss the matter on an informal basis with the Chairmen of the Market Associations."

467. In February 1988 Mr Jackson once again addressed the panel of auditors. The Minutes of the Committee of 10 February report as follows:

"Mr Merrett reported that the Annual meeting of the recognised Auditors had recently taken place and had seemed to have proceeded satisfactorily. Mr Robin Jackson, however, had been referred to as a pessimist as regards Asbestos/Environmental pollution. Mr Merrett had tried to explain that Mr Jackson was in fact being optimistic considering the background against which he was working."

During 1988 more syndicates left accounts open – for example Mr Merrett left his 1985 year open. Inadequacies were again reported for 1984 as compared with 1985. The total (according to S1) was about £95m.

468. Concern was also being expressed during 1988 about the resignation of names and about "talking ourselves into a crisis". On 8 June at a meeting of Council it is noted that "concern had been raised as to the number of open years and this issue would be the subject of a paper to Council once the solvency position was known". The concern would appear to be that of names who were on open years – "an area of major discontent to names ... which might generate questions at the AGM". This led to suggestions that efforts should be made to close open years, and a paper so suggesting was introduced by Mr Steel at the Committee meeting of 27 July 1988.

469. On 19 May 1988 Freshfields produced their report to names relating to Mr Outhwaite. On 20 June 1988 it was supplied also to Lloyd's and its conclusions, so far as material, were as follows:

"Paragraph 1(d) of our Terms of Reference

2. We consider that Mr Outhwaite may fairly be criticised for:- 907

(a) failing to identify sufficiently precisely the basis of the figures, presented with the placing information supplied by the cedant for the purpose of writing the run-off policies, leading to inadequate analysis (Section V, paragraphs 51 and 52);

(b) not investigating more thoroughly the nature of the asbestosis problem and its potential magnitude (Section V, paragraphs 60-64); and

(c) writing a substantial number of run-off policies into Syndicate 661 without giving sufficient weight to the consequent aggregation of risks (Section V, paragraphs 74 and 75).

3. Having regard to these criticisms, we consider that a substantial case based on breach of duty could be made out in relation to the writing of the run-off policies. However, in the light of all the evidence, and the advice we have received from our expert advisers, it is our opinion that a court action against Outhwaites or Mr Outhwaite based on this cause of action, would be unlikely to succeed. It is ultimately for the Names and their advisers to decide whether or not to pursue any remedies. We hope that the material we have assembled will assist them in making their decision."

470. At the General Meeting on 28 June 1988 Mr Lawrence said:

"Present market conditions, uncomfortable though they may be, are overshadowed by the need to provide for the development of past year claims, some as yet un-notified and unquantified, springing mainly from long-tail liability business in the United States. The deterioration in claims in this area over the past 12 months and the provisions that have had to be made as a result, have reduced in many instances the anticipated profit last year for the 1985 account. They are, in addition, responsible for the two current major problem areas in the market namely syndicate number 317 (Outhwaite) for the 1982 account and number 553 (Warrilow) for the 1984 account."

471. At a Committee meeting on 27 July 1988 was considered a paper which provided an analysis of run-off years of account as at 31 December 1987. The paper stated that there were 76 syndicates with years of account in run-off and a total of 120 years in run-off of which 23 showed a profit. The figures excluded Sasse and PCW. US liability explained 56% (67 in number) of the run-offs. In his Chairman's report Mr Lawrence said:-

"Over the past twelve months, two events have served to emphasise the vital role played by insurance and by the Lloyd's market in particular. The devastation created by the storm of October 1987 which cut a swathe across southern England and Western Europe is being described as the world's largest insured loss, estimated to be 3 billion US dollars. More recently, in July this year, the dangers inherent in offshore oil production were brought into stark focus by the explosion which destroyed the North Sea oil production platform, Piper Alpha, involving tragic loss of life. The deterioration in the claims experience over the past twelve months, together with the need to provide for the development of past year claims, specially in relation to long-tail liability business in the United States, have particularly affected the 1985 account results. This emphasises the crucial need to provide for future liabilities by way of full and appropriate reinsurance to close at the end of each year. The same problems are also reflected in the number of syndicates with years of account left open at the end of 1987. At the end of December 1987 there were 76 syndicates with a total of 120 years of account left open. Problems associated with asbestosis and pollution risks, together with other US liability business appear to account for the vast majority of the run-off years. To have so many syndicates left open must be considered unacceptable to underwriters, members and agents alike. Consideration is, therefore, being given by the Council of Lloyd's to ways of dealing with this problem."

Discussion as to 1983-8 **908**

472. The names' case at the trial did not involve dividing the period before the Neville Russell and Murray Lawrence letters from the period after those letters. Events in the period after (and sometimes long after) March 1982 were relied on by them to support a case of dishonesty in actions taken shortly after the Neville Russell letter. But what we must consider, having regard to our conclusions in relation to the Murray Lawrence letter, is whether in the light of the information that people on the Committee and Council of Lloyd's had, following the Murray Lawrence letter, it must have become apparent before the end of 1988 that the representation being made in the brochures, that there was a system which involved the making of reasonable estimates of outstanding liabilities, had become untrue.

473. The names rely on the following matters in particular:

i. The history of more and more years being left open must have brought home to Lloyd's that syndicates could not in fact calculate reserves including IBNRs.

ii. In addition, the history of the year by year increase in the amount of reserves for past years exemplified by the annual analysis of the inadequacy in reserves reported by the auditors must have brought home to those at the centre that it was in fact impossible to calculate reserves.

iii. Mr Kellett's statement in his presentation to the Inland Revenue "We are under reserved. What concerns us is how the industry can survive its under reserving."

iv. A draft paper dated 24 July 1985 prepared for O Group by Head of Finance and Market Services, Mr JAW Moir, suggested in the context of Outhwaite, PCW and the Solvency Test in 1985 that it was open to Lloyd's to "encourage, cajole, bully or instruct auditors to sign an unqualified solvency report on all troubled syndicates". Mr Lawrence in cross-examination stated that the passage did not reflect his experience of the relationship between the auditors and Lloyd's, and further stated that it would have been quite unthinkable.

v. A conversation in November 1986 about which Mr Steel gave evidence in which Mr Lawrence was overheard to say (according to Mr Steel) "You bloody brokers, Lloyd's is nearly bust". The judge found it difficult to place reliance on this conversation and in particular as to its date. The judge also pointed out that Mr Steel increased his underwriting in 1986 and 1988.

vi. On 24 November 1983 it was minuted that "the Lloyd's Audit was a specific and limited exercise designed to monitor the solvency of syndicates and of the individual names ... It is now recognised that the Lloyd's Audit is in this sense a misnomer, and it is now known as the Lloyd's Solvency Test."

vii. On 26 July 1984 at a meeting of LUNMA Mr Smith, supported by Mr Hazell and Mr Jackson, affirmed that the standard of auditors was alarmingly low.

viii. In a speech by Mr Ian Hay Davison in Paris in April 1985, Mr Davison (who was not called to give evidence), is recorded as being critical of the standard of auditing. He suggested possible lack of independence and that auditors may just have been accepting the underwriter's word for the RITC.

ix. Mr Randall was reported as expressing surprise at the position after the sending out of the Murray Lawrence letter, and suggested in evidence to the Donner Inquiry that panel auditors appeared to have turned a blind eye to the adequacy of reserves in the context of asbestos.

x. The names attacked the credibility of Mr Lawrence and Sir Peter Miller in particular. Sir William Jaffray produced a sustained and detailed attack on Sir Peter Miller's evidence (see his statements of 9 and 30 January 2002). He suggested that Sir Peter was not frank with the court about the losses he had suffered over the relevant period and in particular about the effect of stop-loss policies. He was critical of the views expressed by Sir Peter on the brief for the Rota interview. He suggested many aspects on which the evidence of Sir Peter should not be accepted, including Sir Peter's assertion that he had no reason to doubt the accuracy of the figures contained in the audited syndicated accounts, and that Sir Peter and others on the Council or Committee were unaware of the under-reserving for asbestos related claims. Sir William also produced a detailed attack on the statements of Mr Skey, Mr Parry and Mr Maitland (see Sir William's statements of 4 and 5 February 2002). But, since none of those witnesses was called and their statements were thus excluded, the attacks are misplaced.

xi. Reliance was also placed by Sir William and Mr Adams in particular on certain triangulations. They referred us to the Annual Review of Lloyd's Market Reserves for 31 December 1992. The explanatory notes explain the purpose of these triangulations. They explain first that they were produced "to assist the Committee of Lloyd's in reviewing the minimum scales of solvency reserves, details of premiums, claims and percentage settlement have been obtained in respect of syndicates (other than life syndicates where the percentage test is not applied) for 1991 and previous years according to class of business concerned". The notes then explain each of the tables and in particular, so far as concerned Table 2 (which was the table relied on by Sir William and Mr Adams), the note explains:-

"Table 2 sets out the cumulative settlement for each year of account as a percentage of premium income shown in Table 1. For year 3 and subsequent years the settlement is expressed as a percentage of the premium income at the end of year 3."

Table 2 is a triangulation showing the very substantial deterioration which took place on old years where the paid claims were measured against premium. The picture on the document produced by Mr Adams and Sir William is as at 1991 but they made the point that if the picture were looked at as at 1986, for example, the deterioration on the old years was already substantial.

These figures were produced to assist Lloyd's in calculating MPRs. They do show a dramatic deterioration. They do not however demonstrate what the reserving policy was in any syndicate at any particular time.

474. Lloyd's, through Mr Aldous, relied on the same matters as already set out in paragraphs 410ff above to refute any dishonesty. But in addition he relied on the following matters:

i. He reminded us of the evidence of Mr Tovey and Mrs Stynes. Mrs Stynes was a Chartered Accountant with previous experience in the auditing of insurance companies and Lloyd's syndicates between 1979 and 1981. In late 1981 she went to Ernst & Whinney where again, at least in part, her experience was in providing audit partners with support in the auditing of Lloyd's syndicates. She joined the Corporation of Lloyd's in February 1984 in the Accounting and Auditing Review Department. The whole of her evidence was relevant but in particular she said "We believed that the syndicates themselves and their auditors were doing their job properly, and that the results could be relied upon for the purposes of the aggregation exercise which we undertook. Had I felt that the regime for production and auditing of accounts was unsound, or the syndicate results could not be relied upon, then I would not have been content to go forward as I did." Mr Tovey was also an experienced accountant who joined Lloyd's in 1984. He refuted in his evidence any question of dishonesty as far as he was aware.

ii. Mr Aldous relied on the evidence of people who gave evidence on behalf of the names, notably Mr Fredjohn who never suggested that the Council of Lloyd's, or any members of it, believed there was a systemic problem, or that auditors could not be trusted. He relied also on the evidence of Sir Peter Miller, Sir David Rowland, Mr Jackson, Mr Keeling, Mr Lawrence, Mr Kellett, and Mr Murray. He rejected the attack made on the credibility of these witnesses, particularly in respect of Sir Peter Miller. The information on his losses was originally supplied by his members' agent and when supplied to More Fisher Brown by Freshfields, was expressly said to be subject to correction. Indeed Mr Aldous pointed out that when Sir Peter was cross-examined by Mr Goldblatt (day 31 pages 4802-4807) Mr Goldblatt, although somewhat sarcastic about the original production of figures without the stop-loss information in them, did not in fact suggest to Sir Peter that he had been untruthful.

iii. Mr Aldous in this context emphasised how the number of claims escalated over the years, rising between 1982 and 1984 and then rising even more dramatically thereafter. The market, he submitted, simply did not foresee that degree of escalation. The fact that reserves were shown to be inadequate does not show that the system was not working, indeed the fact that inadequacies were being monitored and consideration was given to concerns about those inadequacies demonstrates the opposite. The sheer detail of the documents recording the consideration given to auditing each and every year is quite contrary to any possibility that there was any person who simply did not believe that the system worked. As regards the triangulations, they demonstrate how a dramatic deterioration did occur on the old years in the late 1980s, but they do not demonstrate that the syndicates were under-reserving.

Conclusions as to 1983-8

475. Once again we remind ourselves that the case that we have to consider is whether a representation was being made which was not believed to be true, or was known to be untrue. Did any of those persons against whom dishonesty is alleged come to appreciate that the audit system no longer involved the making of reasonable estimates of outstanding liabilities (including IBNR)? Were they in the relevant sense reckless?

476. As more and more years began to remain open and inadequacies began to escalate a doubt must have come into the mind of those at the centre of Lloyd's as to whether RITCs were producing a fair premium for those taking on the liabilities of past years. History was demonstrating that reserves were not adequate. But that doubt must have occurred to persons not accused of dishonesty as well as those who are accused.

477. We have great anxiety about the fact that names continued to join Lloyd's and be placed on syndicates which were infected by the long-tail liabilities, where the premium received for the outstanding liabilities was in the event massively too little. The risk of that premium being inadequate must on any view have been increasing during this period, and we see no sign of anyone at the centre contemplating that a warning of the increased risk should be given (for instance, at Rota) to names, and particularly new names. The attitude was that it should be left to members' agents. Relevant documents such as Sir Peter Green's fishing trip letter did not focus on the position of new names, (in the sense of future names) at all. So far as persons at the centre were concerned, they were faced with the following facts: profits had been distributed in the 1950s and 1960s, and it was people who had become members since those days who were going to have to pay the losses; in all cases the persons having to pay the losses could say that the premium received on the RITC had not as a fact covered the outstanding liabilities. Some would suffer when years were left open, and would feel that a proper assessment ought to be made for the RITC so that they could at least close their account. Others were suffering having taken on the liabilities when, as they could say, history demonstrated that the year of account should have been left open. Each time the assessment

was made underwriters and auditors were thinking that this time they had got it right, only to find that losses had escalated. Sometimes that assessment was held to be negligent but never fraudulent. It is understandable that there was a desire not to have years kept open, and understandable that any thought that solvency certificates could not be produced was unacceptable.

478. The question is - was there during this period a representation being made without an honest belief in its truth? There was, as the above history demonstrates, a close monitoring from the centre, including a monitoring of inadequacies and of open years. The system was one which employees such as Mrs Stynes and Mr Tovey believed was working. The underwriters and auditors were operating the system without suggesting that it was impossible to do so, and indeed in so far as there were arguments (for instance in the case of Mr Outhwaite) about leaving years open that would support the view that the system was working, and not the opposite. Auditors, including some who were involved in the production of the Neville Russell letter (such as Mr Holland, Mr Blake and Mr Milne) and other firms involved in the production of that letter (such as Ernst & Whinney, Arthur Andersen, and Spicer & Pegler), were issuing unqualified reports both immediately after receipt of the Murray Lawrence letter and for the years thereafter. Those auditors furthermore accepted the introduction of the requirement that an account should show a "true and fair view". Some were members of the Task Groups 4 and 15, following the Fisher report, which were concerned with reporting to names and with solvency and at no time did the auditors suggest that there was any systemic problem. The persons present at Council, Committee, and sub-committee meetings consisted of a mixture of persons accused of dishonesty and those that were not.

479. The judge saw Mr Lawrence, Sir Peter Miller and others in the witness box and had a full opportunity to assess their credibility. The judge is criticised by Sir William for not finding Sir Peter guilty of perjury. Even if the judge had rejected part of Sir Peter's evidence and found him less than frank in relation to any matters, it would not have been possible for the judge to find Sir Peter guilty of perjury, since that would have had to have been the subject of other proceedings. The position in any event is quite clear. The judge did not take the view that either Mr Lawrence or Sir Peter or indeed any other witness on behalf of Lloyd's was guilty of lying to the court or of dishonesty.

480. Given our conclusion that the Murray Lawrence letter was an honest letter, it is impossible, and would indeed be quite unfair, to conclude to the high standard of proof required that any person at the centre of Lloyd's ceased to have an honest belief that it was operating a system which did involve the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses.

General Conclusions

481. In conclusion the names have failed to show to the necessary high standard that those at the centre of Lloyd's did not believe throughout either that there was in place a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities, including unknown and unnoted losses, or that they at any stage knew or were reckless as to whether the representations in the brochures were untrue. We need not therefore go further into the difficult question of whether corporate dishonesty would have to be assessed by counting heads or by some other method, or into any question of whether the representation could have been intended to have some other meaning than its natural meaning.

VII RELIANCE AND INDUCEMENT

482. The judge dealt very briefly indeed with whether any of the three sample names had relied on any of the pleaded representations during the relevant period. In his summary of the witnesses' evidence (in chapter 15) he stated in relation to each of the same names, without giving reasons, that he was not persuaded that any of them relied on any of the alleged

fraudulent misrepresentations. In chapter 21 he stated that the other ingredients of the tort (apart from misrepresentation) had not been made out, without adding anything on reliance.

483. Since the judge reached the firm conclusion that there was not any actionable misrepresentation it would be hard to criticise him for having dealt so briefly with what was, on his view of the matter, not so much an academic as a non-existent point. It would have been unreal to have considered whether the sample names relied on something which, on the judge's findings, never occurred.

484. We have reached a different conclusion as to misrepresentation. If we had found that a misrepresentation was made dishonestly, we would have had to reconsider the issues of reliance and inducement. In doing so we would have had to consider much more closely whether the sample names relied upon the fact that the brochures were expressly intended to convey important information to prospective names, who were expected to read the brochures and take them seriously. The fact that the sample names also relied on other sources of information or advice may be immaterial. It would however also be necessary to review the oral evidence of the sample names to see whether (as Mr Aldous has contended) they themselves accepted in cross-examination that they did not rely on the brochures. But in view of our conclusion on dishonesty that would be an unnecessary prolongation of what is already a very long judgment.

VIII FAIR TRIAL

Introduction

485. Under CPR rule 52.11(3)(a), this court will allow an appeal where the decision of the court below was wrong. For that reason, we have thus far been considering whether the decision of the judge was wrong. By rule 52.11(3)(b) the court will also allow an appeal where the decision was unjust because of a serious procedural or other irregularity in the proceedings. As we indicated earlier, the names seek permission to appeal against the decision of the judge on the basis that the decision of the judge was unjust on the ground that they did not receive a fair trial. On 8 October 2001 this court adjourned that question for consideration by the court hearing the substantive appeal.

Correct approach

486. The names say that they were entitled to a fair trial. We entirely agree. It matters not whether that right derives from the common law or from the overriding objective enshrined in rule 1.1 of the CPR of dealing with cases justly or from Article 6 of the European Convention on Human Rights ("the Convention"). The question is simply whether the names were afforded a fair trial.

487. Both the CPR and the Strasbourg jurisprudence relating to Article 6 of the Convention stress the importance of what has been called equality of arms, although the CPR do not use that expression. Rule 1.1 of the CPR provides:

"(1) These Rules are a new procedural code with the overriding objective of enabling the court to deal with cases justly.

(2) Dealing with a case justly includes, so far as practicable –

(a) ensuring that the parties are on an equal footing;

(b) saving expense;

(c) dealing with the case in ways which are proportionate –

(i) to the amount of money involved;

(ii) to the importance of the case;

(iii) to the complexity of the issues; and

(iv) to the financial position of each party;

(d) ensuring that it is dealt with expeditiously and fairly; and

(e) allotting to it an appropriate share of the court's resources, while taking into account the need to allot resources to other cases."

488. Article 6 of the Convention, provides, so far as relevant:

"*Article 6 – Right to a Fair Trial*

1. In the determination of his civil rights and obligations ... , everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."

No-one suggests that the trial in this case was not before an independent and impartial tribunal established by law, but it is submitted that an important feature of a fair trial is that there should be equality of arms. The approach of the European Court of Human Rights ("the ECHR") to this aspect of Article 6 can be seen from its decision in *Apeh Üldözötteinek Szövetsége v Hungary (Application no 32367/96)* given on 5 October 2000.

489. In that case the complaint was a failure to notify applicants of a submission made by the Attorney General's office to a Hungarian court, which was said to be a failure to observe the principle of equality of arms. The judgment includes the following important paragraphs:

"39. The Court recalls that under the principle of equality of arms, as one of the features of the wider concept of a fair trial, each party must be afforded a reasonable opportunity to present his case under conditions which do not place him at a disadvantage *vis-à-vis* his opponent (see the *Dombo Beheer BV v the Netherlands* judgment of 27 October 1993, Series A no 274, p 19, § 33). In this context, importance is attached to appearances (see, *mutatis mutandis*, the *Borgers v Belgium* judgment of 30 October 1991, Series A no 214-B, p 31, § 24, and the authorities cited therein).

Article 6 § 1 guarantees in principle the opportunity for the parties to a criminal or civil trial to have knowledge of and comment on all evidence adduced or observations filed, even by an independent member of the national legal service, with a view to influencing the court's decision (see, among other authorities and *mutatis mutandis*, the following judgments: *McMichael v the United Kingdom*, 24 February 1995, Series A no 307-B, pp 53-4, § 80; *Kerojärvi v Finland*, 19 July 1995, Series A no 322, p 16, § 42; and *Lobo Machado v Portugal*, 20 February 1996, *Reports*, 1996-I, pp 206-207, § 31).

...

42. As regards the failure to notify the applicants of the submissions by the Attorney General's Office at second instance, the Court notes the Government's assertion that these submissions had no bearing on the merits of the case. However, it is to be recalled that the principle of equality of arms does not depend on further, quantifiable unfairness flowing from a procedural inequality. It is a matter for the parties to assess whether a submission deserves a reaction and it is inadmissible for one party to make submissions to a court without the knowledge of the other and on which the latter has no opportunity to comment. It was therefore unfair that

the applicants were not notified of the submissions made to the Supreme Court by the Attorney General's Office (see, *mutatis mutandis*, the *Bulut v Austria* judgment of 22 February 1996, *Reports* 1996-II, p 359, § 49 *in fine*.)."

The ECHR held that in those circumstances there was a breach of Article 6.

490. The principle of equality of arms does not, in our view, mean that litigants must all have the same resources because litigants very rarely do. However, it does mean that each party must have a reasonable opportunity to present his case under circumstances which do not place him at a disadvantage vis-à-vis his opponent and each party must have a proper opportunity to comment on all evidence adduced and submissions made by his opponent. Moreover, in this regard the ECHR pays attention to appearances.

491. The names thus further stress the importance of the principle that justice must not only be done but be seen to be done. They draw attention both to decisions of the ECHR and to decisions of the English courts in the context of allegations that the tribunal concerned was not impartial or was biased, notably *De Cubbers v Belgium* (1984) 7 EHRR 236, *Hauschildt v Denmark* (1989) 12 EHRR, *Borgers v Belgium* (1991) 15 EHRR 92, *In re Medicaments (No 2)* [2001] 1 WLR 700 and *Porter v Magill* [2001] UKHL 67, [2002] 2 WLR 37.

492. In *In re Medicaments* Lord Phillips MR, giving the judgment of the court, after referring to the relevant decisions of the ECHR including those noted above, said this, with regard to the case in which no actual bias has been shown, at paragraphs 83 and 85:

"83. ... (3) The court then has to decide whether, on an objective appraisal, the material facts give rise to a legitimate fear that the judge might not have been impartial. If they do, the decision of the judge must be set aside. (4) The material facts are not limited to those which were apparent to the applicant. They are those which are ascertained upon investigation by the court. (5) An important consideration in making an objective appraisal of the facts is the desirability that the public should remain confident in the administration of justice.

....

85. ... The court must first ascertain all the circumstances which have a bearing on the suggestion that the judge was biased. It must then ascertain whether those circumstances would lead a fair-minded observer to conclude that there was a real possibility, or a real danger, the two being the same, that the tribunal was biased."

That test was a modification of the test previously laid down in *R v Gough* [1993] AC 646. It was a modification which was subsequently approved, subject to a further modification, by the House of Lords in *Porter v Magill*: Lord Hope (with whom the other members of the House agreed) put the question thus at paragraph 103:

"The question is whether the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased."

See also *Taylor v Lawrence* [2002] EWCA Civ 90, [2002] 2 All ER 353 per Lord Woolf CJ, giving the judgment of the court, at paragraphs 60 and 61.

493. In our judgment, those principles are not directly applicable to the question whether a trial was fair, but they are of assistance. They are not directly applicable because the question is not whether there is a real possibility or real danger that the trial was unfair, but whether it was unfair. We can see no reason why this court (or any court of review) should not be able to judge whether or not the trial was in fact unfair, once it has considered all the relevant circumstances.

494. The principles are, however, of assistance because they stress that the question must be viewed through the eyes of the reasonable observer or litigant. The same principle seems to us to apply here. Thus the question is not whether a disappointed litigant thinks the trial was unfair, but whether a reasonable person in his or her position would think so, having regard to all the circumstances of the case. The circumstances are of importance because, before concluding that a trial is unfair, the court must consider all the relevant circumstances. As appears below, this is in our opinion important on the facts of this case.

495. In the light both of the provisions of the CPR and of the principles set out by the ECHR and this court, we accept the following submissions made by the names:

i. a party is entitled to present his case under conditions which do not place him at a disadvantage vis-à-vis his opponent;

ii. in order to decide whether the trial has been fair or unfair, it is appropriate to take into consideration all the circumstances of the case, including differences between the resources of the parties and the importance of the case for them;

iii. the proper approach is to ask whether, on an objective appraisal, both a reasonable observer and a reasonable litigant in the position of any of the parties would be left with a legitimate fear that the conduct of the trial was such as to place that party at a disadvantage which was more than trivial or illusory, as in *Kremzow v Austria* (1993) 17 EHRR 322, paragraphs 73-75; and

iv. once inequality of arms in this sense is established, it is not necessary to identify further, quantifiable unfairness, in order to hold that the trial was unfair.

The alleged unfairness

496. The names' case is summarised in paragraphs 12 to 15 of the grounds of appeal of the represented names as follows:

"12. At the outset of the trial the learned judge expressed his determination that the hearing should conclude by the middle of July 2000. That decision placed unacceptable pressure on the Names and their small team of legal advisers who were unable within the available time scales adequately to consider and assimilate the documentation used at the trial (estimated at over 60,000 pages). The difficulty of assimilating documents was aggravated by extensive and unnecessary redaction.

13. The vast majority of the documentation was in the possession of Lloyd's. In an order dated 30th June 1998 Mr Justice Colman ordered that disclosure was to be completed by 31st March 1999. Notwithstanding this order the learned judge permitted Lloyd's to control the rate at which discovery, disclosure and the provision of copying documentation to the Names and their legal representatives was made. By way of example, as at 31st March 1999 Lloyd's had listed 21,262 documents for discovery of which 20,120 were irrelevant. Between the deadline for completion of discovery and the commencement of trial, Lloyd's listed a further 26,095 documents for inspection. During the hearing lists 24 and 33 were served as primary discovery more than 12 months after the final date for discovery. Thus, disclosure continued at all stages up to and throughout the hearing giving the Names and their counsel insufficient opportunity of assimilating (for the presentation of their case and the examination of the witnesses) the documents so disclosed.

14. During the hearing:

a. Equitas submitted figures to the Court relating to the quantum of asbestos-related liability affecting the Lloyd's market, contending that the figures were commercially confidential and should not be disclosed in open court. The figures were revealed to the Names' legal advisers under a confidentiality order which wrongly prohibited their disclosure to the lay client and to litigants in person. The Names' legal advisers wished to make submissions in open court regarding the figures so disclosed but the learned judge wrongly refused to permit such submissions to be made.

b. Finality Statements relating to the underwriting of the 33 individuals set in paragraph 1 of the Re-Re-Amended Particulars of Claim were disclosed by Lloyd's with the learned judge's consent on condition that they could be seen by the litigants legal advisers but not by the litigants or their specialist advisers.

15. The learned judge:

a. wrongly treated the Minutes of Market Association Committee (and LUNMA in particular) as not being in the possession or power of Lloyd's;

b. wrongly permitted Lloyd's to select those Minutes of Committee and Council to be the subject of discovery, when all Minutes during the Relevant Period ought to have been available for inspection;

c. failed to draw adverse inferences against witnesses central to the case whom Lloyd's elected not to call, notwithstanding that witness statements for such witnesses had been served on behalf of Lloyd's and that the learned judge had refused to require those witnesses to be summoned to court to testify;

d. imposed a timetable for final submissions which required the Names to answer Lloyd's closing argument without having heard, or read through, it;

e. substantially disregarded the submissions of litigants in person, notwithstanding that the material furnished, in particular by Mr Holman, was inconsistent with the distribution of the Murray Lawrence letter to members' agents."

497. A number of further points were made by or on behalf of the names in the course of the argument but, before considering them, we think it important to set out briefly the relevant surrounding circumstances.

The relevant circumstances

498. These were set out in considerable detail by Lloyd's in no less than 35 pages of its outline submissions. The underlying facts set out in those submissions are not in dispute. We therefore take this account largely from Lloyd's account of them. In earlier actions involving a considerable number of names who sought to avoid their liability to pay Equitas premiums, namely *Society of Lloyd's v Leighs, Lyon and Wilkinson* [1997] CLC 759 and 1012 and *Society of Lloyd's v Fraser* [1999] LRLR 156, this court held that none of the matters relied upon by the names gave rise to an arguable defence, but that the claims for fraud which many of the names sought to advance should be pursued as independent claims or counterclaims.

499. The names accordingly pursued their allegations of fraud in a number of different actions, with the result that it became desirable that there should be a rationalisation of the position in order to ensure that there was only one determination of what was essentially the same issue in different actions. That rationalisation was carried out by Colman J at a hearing on 29 and 30 June 1998 which led to his order of 30 June which both formulated the threshold fraud issue and identified those who would be bound by the decision on that issue. The order also designated the action in which Sir William Jaffray was counterclaiming as the lead action. As

we understand it, at that time all those affected by the order were members of the United Names Organisation ("UNO"). At a case management conference on 16 March 1999 Colman J ordered that names should only be severally liable for their proportionate share of Lloyd's costs in the event that the action was not successful.

500. At a case management conference on 29 October 1999 Cresswell J, who was of course in charge of the Lloyd's litigation, decided that any names who wished to reserve the right to advance a case that they had been induced to become or remain members of Lloyd's by reason of Lloyd's failure to disclose the nature and extent of the market's liability for asbestos-related claims must give notice that they intended to become parties to the litigation. He made an order to that effect. Such an order was plainly appropriate since it would be unthinkable for either names or indeed Lloyd's to be able to use valuable court resources twice (or many times) in order to have the same issues determined.

501. That is, in our judgment, so even though some of the litigants in person, especially Mr Harrison, have expressed some unhappiness that they could not pursue their own actions on their own. Mr Harrison also submits that the judge should have advised him to take independent legal advice. However, it was not for the court to give Mr Harrison or anyone else advice. It must have been obvious to every name that it was desirable to take legal advice.

502. It was no doubt because there was no realistic alternative to a single determination of the threshold fraud issue which would be binding on everyone that both Lloyd's and the represented names consented to such a course and no-one has since challenged the order to that effect. In our view, such an order and the subsequent control of the litigation was not only sensible but entirely consistent with the principles relating to group litigation which have been developed in recent years and with the provisions of CPR 19 Part III, which subsequently came into force on 2 May 2000. The order directed that a statement recording the terms of the order and the background to it be publicised on the Court Service website and Lloyd's sent a copy of the statement to every name who had not accepted the R&R settlement offer.

503. At a further case management conference on 10 December 1999 the court considered the issue of the participation of the non-UNO names who had indicated that they wished to join the action pursuant to the order of 1 November but who did not wish to instruct More Fisher Brown. Until then More Fisher Brown had represented all the names in the action including Sir William Jaffray. A number of the non-UNO names, namely two represented names and five litigants in person, attended the hearing and made submissions to the court. The order of 10 December 1999 provided that:

(a) the deadline for notification by names who wished to join the action be extended to 5 January 2000;

(b) names considering participating in the trial should be permitted to inspect the pleadings;

(c) More Fisher Brown were to remain the nominated or lead solicitors in the actions;

(d) names who did not wish to instruct More Fisher Brown were entitled to instruct solicitors or counsel of their choice or to appear in person, provided that such names:

(i) would adopt the evidence adduced by the lead solicitors and would not adduce additional evidence;

(ii) would adopt the cross-examination of the lead solicitors and counsel;

(iii) would be permitted to make written closing submissions and such oral closing submissions as the trial judge allowed;

(iv) would be provided at Lloyd's cost with access to a set of trial bundles and an office at Lloyd's solicitors where the bundles could be reviewed;

(v) would become subject to the various confidentiality orders previously made in the proceedings; and

(vi) would have several liabilities for their proportionate share of Lloyd's costs;

(e) joining names could seek any further directions that they saw fit to seek;

(f) any prospective name who joined the action and who did not formally instruct More Fisher Brown to act on his or her behalf had to communicate with More Fisher Brown to enable them to consider whether any additional point should be advanced as part of the threshold fraud issue; and

(g) a copy of the order was to be sent by Freshfields to all prospective names who had made contact with Freshfields, the court or More Fisher Brown to indicate an interest in joining the action.

504. Those directions were supported by all of the non-UNO names present or represented including Mr Evans, Mr Adams (for Mrs Adams) and Mr Harrison. The notification date was further extended at a case management conference on 14 January 2000.

505. Cresswell J also directed on 14 January 2000 that there should be a separate hearing before Colman J to determine the issue of what contribution the non-UNO names should make to the names' costs in the action. At a subsequent hearing on 26 January at which Lloyd's was not present Colman J made a costs-sharing order that provided for an equitable sharing of the costs in the action.

506. By the time of the hearing of 14 January, Sir William Jaffray had left UNO and had elected to be a litigant in person rather than be represented by More Fisher Brown. He did not, however, object to any of the orders that had previously been made regarding the case management of the action while he had been represented by solicitors and leading counsel. A number of the non-UNO names attended the hearing and made submissions to the court which were supportive of the directions given. They included Sir William Jaffray, Mr Evans, Mr Adams (for Mrs Adams), Mr Harrison and Mr Carter.

507. A yet further hearing took place on 11 February 2000 at which More Fisher Brown's status as lead solicitors was confirmed. Provision was made for Grower Freeman and Goldberg to act for legally aided members of UNO and for their counsel to assist in the conduct of the trial. Provision was also made for any disputes that might emerge between any of the participating names as to the conduct of the action to be referred to another judge of the commercial court for directions, although in the event no such disputes arose. At that hearing Sir William Jaffray expressed his delight at the court's rulings on representation.

508. On the first day of the trial the judge addressed all non-UNO names and summarised the arrangements for trial that had been agreed in respect of such names "to make sure that all names in person understand those arrangements and are content with those arrangements". The judge subsequently addressed each such name individually to confirm that he or she understood and was content with the arrangements, which those present, namely Mr Adams, Mr Butler, Mr Harrison and Sir William Jaffray, duly did. Thus the position as at the beginning of the trial was that 171 UNO names were represented by More Fisher Brown, Mr Simon Goldblatt QC and Mr Vincent Nelson (now Mr Vincent Nelson QC), 31 UNO names (who were in receipt of legal aid) were represented by Grower Freeman and Goldberg, Mr Patrick Talbot QC, Mr Giles Richardson, Mr David Drake and Mr David Craig and 15 non-UNO names acted as

litigants in person although four of them had instructed solicitors, namely Mr Holman, Mr Troostwyk and Mr and Mrs Harper.

509. The names' case was essentially presented by Mr Simon Goldblatt QC and Mr Patrick Talbot QC who shared much of the work between them. As just stated, they were supported by a total of four junior counsel and two firms of solicitors. In the course of the trial the various non-UNO unrepresented names frequently wrote directly to the judge, made submissions to the court and raised issues which were taken up by the court or by counsel. They each made written and oral closing submissions.

510. In the light of the submissions now made that the trial was unfair, it is a striking feature of the case that no complaint was made at the time and no-one sought to appeal any of the interlocutory rulings made by the judge or sought an adjournment of the trial. On the contrary Mr Adams, who represented his wife, expressed his gratitude to the judge and thanked "all the UNO legal team and especially Mr Goldblatt and Mr Talbot, to all of whom we are extremely grateful for their masterly presentation of our case": see day 61 page 9073. Mr Harrison thanked More Fisher Brown "for their diligence in keeping the Names' bundles and transcripts up to date" and added that he had become "proud to be associated with Messrs Goldblatt, Talbot, Nelson, Drake, Craig and the Names' solicitors": see day 61 page 9131. Mr Evans and Mr Troostwyk made comments to similar effect: see day 61 pages 9077, 9100 and 9111. We will return to particular aspects of the trial in the context of the individual points taken by or on behalf of the names, but we are bound to say that a review of the transcript shows, in our judgment plainly, that the judge took every step he could to ensure that the trial was fair and that he held the balance fairly between Lloyd's on the one hand and the names on the other. We turn to the grounds of appeal set out above.

Unacceptable pressure.

511. The names complain that, having regard to the inequality of arms between themselves and Lloyd's, they were put under unacceptable pressure. In particular they complain that at the outset of the trial the judge expressed his determination that the hearing should conclude by the middle of July 2000 and that Lloyd's produced a vast amount of documents in a plethora of lists of documents which made it very difficult, if not impossible, for them to cope. They emphasise that the process of disclosure continued during the trial. Thus, of the 34 lists of documents served by Lloyd's, nos 24 to 33 were served during the trial. They also complain about access to witnesses.

512. In the course of his oral submissions before this court Mr Nardell said this (at day 6 page 100):

"But by far and away our primary complaint, if it is necessary to identify a complaint about acts or omissions by the judge ...; if there is a complaint to be made, if I can put it in this slightly colloquial way, the judge failed to get a grip at an early stage of the pre-trial process, and by the time we came in it was too late, the damage had been done.

It may well be that one can conceive of some Herculean effort that could have been made by a judge to rescue things; it was not made. So we say of the judge during the trial process that yes, he sought to achieve fairness, as Mr Goldblatt stresses, but in a sense he was condemned to making the best of a bad job. He had hobbled himself."

513. In short, Mr Nardell submits that by the time legal aid was granted and solicitors and counsel were separately instructed for the legally aided names, it was too late for a fair trial to take place. Yet no application for an adjournment was made at the time. In our judgment, that is little short of extraordinary. If solicitors and counsel take the view that it is not possible to have a fair trial it is their duty to apply to the court for an adjournment on that ground in

order that the trial judge can decide whether or not there is a risk that the trial might not be fair and, if he decides that there is such a risk, to decide what should be done about it. Absent such an application, it is difficult to imagine a case in which it would be appropriate for this court to hold that the decision of the trial judge, while not wrong within the meaning of CPR rule 52.11(3)(a), was unjust because of a serious procedural or other irregularity in the proceedings within rule 52.11(3)(b).

514. Save perhaps in very exceptional circumstances, in our view no sensible legal system could permit a party who was aware of the problems at the trial to allow a trial to proceed for days or weeks and then, having lost on the merits and having failed to persuade the Court of Appeal to hold that the judge was wrong in fact or law, to argue that the trial was unfair and to invite this court to order a retrial. The proper course in such circumstances is to apply for an adjournment at or before the trial.

515. In this case the names took no such step. On the contrary, from early 1998 they pressed for an early date for trial and, at the names' request, on 15 March 1999 Colman J indicated what he later described as a very provisional trial date of 4 October 1999. In pressing for that date Mr Goldblatt said this:

"It may be that Lloyd's Names are putting themselves under pressure by propounding this timetable. There is no room for doubt about it: a trial date of 4 October is undoubtedly going to impose pressure on both sides. We recognise that. But we adopt the line that it is salutary for that pressure to be applied because it will enable the parties to concentrate on the things that matter and to discard the peripheral matters."

Lloyd's said that it would not be ready by then and pressed for a date in November 1999 at the earliest. In the event by the order of 16 March 1999 the court provided for a trial window of 11 October to 8 November 1999. Mr Goldblatt at that time indicated that it was practicable to complete the trial within 12 weeks.

516. On 24 June 1999 Lloyd's applied for the trial date to be put back. The names again said that they were anxious to see the trial come on at the earliest moment that the action could be fairly tried. Mr Goldblatt added that the names could manage whatever start time the court laid down and again said that the names were aiming at a three month trial and not a six month trial, which was suggested by Lloyd's. There followed various further case management conferences at which directions of different kinds were made and the date was discussed. In the main it was the names who were pressing for an earlier date than Lloyd's, although at the last the trial was delayed by a week at the names' request.

517. The trial began on 28 February 2000. The names made oral opening submissions for eight days and Lloyd's for two days. The witnesses gave evidence for over 40 days. The names' witnesses gave evidence over about a month and the Lloyd's witnesses over about two months. The timetable for the closing submissions was discussed on day 55 of the trial, which was 19 June 2000. The names were given two weeks in which to prepare written submissions. Although Mr Goldblatt initially expressed some concern about the timetable, he ultimately accepted that it sounded workable and it was agreed that the names would make their oral closing submissions on 6 and 7 July and Lloyd's would then submit their written submissions on 11 July and make their oral submissions on 12 and 13 July. Mr Goldblatt was given a further half day in which to make oral submissions in reply. We should add that no attempt was made to revisit this timetable in the light of the fact that a number of interlocutory matters were discussed in the period between 19 June and 11 July.

518. In these circumstances we are unable to accept the submission that the names were under unacceptable pressure in any of the respects alleged. The judge made sensible case management decisions which the names did not challenge at the time. He acceded to the

names' submission that the trial date should be earlier rather than later. The legally aided names did not apply for an adjournment and their counsel played an important part in the trial. We expressly reject Mr Nardell's submission that by the time the legally aided names were legally represented it was too late because the damage had been done or that, as Mr Nardell colourfully put it, the judge had hobbled himself. On the contrary the judge acted entirely fairly throughout the period both before the trial and during the trial itself.

The documents: disclosure and trial bundles

519. We recognise that both the parties and the court were faced with a massive number of documents (as have we) but we have had first hand evidence during the appeal of Mr Goldblatt's mastery of the documents. In our view both at the trial and on this appeal counsel have been able to identify the documents of importance and to dwell upon them appropriately.

520. We should add that this complaint should be seen in its context. On 24 June 1999 Mr Goldblatt said that discovery was not now likely to be a problem and on 29 June 1999 he said that after a slow start Lloyd's had got busy on discovery and that enquiry for further documentation was going to be restrained and limited and not something which was likely to hold up the trial.

521. We fully understand the frustrations of being presented with late disclosure of large quantities of documents which occurred here, although it is fair to say that some of those documents were not primary disclosure but documents which would or might be required for cross-examination. Nevertheless we thoroughly deprecate late disclosure, but it does not follow that the trial was in any way unfair. If there was any real risk of unfairness we feel sure that counsel would have applied for an adjournment of the trial, which no-one did. Moreover, since the trial there has been a further opportunity to consider the vast array of available documents ultimately disclosed by Lloyd's and to deploy them on this appeal. Indeed very many documents have been deployed on this appeal in seeking to show that the judge's decision was wrong.

522. In the course of the trial there were discussions about documents from time to time. For example, it was agreed on day 14 that cross-examination bundles should be prepared 48 hours before a witness gave evidence which were to include documents not included in the main trial bundles. At day 14 page 1800 the following exchange occurred between the judge and Mr Goldblatt in relation to documents recently obtained by Lloyd's:

"MR JUSTICE CRESSWELL: If you consider that your clients' case is impaired in any way and you have not had the opportunity to cover the matter you must tell me so and we will recall the witness, or otherwise provide for the problem.

MR GOLDBLATT: I shall not hesitate to rise to my feet and shall be ready to do so when necessity demands."

523. In their skeleton argument in support of this application, the represented names complain about the make-up of the trial bundles. Thus it is observed that trial bundles were delivered to leading counsel in tranches during January 2000. Prior to that, discovery bundles had been delivered to leading counsel in the autumn of 1999 but they were not complete bundles for use at trial, were not paginated and were not always in the sequence in which they were to be found in the trial bundles. It is submitted that, in conjunction with the continuous disclosure of documents after June 1999, those facts put counsel under unfair pressure.

524. There were no doubt difficulties, but in our judgment the evidence shows that counsel were able to cope with them. The names themselves were responsible for including a large number of documents in the trial bundles. The bundles were delivered in January 2000 and the names' skeleton was delivered in two tranches on 25 February and 1 March. Oral submissions in

opening began on 8 March and continued for eight days. The transcripts show that counsel were able to cross-examine the witnesses called by Lloyd's in great detail and by reference to a plethora of documents. As the exchange quoted above made clear, the judge would have been sympathetic to any problem which counsel faced as a result of problems with the documentation.

525. In the course of the trial Sir William Jaffray did suggest that Lloyd's had suppressed documents, without stating clearly what documents. No application was made during the trial by either Mr Goldblatt or Mr Talbot for an order for further disclosure. On day 55 the judge made it clear that in view of the complexity of the case, if either party felt that some matter had not been dealt with appropriately he wished to be told. Yet no complaint was made. While not perhaps conclusive, that seems to us to be a telling indication that the trial was fair and not unfair. In short, we detect no unfairness in the trial process because of the way that the judge dealt with either problems of disclosure of documents or, indeed, the trial bundles. Counsel for the names were able to deal with such problems as there were admirably.

526. However, in addition to complaints about the number of documents which Lloyd's disclosed late, the names further say that they were faced with many redacted documents and with directions both that many documents could not be read out in open court and that many documents could be disclosed only to lawyers representing names and not to names themselves. The names submit that those features render the trial either in fact unfair or apparently unfair in the sense described above.

Redaction and relevance

527. It is true that a number of documents were redacted. However, the mere fact of redaction does not suggest that the trial was unfair because documents are often redacted in order, for example, not to disclose either confidential but irrelevant material or material subject to legal professional privilege. In particular Lloyd's refused to disclose some minutes of the Committee or Council of Lloyd's which it said were irrelevant and disclosed other minutes in a redacted form to protect legal professional privilege. The selection of documents was expressly checked by junior counsel for Lloyd's, which led to some further material being disclosed. The judge directed on 29 October 1999 that, if the names were not satisfied with the result, they could return to the problem, but they did not.

528. Mr Nardell submitted as follows at day 6 page 140:

"The problem we have was that it was left by the judge to Lloyd's to assess relevance, not just to assess whether a claim for privilege could be made out, but to assess relevance, and we say that in the special circumstances of this case and these documents, that was an abdication of responsibility by the judge. He should have allowed inspection of documents, redacted to preserve privilege if necessary, so that the Names themselves could select what it was that they wanted to rely on or not rely on."

We are unable to accept those submissions.

529. In every case it is the responsibility of the solicitors for each party to consider documents in the control of their client and to decide which are relevant and which are not. Freshfields are very experienced solicitors who have been carrying out that responsibility (which is owed to the court) for many years. They were fully aware of the potential importance of the minutes of the various committees, including of course the Committee of Lloyd's and the Council of Lloyd's. We can see no reason why they should not have been relied upon to discharge their responsibilities with regard to both relevance and redaction in this case. In addition there was here the added safeguard that the minutes were expressly checked by junior counsel. In our view the judge approached the matter in an entirely appropriate, and indeed very sensible,

way. No case has been made out that the judge should have ordered redacted parts of particular documents to be disclosed.

Confidentiality: general

530. As to documents which were the subject of a confidentiality order and which the judge ordered should not be referred to in open court or disclosed other than to the lawyers, these are the subject of ground 14 a and b of the appeal quoted above. Those orders should be seen in their context. A number of different confidentiality orders were made as follows. We take this account largely from Lloyd's written submissions, which it was not suggested were factually inaccurate.

531. On 30 June 1998 Colman J made a confidentiality order of the kind that had been made in earlier litigation. In essence it required those to whom documents were made available for inspection to give an undertaking not to use them for any purpose other then this litigation. The order was expressly supported by Mr Goldblatt on behalf of the names whom he then represented.

532. Further confidentiality orders were made as a result of the intervention of London Market Claims Services Limited ("LMCS") in early 1999. LMCS was established by insurers in the London market to receive and retain legal advice sent to the market, and to preserve the confidentiality and privilege in that advice. It became aware that both Lloyd's and the names had in their possession attorneys' reports recording legal advice given to syndicates and insurers in the London market in relation to asbestos claims. In February 1998 it sought the re-possession of the reports, or alternatively orders to preserve confidentiality and privilege in the reports and documents referred to in them. The position of LMCS can be seen from paragraph 25 of a statement filed in this court on 18 June by Mr Graham of Barlow Lyde & Gilbert, who were and are the solicitors for both LMCS and Equitas:

"Confidentiality is important because of the danger of disclosure to actual and potential claimants and because of the commercially sensitive nature of the information with respect to competitors. Although the information in some of the Attorney's Reports may be old, this concern must remain strong. To illustrate the first point: estimates of the costs to dispose of APH cases, if known, could easily influence APH claimants' attorneys in determining the level of their demand. The gross extent of coverage remaining to an assured would likewise be of interest to them. Insureds will take the view that such information are matters of utmost confidentiality and disclosure could adversely affect the costs of disposing of the cases, the competitive position of the companies, the price of their shares and may even ultimately concern the survival of the companies themselves".

533. LMCS made an application to the court for repossession of documents already in the hands of the parties, which was opposed by both Lloyd's and the names. At a hearing on 10 May 1999 Cresswell J, effectively with the consent of all the parties present, rejected LMCS' applications seeking delivery up of the attorneys' reports or the prohibition of disclosure of them, but made similar orders to those previously made in the litigation brought by names against the Merrett, Secretan and Janson Green agencies which sought to preserve the confidentiality of and privilege in the attorneys' reports as between the litigants and third parties, without inhibiting the access of litigants (whether represented or in person) to the documents.

534. Names who joined the action at subsequent dates became subject to the confidentiality orders previously made by the court, with the result that they stood in the same position as all of the other litigants: see the orders of 10 December 1999 and 14 January 2000. When documents were subsequently obtained from third party sources, they were made subject to the same regime of confidentiality as applied to documents disclosed by the parties: see the orders of 4 November and 10 December 1999 and 28 February and 11 July 2000. Provision was also made

to preserve the confidentiality of these documents at the trial and thereafter, by providing a code system for references to particular attorneys and assureds: see the orders of 10 December 1999 and 28 February, 9 May, 23 June and 11 July 2000.

535. A procedure was also agreed at the hearing of 10 December 1999 whereby the non-UNO Names would be informed of the various confidentiality orders and required to sign an undertaking in this respect to allow them access to the trial bundles which contained the confidential documents. At no stage did any of the parties object to such arrangements. When the matter of confidentiality was referred to on the first day of the trial, in the context of access for the non-UNO Names to a set of trial bundles in the courtroom, all non-UNO names present (including Sir William Jaffray) agreed to sign a document stating that they understood, consented to and agreed to observe the confidentiality orders made by the court: see day 1 pages 56-63. The litigants in person had access to all of these documents at the trial.

Attorneys' reports

536. Correspondence between Barlow Lyde & Gilbert and More Fisher Brown revealed the existence of 37 boxes of material held by Equitas which appeared to contain material falling within the classes of documents which the names had sought in correspondence. The names made an application against LMCS and Equitas seeking production of various classes of documents, including assured-specific attorneys' reports and material within the 37 boxes which Barlow Lyde & Gilbert had identified. At the hearing of the application before Cresswell J on 4 November 1999, Mr Goldblatt said that he did not wish to pursue his application for attorneys' reports, stating that he was not interested in seeing assured-specific reports and that there were already a substantial number of attorneys' reports available to the parties. An order was made requiring Equitas to review the 37 boxes of documents identified in order to search for particular classes of documents which the names had sought at the hearing. These documents were in due course produced and incorporated into the trial bundles.

537. With a view to preserving privilege and confidentiality in legal advice concerning specific assureds, some passages in those documents were redacted by Barlow Lyde & Gilbert before they were produced to the names and Lloyd's. The judge indicated to Mr Goldblatt that if he had any concerns about the redaction of any particular documents, they should be raised with the court: see day 50 page 7643. No further directions were sought by Mr Goldblatt, although we feel sure that he would have made an appropriate application if he had thought that the interests of his clients warranted it. The same goes for Mr Talbot. In our judgment, here again the problem was dealt with very sensibly and without injustice to anyone.

Equitas reserving figures

538. This is the subject of ground 14 a. The names say that Equitas submitted figures to the court relating to the quantum of asbestos-related liability affecting the Lloyd's market, contending that the figures were commercially confidential and should not be disclosed in open court. They say that the figures were revealed to the names' legal advisers under a confidentiality order which wrongly prohibited their disclosure to the lay client and to litigants in person. The names' legal advisers wished to make submissions in open court regarding the figures so disclosed but the judge, it is said wrongly, refused to permit such submissions to be made.

539. The problem arose in this way. Again we take the facts from Lloyd's written submissions because it is not suggested that their factual account is inaccurate. The names initially made an application during the trial for the disclosure of information held by Equitas in respect of the R&R reserving exercise in respect of asbestos and pollution claims as at 31 December 1994. The scope of that request was subsequently widened to include data held by Equitas relating to syndicate reserves established by Lloyd's managing agents as at 31 December 1986, 1987 and 1994, and various other figures comparing Equitas reserves with those of Lloyd's

managing agents.

540. The issue had first arisen as a result of questions which the judge asked Mr Sturge and was subsequently followed up with some of Lloyd's witnesses who had been involved in the Equitas reserving project. The judge suggested that the names' solicitors send a letter to Equitas' solicitors formulating the precise evidence that they wished to obtain. After extensive correspondence between the parties as to the nature of the information available and the terms on which it should be produced to the court, a draft order for disclosure of the information sought was placed before the court in terms that were substantially agreed. It was finalised on 16 June 2000. On this aspect of the case Mr Talbot took the lead for the names both in formulating the requests and in making submissions as to the form of the orders made.

541. The orders made restricted access to the documents to specified legal advisers and the court and not to litigants in person. The reason for that approach, which was agreed between the represented parties was that, as was common ground between all parties, this was material of great commercial sensitivity, which it was in the interests of the entire Lloyd's community should remain confidential. It was Equitas' view that information in relation to the basis upon which particular classes of claim had been reserved would be of the greatest interest to insurers and assureds seeking to bring claims against Equitas, and that loss of confidentiality in this information would seriously prejudice Equitas in handling such claims. Equitas' counsel made it clear that, in the event that wider dissemination of the material was sought, his instructions would be to seek to resist disclosure and to take all necessary steps to protect his clients' position.

542. Litigants in person were not permitted access to the documentation on the basis of its great commercial sensitivity. We accept Lloyd's submission that this was a matter which was recognised by both Mr Goldblatt (at day 44 page 6643) and Mr Talbot (at day 52 page 7833). When it was suggested by leading counsel for Equitas that Equitas might withdraw its consent should litigants in person be afforded access to the information, the judge said this (at day 54 p 8130):

"There is provision for lead counsel and lead solicitors in this case; the important thing, as it seems to me, [is that] Mr Goldblatt as lead counsel should have access to this information and I'm sure that the litigants in person will realise that it is much better that this material should come in and that Mr Goldblatt should have access to it and be able to deploy it as he thinks appropriate subject to the restrictions, than that it should not be available to the Court at all".

543. The agreed form of the orders also stated that the information provided by Equitas should not be referred to in oral submissions unless the court was sitting in camera, and that written submissions on the matter should be restricted to a separate confidential document provided only to the judge and those legal advisers who were permitted to have access to this information. The orders further provided that any reference by the judge to the information in his judgment would be contained in a separate and strictly private and confidential schedule that could only be read by those permitted access to the materials under the terms of the orders.

544. The application for this information was made after extensive submissions in open court in the presence of all interested parties. The information was made available to Lloyd's and the names on the same terms, namely that it would be provided only to leading counsel, certain junior counsel and individual partners at the firms of solicitors. Both sides made written submissions on the material. Mr Goldblatt submitted to the judge that he would prefer to make oral submissions with regard to it, but the judge indicated his preference for receiving submissions in writing "in the first instance", expressly inviting Mr Goldblatt to review the position overnight: see day 59 pages 8723-8725. Mr Goldblatt subsequently filed a further written submission but did not thereafter invite the judge to allow him to make oral

submissions. Nor did the names make an application to recall any of Lloyd's witnesses in order to cross-examine them with reference to the material, although the judge had indicated that he would permit further cross-examination on the new material.

545. It may be that (as Lloyd's submits) the reason why it was decided not to apply to make oral submissions or further to cross-examine the witnesses reflects the limited relevance of material created by or for Equitas in the course of the Equitas' reserving project in 1994 and 1995 to the issue of whether reserves established by syndicates between 1978 and 1988 were known by the Committee of Lloyd's to be insufficient. However, whether that is so or not, we again feel sure that counsel for the names would have made a further application to the judge either to make oral submissions or to cross-examine particular witnesses if they thought that it was in their clients' 'interest.

546. We have set out the position in some detail because of the suggestion that it shows that the trial was not fair. However, we do not accept the submissions made by or on behalf of the names. The solution was a sensible and fair approach to a difficult problem. No-one sought to challenge the orders at the time and counsel for the names had every opportunity to make submissions and to cross-examine Lloyd's witnesses with regard to the material. The material has played little or no part in the appeal on the merits, which is scarcely surprising given its limited relevance to reserving in the relevant period.

547. Further, Lloyd's correctly submit that on 8 October 2001, this court rejected a challenge by Sir William Jaffray and certain other litigants in person to the court's order of 16 June 2000. That challenge was based on essentially the same grounds as are advanced now. In his judgment Lord Phillips MR, with whom two members of the present constitution (Waller and Clarke LJJ) agreed, recognised the very unusual terms of the order, which (he said) were explained by the fact that it was the product of agreement between the lawyers representing the parties. He added that Equitas had made it plain that it would not provide information save subject to the conditions agreed and that it would strenuously resist any subpoena that was issued.

548. The Master of the Rolls then said this:

"13. The object of the strict confidentiality was, as I understand is common ground, to prevent information being disclosed which would be potentially damaging to Lloyd's and the whole Lloyd's market including Names party to this litigation.

14. The purpose for which Sir William Jaffray and those who ally themselves to him seek to have this order set aside appears from the following paragraph from a witness statement dated 1st October which he has filed with the court:

"The reserving information will show the calculations used to ensure Equitas was adequately capitalised in 1996, and the discussions which took place with the DTI. The DTI's initial estimates of capital required for Equitas were substantially reduced to get Equitas approved by the accepting Names in the R&R scheme. We contend the Equitas reserving figures will establish three things: (1) that Lloyd's and Lloyd's syndicates had been consistently under-reserving for APH claims year in and year out for approximately 30 years and (2) that with connivance with the DTI and Lloyd's Equitas was deliberately under-capitalised to bring in the accepting Names and (3) that progressive deterioration of APH claims through to the present day will show Equitas is insolvent and unable to meet its liabilities, thereby proving that claims on old policies written on 1967 and post years of account continue to bleed into the future."

549. Thereafter the Master of the Rolls set out the statement made by the judge which we have quoted in paragraph 542 above and continued:

"18. That then, as it seems to me, is the material material to this application. I consider that the application should be refused for the following reasons.

19. First, it comes too late. Equitas has provided confidential information in reliance on the order and the undertakings given pursuant to it to which no objection was raised at the time. I think it would be quite wrong to accede to an order designed to enable the litigants in person to have access to information that was provided on that basis. I say that, although it is by no means certain that if the order was set aside that result would follow.

20. Second, this was an order made in group litigation. Group litigation proceeds on the basis that legal representatives will have the conduct of the litigation and that litigants in person will play only a limited role relying upon the professionals to protect their interests.

21. Third, the reasons for seeking to obtain this information are, for the most part, not relevant to the litigation. The fact that there was under-reserving is relevant but that, as I understand it, is not in issue. For myself, I do not see how attempting to show that Equitas was under-capitalised or is insolvent could properly further the Names' case on the issues raised by this litigation.

22. Finally, it does not seem to me that the Names have been prejudiced by this order. The lawyers with conduct of the litigation can make use of the information provided by Equitas, albeit subject to the measures in the order designed to ensure that it remains confidential.

23. I should indicate that Mr Goldblatt has intimated to the Court that he will in due course urge that the constraints imposed upon him by the order were prejudicial, but he did not feel it right to support the attack being made on the order, the order being one to which he agreed, on this application. As I see the matter at present I do not see the basis upon which the Names can say they were prejudiced. So, for those reasons, I would dismiss that part of the application."

550. We have reconsidered these points in the light of the arguments advanced before us, but have reached the conclusion that they remain correct. The Master of the Rolls was there considering the litigants in person, but we accept Lloyd's submission that those reasons apply equally to the represented names and that it particularly ill-behoves the represented names to be complaining about the approach adopted by the judge when the material was handled in accordance with terms which their representatives agreed at the trial. In any event, we are firmly of the view that the judge again dealt with this difficult area of the case both fairly and with great good sense.

Finality statements

551. This is the point raised by paragraph 14 b of the grounds of appeal. During the course of the trial a request was made on behalf of the names for the disclosure of the personal finality statements produced in connection with R&R, recording the final underwriting balance and R&R settlement offer as at 31 December 1995 for each of the individuals accused of fraud and certain members of their families. Lloyd's agreed to provide these documents to the names. However, given the confidential and private nature of the information set out in them, Lloyd's was only prepared to disclose such information subject to certain confidentiality provisions.

552. Those conditions were in essence that the finality statements would only be provided to certain representatives of More Fisher Brown and Grower Freeman & Goldberg and to counsel for the names, who would not disclose the finality statements to any other person, including litigants in person, and would take all necessary and reasonable steps to preserve the confidentiality of the information. In addition, each finality statement would subsequently only be used in the cross-examination of the individual to whom it related, and counsel would not read aloud in court any of the figures set out in the statement, but would simply refer witnesses to the

relevant sections of it.

553. Mr Goldblatt subsequently confirmed his agreement on behalf of the represented names to those conditions and the finality statements were provided on that basis. As we understand it, after they had been reviewed by the names' legal team, the finality statements did not feature to any significant extent during the remainder of the trial, or in the names' closing submissions.

554. The names now submit that the judge should not have agreed to such a course. However, we do not accept that submission. The represented names agreed to that approach. Moreover we accept Lloyd's submission that the first, second and fourth reasons given by the Master of the Rolls in the passage quoted above applies equally to the finality statements. So does the comment about the change of position of the represented names. In any event, our conclusion is the same as in the case of the Equitas reserving figures, namely that the judge cannot fairly be criticised for agreeing to a very sensible arrangement which prejudiced no-one.

LUNMA minutes

555. In paragraph 15 a of the grounds of appeal it is said that the judge wrongly treated the minutes of various committees, and in particular of LUNMA, as not being in the possession or power of Lloyd's. We can again take the history of this matter from Lloyd's written submissions.

556. The names made a pre-trial application for production of minutes and other documents held by LUNMA, which was a trade body representing the interests of underwriters specialising in the writing of non-marine business in the Lloyd's market. The court heard the application on 10 December 1999, and Mr Edelman QC and Barlow Lyde & Gilbert represented LUNMA.

557. LUNMA explained that the cost of looking through its records for the purpose of ascertaining the existence of the specific classes of documents that the names were seeking would be prohibitive. However, at the court's request, the LUNMA minute books were brought along to court, and Mr Edelman undertook a sample review of the books and reported the results in open court. On the basis of that review, Mr Goldblatt said this:

"It follows that it would be inappropriate to pursue, because we take the view that the cost of pursuit in relation to what we have been hearing from [Barlow Lyde & Gilbert] would not be justified within the context of the action". [Transcript, 10 December 1999, page 106]

558. During the trial, after Mr Goldblatt had made further reference to the minutes, the judge said that he believed that it would be appropriate for all of the minutes to be reviewed by one of Lloyd's counsel to determine if there was anything of relevance in them: see day 41 page 6242. In doing so the judge said that he did not want to proceed on the basis that the court had not seen a critical document. At the names' request, the review was limited to the period between 1979 and mid-1982 and the cost of the exercise was shared between the names and Lloyd's: see the order of 11 July 2000. The exercise was in the event performed by an independent counsel and one relevant passage in the minutes was identified and produced, although it was not of assistance to the names' case.

559. In these circumstance we do not think that there is anything in the point made in paragraph 15 a. At the trial the problem was sensibly dealt with by agreement and could not possibly form a proper basis for an argument that the judge did not conduct a fair trial.

560. We should add in this regard that whether the minutes were treated as within the possession or power of Lloyd's was not directly relevant to the way in which the issue was resolved, which

was based upon the practical problems of making further documents available, including the cost of doing so. In circumstances in which the problem was resolved by agreement, no complaint can be made about it now.

Adverse inferences

561. In paragraph 15 c of the grounds of appeal the names argue that the judge failed to draw appropriate adverse inferences by reason of Lloyd's failure to call witnesses said to be central to the case notwithstanding the fact that witness statements had been served, that the judge had read them and that he refused to direct that the witnesses be summoned to testify. In the course of argument it was further suggested that the judge should have required Lloyd's to call the witnesses in that category, or perhaps even called them himself.

562. The question what, if any, adverse inferences should be drawn does not seem to us to be relevant to the question whether the trial was fair, but to the question whether the judge reached the wrong conclusion. As Mr Nardell put it at day 6 page 157, the refusal to draw adverse inferences really belongs to the names' substantive challenge to the judge's decision on the merits. We have therefore considered that question in that connection: see in particular paragraphs 406 and 407 above. In the present context, the question does, however, potentially arise as to whether the trial was unfair because the judge did not require the witnesses to be called.

563. Lloyd's has drawn our attention to the fact that it served over fifty witness statements to cover the wide-ranging allegations brought by the names, and subsequently called seventeen witnesses to give oral evidence and served hearsay notices in respect of a further eight witnesses. Lloyd's in the event decided not to call all the witnesses whose statements had been served. It is fair to say that, although the witness statements were all read by the judge, Mr Aldous told Mr Talbot at an early stage that Lloyd's might not in fact call some of the witnesses. In our judgment, Lloyd's was entitled to reserve the right not to call all the witnesses whose statements had been served on the other side.

564. We would, however, add this. In our view, in such a case, it is desirable for a party to inform the judge that it may not call all the witnesses before he is asked to read their statements. It does not seem to us in principle to be desirable that a judge should be asked to read the statement of a witness until a decision to call him has been made, at any rate unless he is informed of the position. Nevertheless, it is not, as we understand it, submitted on behalf of the represented names that the trial was unfair because the judge read the statements of witnesses not called, no doubt because it is correctly appreciated that judges often have to put matters of which they were once aware out of their minds in resolving issues of fact.

565. Such a suggestion has been made to us by Sir William Jaffray, who submitted at day 8 page 18 that "by putting in false statements and then asking the court to ignore them, Lloyd's manipulated the trial and its result". We do not accept that submission. While, as just stated, the judge should have been warned that Lloyd's might not call all the witnesses, there is no reason to believe that the judge was not able to disregard the statement of such witnesses or that his judgment was in any way affected by their contents: see eg *Barings Plc v Coopers & Lybrand* [2001] EWCA Civ 1163. What in fact happened was as follows.

566. In the light of Lloyd's decision, the names applied for an order that the judge require Lloyd's to call six of the witnesses whose evidence would not be relied upon by Lloyd's, namely Mr Randall, Mr Blake, Mr Coleridge, Mr Barber, Mr Nelson and Mr Skey. Sir William Jaffray put forward a longer list of witnesses whom he wanted called before the judge. The names, however, chose not to issue witness summonses or adduce the withdrawn statements as hearsay under CPR rule 32.5(5). All but one of the six witnesses were accused of fraud, so that the names did not want to call them to give evidence themselves but wanted to cross-examine them.

567. The application was heard on 8 and 9 June 2000 during the trial. Submissions were heard from Mr Goldblatt and also from a number of the unrepresented names, as well as from Mr Aldous on behalf of Lloyd's. The judge held that he had no jurisdiction to direct Lloyd's to call witnesses whom it did not want to call: see day 50 pages 7624-7636. The question of jurisdiction turned on the construction of CPR rule 32.1. It was not suggested to the judge that, since the judge had read the statements, the names were entitled to cross-examine their makers. Nor was it seriously suggested to him that he, the judge, should have called the witnesses himself. He accordingly ruled in favour of Lloyd's, while noting that it was open to the court to draw all such adverse inferences against a party seen to withhold evidence from the court as it saw fit.

568. Permission to appeal was refused by the judge, but a timetable was laid down within which the names could apply to this court for permission to appeal if they wished. No such application was made. Moreover, the names do not even now challenge the judge's decision on jurisdiction. In these circumstances this court could not properly hold that the trial was unfair in this respect. We would, however, add that, even if the court had jurisdiction to direct Lloyd's to call witnesses, and thus a discretion to do so, it does not seem to us that it would be appropriate to exercise that discretion in a case in which the witnesses were accused of fraud, solely for the purpose of enabling the names to accuse them of the fraud in the witness box. It was for the names to prove their case on the evidence which they called and put before the court.

569. In our view, again the judge dealt with this part of the case entirely fairly, by indicating that he would draw whatever inferences he thought appropriate from Lloyd's failure to call the witnesses concerned. It follows that we have reached the firm conclusion that the trial was not in any way unfair in this respect.

Witness statements

570. Sir William Jaffray, supported by at least some of the other names, submits that witness statements were served too late to enable names to cope with them. He draws attention to the fact that Lloyd's served witness statements in the six weeks before the trial and in some cases during the trial. However, apart from the names' reliance statements, as we understand it, the statements of both sides were exchanged on 17 January and reply statements were exchanged on 15 February. The represented names accepted those dates at the time and no-one applied for an adjournment of the trial on the ground that they needed more time to deal with any particular witness.

571. In our judgment, in these circumstances it could not fairly be said that the trial was unfair because of the dates upon which witness statements were exchanged. No-one said so at the time, no doubt because at the time it was decided that counsel had sufficient time to prepare their clients' case including cross-examination of the witnesses. As to events during the trial, in very many substantial cases statements of particular witnesses are produced after the trial has begun. No doubt it would not happen in a perfect world but, provided that there is no prejudice to a party which cannot be remedied, the mere fact that witness statements are produced then will not make the trial unfair. We are not aware of any particular statement which was produced so late that counsel could not fairly present his clients' case because of it. If there had been such a statement, appropriate submissions would no doubt have been made to the judge at the time. This was not, in our judgment, a real problem in the case.

Timetable for final submissions

572. In ground 15 d it is submitted that the judge imposed a timetable for final submissions which required names to answer Lloyd's closing argument without having heard or read through it. This is not a fair criticism. As described above, the judge heard submissions as to when the

names' written submissions should be prepared. He made a sensible ruling which was accepted at the time as being workable. He then gave further directions as to final written and oral submissions which were essentially agreed.

573. It was appropriate for the names to make their submissions first at the end of the evidence. When those submissions were prepared the names had a clear idea of what Lloyd's case was. In addition to its oral opening submissions Lloyd's had lodged very detailed written opening submissions. Moreover, by the time that the names came to prepare their final submissions, the trial had been proceeding for some 55 days during which it was plain what Lloyd's case was on each relevant point. As already stated, the names had a substantial team of solicitors and counsel (quite apart from the litigants in person) who could (and no doubt did) divide the work between them.

574. It cannot fairly be suggested that the names did not sufficiently know what Lloyd's case was when they prepared their final submissions. After the names' submissions, Lloyd's both lodged final written submissions and made oral submissions, to which Mr Goldblatt was able to reply on behalf of the names. By that time the names had had an opportunity both of reading Lloyd's written submissions and of hearing its oral submissions. In these circumstances we cannot accept that the names did not have a fair opportunity to answer any point made by Lloyd's which they wished to answer. Nor can we accept that either a reasonable litigant or an impartial observer would have reached any other conclusion. We should perhaps add in this regard that after the trial and before the judgment was handed down, the names made a number of further submissions in writing to the judge. Particular directions were given by the judge in this regard as a result of post-trial correspondence. We are in no doubt both that the names had every proper opportunity to put their case before the judge and that they availed themselves of that opportunity by putting very detailed submissions before him.

Role of litigants in person

575. Some of the litigants in person complain that they were denied the right to cross-examine witnesses and to participate more widely in producing pleadings and at the trial. We can see that this may be frustrating for individual litigants in person, but the answer to it is clearly stated in paragraph 20 of the Master of the Rolls' judgment on 8 October 2001 quoted above. This is group litigation, which, as the Master of the Rolls put it, proceeds on the basis that legal representatives will have the conduct of the litigation and that litigants in person will play only a limited role relying upon the professionals to protect their interests. We do not see how complex group litigation could sensibly proceed in any other way. It is simply impossible for any legal system to permit all individuals concerned in group litigation to cross-examine every witness.

576. Nor is it necessary in order to ensure a fair trial. This can be seen on the facts here. There were two teams of solicitors and counsel representing the names who were able to (and did) put every point which it was appropriate to put to the witnesses and made every submission that they wanted to make. It was open to the litigants in person to ask counsel for the represented names to call a witness or to put particular evidence before the judge, There is, however, no suggestion that any such request was not complied with.

577. In fact, as stated elsewhere, the litigants in person, including Sir William, were given every latitude by the judge at the trial. Indeed scarcely a day went by without one or more litigants in person making a point or points to the court. Moreover some material at least was put before the judge directly by the litigants in person. For example, Mr Harrison referred in the course of his submissions to us to an affidavit of a Mr Newton Grant, which was (as we understand it) before the judge and which expressed the view that Lloyd's was in breach of duty in a number of ways. It is an indication of evidence which names were able to put before the judge and thus provides no support for the suggestion that they received an unfair trial.

Disregard of submissions of litigants in person

578. This is an allied point. The names further complain in ground 15 e that the judge substantially disregarded the submissions of the litigants in person, notwithstanding that the material furnished, in particular by Mr Holman, was inconsistent with the distribution of the Murray Lawrence letter. In considering this point it is important to have in mind that it is not incumbent upon a judge to refer to every point made by or on behalf of a party, whether the point is made by counsel or by a litigant in person. In a case of this complexity it is impossible for a judge (or indeed this court) to discuss every argument in the course of the judgment. It does not follow from the fact that the judge has not mentioned a particular point that he has not had it in mind.

579. The duty of a judge is to consider the evidence given and the submissions made and to give reasons for his decision. Those reasons should be as concise as possible in the circumstances. The judge here cannot possibly be fairly be criticised for not mentioning every argument advanced before him. It is true that he did not expressly refer to every point made, but his judgment shows the care which he took in considering the case as a whole and, in our opinion, he made no procedural error in deciding what to include in his written judgment and what to omit.

Relationship between Lloyd's, Equitas, LMCS and LUNMA

580. A recurring theme of the names' submissions on this part of the case is that Lloyd's hid behind the legal fiction that it was separate from Equitas, LMCS and LUNMA in order to make it difficult for names to obtain appropriate documents and information and in order to impose unfair restrictions upon them, and in particular upon the litigants in person, with regard to which documents they could see and what use could be made of them. They say, with force, that, whatever the strict legal position, if Lloyd's had wanted each class of disputed document there can be no doubt that in practice they would have been able to obtain them.

581. We understand the strength of the names' feelings in this regard, but the problems of confidentiality to which we have referred were very real and had to be addressed in a sensible manner for the benefit of the market as a whole including Lloyd's names. We have addressed the problems which arose with regard to each class of document and each area of confidentiality in order to see whether it can properly be said that there was any unfairness in this regard. The problems which arose required careful and balanced handling for the benefit of all. They were for the most part solved by agreement and were throughout dealt with fairly and dispassionately by the judge.

582. In all the circumstances we have reached the clear conclusion that there was nothing in the separation between Lloyd's on the one hand and Equitas, LMCS or LUNMA on the other, which could properly lead to the conclusion that the names did not receive a fair trial. We are entirely satisfied that they did.

Conclusions on fair trial

583. We recognise that this is a most exceptional case. For that reason we have considered the arguments advanced at much greater length than we would ordinarily think appropriate on an application for permission to appeal. We have already expressed our view that none of the particular submissions made by the names can succeed.

584. However Mr Nardell puts the argument more generally. He submitted as follows (at day 6 page 108):

"... the right approach is not to treat consideration of these complaints as if [the court] were

hearing an appeal from individual orders of the judge, but rather to stand back and look at the trial process as a whole, and ask whether the Names enjoyed not only the substance but also the appearance of a fair trial, and in doing that, [the court] will be adhering to the spirit of the approach which Article 6, now part of domestic law, requires a court to whom complaints about the fairness of a trial are made."

585. We have, however, reached the conclusion that, whether we approach the present problem by looking at each of the particular aspects of the trial complained of or whether we stand back and consider whether the trial process had the substance and appearance of a fair trial, the answer is the same. It is that there was nothing unfair about this trial either in terms of substance or appearance. We recognise that there may be cases in which, in the interests of justice, it would be incumbent upon a judge to adjourn a trial or take some other course of his own motion, but this is not, in our judgment, such a case. Both parties were represented by more than one leading and junior counsel instructed by experienced solicitors. In complex litigation of this kind, it would be a rare case indeed in which in such circumstances a judge could fairly be criticised for not taking some particular procedural step without being asked to do so.

586. CPR 52.3(6) provides:

"Permission to appeal will only be given where –

(a) the court considers that the appeal would have a real prospect of success; or

(b) there is some other compelling reason why the appeal should be heard."

Having heard very full argument on this question we have reached the clear conclusion that the names cannot satisfy either limb of this test. The application for permission to appeal is therefore refused.

IX CONCLUSIONS

587. As to the appeal on the grounds for which permission has been given, our conclusions may be summarised as follows:

i. There was a representation in the 1981 brochure that there was in place a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses. (Paragraph 321)

ii. Subsequent brochures contained essentially the same representation, even though the word 'rigorous' no longer appeared. (Paragraph 323)

iii. The 1981 brochure also contained a representation that Lloyd's believed that such a system was in place. So did subsequent brochures. (Paragraphs 321 and 323)

iv. The globals contained no relevant representations. (Paragraphs 326 to 343)

v. The representations in i) and ii) were, during the relevant period, untrue. (Paragraphs 375 and 376)

vi. The names have however failed to prove that Lloyd's did not believe the representations to be true or that they either knew that they were or became untrue or were reckless as

to whether they were true or untrue. (Section VII)

vii. It follows that the judge was right to determine the threshold fraud issue in favour of Lloyd's and to hold that Lloyd's is not liable to the names in the tort of deceit. It further follows that the appeal on the merits, which the names had permission to bring, fails and must be dismissed.

588. As to the names' case that the trial was unfair, upon which they need permission to appeal, we have considered the arguments advanced in considerable detail in section VIII but have reached the conclusion that an appeal would have no real prospect of success and that there is no other compelling reason to give permission. It follows that the application for permission to appeal is refused.

589. Finally, we would like to thank all those concerned, whether counsel, solicitors or litigants in person for their very considerable assistance in this difficult and worrying case.

after crediting investment income and gains.

Chronological summary: 1983 - 8

202. The 1982 Act came into force on 1 January 1983. Sir Peter Green was the first Chairman of the newly-constituted Council with Mr Brennan and Mr Barber as Deputy Chairmen. Mr Ian Hay Davison became the first Chief Executive (as well as being a third Deputy Chairman). He remained in post until 1986 when he resigned in circumstances which the Neill Report described as a matter of 'fresh controversy'.

203. In April 1983 the Chairman wrote to all managing agents, members' agents and panel auditors setting out a new scheme for the disclosure of reinsurance arrangements. This required managing agents to disclose particulars of reinsurance contracts and arrangements, including 'related party' arrangements which conferred an element of discretion on the managing agents or the underwriter.

204. By mid-1983 the number of asbestos-related claims had risen to over 27,500 (and it was to continue to rise relentlessly, repeatedly falsifying all previous estimates). The judge devoted a section of chapter 16 of his judgment to what he referred to as

" ... the interlinked reasons why things looked so different at the end of the 1980s and in the early 1990s, from the way in which they had looked in the early 1980s."

The judge's account has not been challenged in this court. In brief summary he identified the following reasons:

i. Various defences which had been regarded as likely to negative liability in many cases proved to be of little assistance in United States courts.

ii. The sheer volume of claims made it increasingly difficult to scrutinise claims in depth.

iii. Insured producers were increasingly reluctant to contest liability in case publicity led to more claims against them (the judge instanced Keene Corporation which was forced into bankruptcy though it had, according to its management, never sold as much as $1m-worth of asbestos products).

iv. Insurers had little success in disputes with their insured on issues of coverage.

v. Asbestos-related litigation was very lucrative for American lawyers, who actively recruited claimants (even to the extent of installing mobile x-ray units in workplaces) and cast their nets wider and wider to bring in new categories of defendants.

vi. Some producers (notably Owens Corning) contributed to this process and themselves encouraged the joinder of other defendants in order to spread the liability. The 14 defendant producers identified by the London market early in 1982 eventually increased to over 250.

vii. Apart from claims for bodily injury, there were also (from about mid-1983) an increasing number of property damage claims based on the proposition that the use of asbestos in building had reduced the value of the building so as to amount to an actionable loss. In June 1983 two actions for property damage were commenced against Dana Corporation. One was brought on behalf of all schools in Pennsylvania, and the other on behalf of over 100,000 public and private schools in other parts of the United States.

205. In September 1983 Lloyd's presented its global results in a new and clearer form ("the globals") which was used throughout the rest of the relevant period. The globals included a statement by the Chairman and separate reports by the chairmen of specialised associations of underwriters. Mr Cockell, the chairman of LUNMA, referred in rather guarded terms to asbestos-related risks and then commented:

"It takes a brave man, or a foolish one, to forecast the outcome of the open years. For what it is worth I would personally expect the bottom line on each to show a deterioration on the preceding one."

206. In October 1983 a question arose as to what should be said at Rota interviews to prospective Names who were intending to commence underwriting through an agency which was the subject of investigation. It was decided that the prospective Names should be given this information. There was no change of policy as regards information about asbestos.

207. Also in October 1983 the secretary of LUNMA wrote to Mr Chester (as chairman of the Audit Committee) giving the views of a LUNMA working party on the proposal (which Mr Lawrence had raised in 1979) for the subdivision of the "All Other" category of business. The LUNMA working party did not recommend a split.

208. In 1984 Mr Miller became Chairman with Mr Barber and Mr Lawrence as Deputy Chairmen. During this year the Inland Revenue took an increasingly active interest in Lloyd's reinsurance practices (and especially roll-over policies) as a means of avoiding or evading tax. Mr Miller took a personal interest in this matter and began by meeting with the Chairman of the Board of Inland Revenue and the Governor of the Bank of England. Mr Miller aimed at negotiating a general settlement of a large number of protective assessments to income tax made on both working and external Names.

209. Mr Barber was also concerned in preparing for negotiations with the Inland Revenue. He prepared a memorandum dated 19 January 1984 after interviewing several underwriters (including Mr Skey, Mr Chester, Mr Outhwaite and Mr Murray) and brokers. He also interviewed Mr Holland of Ernst & Whinney. In his memorandum he described roll-over policies as

" ... policies which parade as ordinary reinsurance policies but which, either by their express terms or as a result of some undisclosed understanding between the parties, in fact contain no genuine or significant element of risk. In their most extreme form they enable a Syndicate from time to time at its discretion to place funds by way of 'premiums' with a reinsurer, usually overseas, with the right for the Syndicate at any time to call for repayment of those funds, together with interest, by way of 'claims'."

210. The memorandum identified another form of policy, a funding policy. In his memorandum Mr Barber commented on this type of policy:

"The obvious case for such a policy would be for a Syndicate's asbestosis liabilities. These losses are coming in at a frightening rate and for many Syndicates a full reserve would bring massive losses to Names in 1981/1982 Accounts. This type of loss may settle very slowly if every case is contested through the Courts OR it may settle very quickly as Underwriters attempt to reach a compromise with their assureds or re-assureds. In the former case, the Reinsurer will make profits, in the latter, there exists the probability of severe losses.

It cannot be too strongly stressed that had these policies not been available there is a question as to whether some Syndicates could have survived. If they are ruled as being inadmissible and funds have to be brought back at a time of bad results, then some may well go under.

These policies must be fought for. The effect of bringing back a 'roll-over' is one thing. This

would be quite another."

211. Also on 19 January 1984 attorney H reported in a long letter to Mr Jackson (as chairman of the AWP). The letter covered many topics in detail, including the following:

i. It reported the formation of Toplis & Harding (Asbestos Services) Ltd as a service company, initially in order to avoid attorney reports being passed through brokers (with adverse implications for discovery of documents in actions in the United States).

ii. Attorney H emphasised that its recommendations for reserving were based on known claims outstanding "and no attempt has been made to project an IBNR factor".

iii. The letter explained the "unique" practical and logistical problems of handling asbestos-related claims and referred to continuing negotiations (which eventually led to the Wellington Agreement and the establishment of the Asbestos Claims Facility).

212. On 8 February 1984 there was a meeting between the panel auditors and Mr Lawrence (as Deputy Chairman with responsibility for audit matters) and Mr Jackson (as chairman of the AWP). The purpose of the meeting was to inform panel auditors of the latest position and enable them to ask questions.

213. On 9 February the Chief Executive wrote an internal memorandum in response to one from Mr P A R Brown, the Head of External Relations. Mr Brown's memorandum had included the following outspoken passage:

"The evidence can only be anecdotal, but it seems to me (and to others with whom I have discussed the question) that market members are beginning to think that, having kept their heads down and let the blast of the past 18 months blow over them, and having taken a great deal in the way of uprooting and rearranging from an imposed outsider – you – they can now successfully fight back in defence of their traditional ways of work, that by obstinacy they can blanket your reforming power, and in short that they can dive back into a cosy system that will be not much noticed by Press and Parliament – or, one supposes, the Names. If anyone is thinking like that – and I believe that more and more people are – they are profoundly wrong, and in my judgment most dangerously so for the future. I hope that I do not need to emphasise the consequences of, for instance, disappointing the Revenue's expectations in the matter of disclosure, or conniving at the concealment from Names of information which, if they were company shareholders, they would be statutorily entitled to have."

214. Mr Davison's more measured response stated, among other things:

"As to syndicate accounting I believe in all honesty it can be said that we have made great progress in arranging for the publication of syndicate accounts and by incorporating by byelaw certain basic essentials which will go to Council on 13 February. I do not share your view that the AASC memorandum represents a substantial defeat. Disclosure is the name of the game and disclosure is what we are achieving. There is an inevitability about the work of accountants in this field which even the high Tories on the Committee know they cannot reverse."

It would be wrong to attach much weight to these observations by individuals who did not give evidence, but they give something of the flavour of the position a year on from the coming into force of the 1982 Act.

215. Negotiations between Lloyd's and the Inland Revenue continued throughout 1984. Over 17,000 Names (about 92 per cent of the membership for the 1981 year of account) received provisional assessments. By April 1984 the Inland Revenue had set up a separate Lloyd's unit

of its Special Investigation Section.

216. In July 1984 there was an overall settlement of insured claims against Johns Manville. The total settlement was for $ 315m of which the London market's share was $94m. Mr Rayment stated in his witness statement that this had proved to be a good deal. From the insurer's point of view that must be correct, since the insured's projection (as at mid-1984) of a total of 40,000 claims has proved to be far too low.

217. In August 1984 the globals for 1983 were published showing an overall profit for 1981 of £152m but a pure overall underwriting loss (the first for many years) of about £43.5m. Mr Rokeby-Johnson, the chairman of LUNMA, said in his report,

"It is rapidly becoming apparent that the potential claims arising from asbestos will dwarf any claim in the history of our industry. It is very sad that in the United States to date under half of the money paid by our industry has ended in the hands of the injured party, the balance is in the capacious coffers of the more rapacious lawyers: for this reason we support, and I very much hope all our industry will support, the concept of a claims handling facility set up by the insurers and manufacturers to look after the interests of the injured."

We will come back to this report and to other reports by LUNMA chairmen in considering the globals (paragraphs 326ff below).

218. On 2 November 1984 there was a presentation to the Inland Revenue by a team representing Lloyd's. The speakers were Mr Tony Parkington, Head of the Members' Solvency and Security Department; Mr Merrett and Mr Kellett as underwriters with marine and non-marine experience respectively; and Mr Holland of Ernst & Whinney. The appellants have drawn particular attention to a passage near the end of Mr Kellett's address:

"In virtually every year since I became an underwriter the committee have found it necessary to increase the [minimum recommended] percentages. When one considers the billions of dollars now being paid out, on claims such as asbestosis, claims totally unprovided for out of the years in which they fell. When one considers further, such losses as environmental pollution claims, now beginning to be presented in respect of waste, haphazardly dumped over decades. When one considers the ever changing attitudes of courts, especially in the USA, but also here, and around the world, towards all accepted ideas of negligence and the duty of care owed to others, towards the interpretation of policy forms, towards our right to rely on exclusions, all of which will affect unsettled claims currently being handled.

When one considers all these factors, it is clear that what properly concerns underwriters is not the question of whether we are over, or under reserved. We are under reserved. What concerns us is, how the industry can survive its under reserving."

219. On 6 December Mr Kiln gave a lecture on 'Reserving Reinsurances to Close and their Effect on Profits' at the Insurance Institute of London (subsequently reprinted as a chapter in his book on reinsurance). He expressed the view that many syndicates writing long-tail business were regularly under-reserved:

"I can think of no syndicate since 1946 with a volume of business in long-tail which has stopped underwriting and on which the run-off has been contained within its original RITC taking interest into account."

220. Earlier in the lecture Mr Kiln had said,

"It is vital that Underwriters and management do study and understand the problem in a technical sense. The days are gone when reserving can be done on a case-by-case basis plus

something extra for luck. Our industry must cope if it is to continue to serve society in the way society demands of us and we are to remain solvent."

At the end of his paper he acknowledged the assistance of a distinguished actuary, Mr Sidney Benjamin. It is apparent that during the relevant period active underwriters, claims directors and auditors were becoming more aware of the assistance which they could obtain from actuaries in reserving for non-life business.

221. At the panel auditors' meeting on 19 December 1984 members of the MSSC spoke about factors affecting reserving as at 31 December 1984. Manuscript annotations on a copy of the agenda indicate that Mr Jackson spoke on asbestosis and latent diseases, but there is no further record of what he said.

222. In 1985 the Lloyd's office-holders were the same except that Mr Lawrence became senior Deputy Chairman and Mr Coleridge became junior Deputy. Early in the year there was a perceived problem of under-capacity in the non-marine market. This was discussed at a meeting of the LUNMA committee, attended by Mr Miller, on 10 January. The minutes of the meeting show that some of those present (including Mr Skey and Mr Cockell) thought that the market had begun to turn in favour of underwriters, and that underwriters wished to take advantage of this.

223. The MSSC was asked to consider the problem of capacity and reported on it to the Committee of Lloyd's in a paper dated 8 February 1985. The MSSC put forward no specific recommendation beyond its view that deliberate over-writing (that is, deliberately ignoring premium limits) could not in any circumstances be acceptable.

224. On 19 March 1985 Mr Jackson, as Chairman of the AWP, gave written testimony to the United States Senate Sub-Committee on Labor chaired by Senator Nickels. His testimony was mainly directed to explaining the need for the Asbestos Claims Facility. It began as follows:

"1. The number of present and expected asbestos related claims is enormous, and the problems they are creating for the producers and insurers are unprecedented, both in terms of the total dollars involved and of the human resources needed to handle these claims.

2. The considerable liberalisation and wide divergence in judicial interpretations on such critical issues as coverage triggers and continuing defence obligations have shaken insurers' confidence in their traditional approaches to policy wordings and risk evaluation.

3. The emergence of complex multiparty litigation drawing in laundry lists of producers and their insurers has escalated the cost of pleading and defending each aspect of each claimant's case to the point where it now takes nearly $2.00 of costs to recover $1.00 of damages.

4. Against this background of judicial uncertainty, already catastrophic losses, and the reality of massive property damage claims yet to come, the task of fixing meaningful reserves and managing cashflow to pay claims will continue to demand virtual clairvoyance and a near reckless courage from executives involved at primary level, as well as from their reinsurer counterparts.

You might well ask if we are getting it right. I will show you how we propose to do just that."

He then went on to explain about the AWP and the proposed Asbestos Claims Facility.

225. On 12 April 1985 Mr Randall (who had ceased to be employed by Lloyd's and was with Merrett syndicates) disclosed to Lloyd's the disastrous results of eleven run-off policies written by Merrett syndicates 418/417. About two-fifths of Merrett personnel were on these syndicates.

Nevertheless the 1982 year was closed into 1983. The judge, who as trial judge in *Henderson v Merrett Syndicates* [1997] Lloyd's LRLR 265 was uniquely knowledgeable about this part of the litigation, commented in chapter 19 of his judgment:

"I suspect that if 418/417 had left its 1982 year open, this would have had a marked effect on the Lloyd's market and underlined the depth of the problems represented by asbestos-related and pollution claims. The extent to which subsequent events would have taken a different course is a matter of speculation, but the effect would have been significant."

226. On 19 April 1985 Mr Davison gave a lecture to the conference in Paris of the National Association of Accountants. In his talk he spoke of "the great drive for new Names" but he described it as having begun in the mid-1970s (not the early 1980s). He also spoke of scandals at Lloyd's:

"But the fact remains that poor accounting practices and inadequate audits, together with a tax climate that encouraged sub rosa arrangements, had all contributed to a situation in which a few Lloyd's agents milked their Names of up to £100m. Many at Lloyd's have asked "where were the auditors?", in the second part of this talk I propose to address that question."

227. The second half of the lecture was devoted to the reforms of accounting and auditing practice. Its criticisms of the earlier position deserve to be set out at some length:

"For a number of reasons, therefore, there was a continuing risk, not always avoided, that the panel auditors at Lloyd's lacked independence from their clients: some kept the books; some were too dependent upon Lloyd's for their fee income; together they formed a small group specialising in an arcane area of accounting work; and the different interests of Names and their agents were not necessarily adequately reflected in the audit arrangements.

But there was a more difficult problem, the panel auditors were not in fact charged with carrying out an audit at all. Their duty was to assist by providing the Annual Solvency Certificate which merely shows that each Name has sufficient assets to meet his liabilities calculated in accordance with the formulae laid down by the Committee of Lloyd's. Agents, underwriters and the Committee of Lloyd's were all under the misapprehension that the work done by the panel auditors was an audit in the sense which you and I would understand it. But it was not, a fact which the auditors themselves, to give them their due, had protested from the very beginning. The accounts of an underwriting syndicate, and the determination of its profit, depends upon how much reserve is necessary to close the account. The figures for the closing reserve is provided by the underwriter in the form of the "reinsurance to close". Some of the panel auditors at Lloyd's were still living in the days of "inventory at director's valuation" which used to be the way in which profit was calculated in manufacturing companies in the UK 30 years ago: they did not consider it part of their duty to audit the reinsurance to close."

228. On 13 May 1985 there was a meeting of the Council at which the Chairman, Mr Miller, spoke to the agenda item 'Attraction of New Names'. The minutes record that he referred to

" ... the need for increased membership as a result of the shortage of capacity and the conflicting adverse publicity arising from reported underwriting losses for recent years."

229. The market's recent losses were the focus of attention the very next day, when a meeting (minuted as 'Lloyd's Most Sensitive – Outhwaite') was told that the Outhwaite Agency intended to close the 1982 year of account for syndicate 317, but that Ernst & Whinney could not give an unqualified syndicate solvency report. (Syndicate 317 had written numerous run-off contracts as explained in chapter 17 of the judgment; see also paragraph 127 above). There was a further meeting on 17 May (with the two Deputy Chairmen) at which allegations were made of undue pressure being put on auditors by Lloyd's staff. The outcome was that on 1 July

1985 Mr Outhwaite decided to leave the 1982 year open, while still expressing the view that it would prove profitable.

230. On 19 June 1985 the Wellington Agreement was signed on behalf of 30 United States insured producers, 16 United States insurance companies and all interested Lloyd's syndicates. There is a full description of the agreement in chapter 16 of the judgment. It emphasises that although the Asbestos Claims Facility ("the ACF") was terminable (and was in fact terminated after a few years) the compromise of rights and obligations effected by the agreement was permanent.

231. The ACF's opening inventory of claims was about 25,000. Mr Jackson and the other members of the AWP most closely concerned with the Wellington Agreement believed (as Mr Rayment put it in his witness statement) that

"Although we believed that this would take some years, the end was now in sight, and the way in which we would reach the end had been put in place. ... No-one foresaw the way in which asbestos claims would take off, as they did, in the years following the Wellington Agreement."

232. Claims did indeed take off after the signing of the agreement. Having run at a steady monthly rate of 500 or so for about three years, they increased rapidly to 1000 a month in the latter part of 1986 and 2000 a month in 1987 (with 3000 claims being filed during the month of August 1987).

233. On 5 July 1985 Sir Peter Green, the retired Chairman, began a letter ("the fishing trip letter") to Mr Miller. He completed it, it seems, during the course of the next ten days while he was on a fishing trip. In the letter Sir Peter Green gave his successor the benefit of his views (which Mr Miller in cross-examination said he found irritating) as to the terms on which they should settle with the Inland Revenue. He concluded with his views on the situation generally:

"There are plenty of horrors in the pipeline and they must be reserved even if figures are not available. The 'true and fair' requirement should assist in this.

It is perhaps fortunate that the overpayment of past profits is falling for recoupment from a far larger number of current Names. This may not always be the case and if new Names won't join, or old Names resign from the old syndicates which have back year problems the situation may become critical."

234. At a meeting of the MSSC held on 19 August 1985, chaired by Mr Merrett, there was a discussion on RITC in the context of the new syndicate accounting byelaw. Mr Murray is recorded as having said,

"In the past, Underwriters had used inadequate techniques, resulting in inadequate reserving. The Market had been 'saved' by high interest rates and a soft reinsurance Market and it was vital that Lloyd's became more professional in its approach, in particular by taking actuarial advice."

235. In September 1985 the globals for 1984 were published. The modest overall profit concealed a pure overall underwriting loss for the 1982 year of account equivalent to 6.5 per cent (against 1.9 per cent for 1981). The general (non-marine) liability account showed a pure underwriting loss of £425m. In his chairman's statement Mr Miller described this loss as enormous and stated,

"Figures such as these make it obvious that underwriters must take stringent remedial action as indeed they are. It is worth repeating that a combination of three things is needed, particularly in the all-important American casualty business; first, a realistic rating level;

second, a reformed policy wording embracing, where needed, a claims-made basis for claims and an overall limit, including legal costs; and third, a measure of tort law reform. Without real progress in all three areas, it is hardly to be wondered at if underwriters increasingly withdraw from this class of business, with the result that certain industries will be left without the insurance coverage which they need to continue in business, to the detriment of society in general."

It will be apparent that all those proposals related to future underwriting, rather than to the past. Mr Hazell, the chairman of LUNMA, made similar observations (but referred to the ACF as a hopeful development).

236. In October 1985 there was an overall settlement with the Inland Revenue. All the outstanding assessments were withdrawn in consideration of a sum of £43.5m paid to the Inland Revenue out of central assets of Lloyd's. Sir Peter Miller said in his witness statement (perhaps with a degree of understatement) that there was "a considerable amount of discussion at Council" before agreement was reached that it was appropriate for this payment to be made out of the Central Fund (corrected in his oral evidence in chief to 'central assets'). He does not seem to have been cross-examined on this point.

237. On 11 November 1985 Mr Davison gave notice of his resignation as Chief Executive at the expiration of his minimum term of office (he had been appointed for an indefinite term of three to five years). He had carried through many changes but he felt that the organisational structure was unsound. He said in his published letter, after referring to a working party chaired by Sir Kenneth Berrill (one of the nominated members of the Council),

"My own views on the paramount necessity of an independent Chief Executive, with appropriate terms of reference, responsible directly to the Council have not changed and, therefore, I would find it impossible to continue in office were those terms to be significantly altered. At the same time, the argument is a perfectly proper one for a self-regulatory body and, by resigning at this time, I remove an obstacle to the Council's freedom of discussion and to my freedom to argue for the retention of the position of the Chief Executive with independent powers without any suggestion of self-interest."

238. The report of a working party established in November 1985 to consider discounting of reserves for solvency purposes – a common topic of discussion at this period – referred to "the continuing requirement to expand the capital base of Lloyd's from sources not already exposed" as a reason for "assurance that all undischarged liabilities have been fully reserved".

239. In 1986 Mr Miller continued as Chairman with Mr Lawrence and Mr Cockell as Deputy Chairmen. Mr Alan Lord took up his duties as Chief Executive in March. On 10 January 1986 the Secretary of State (Mr Leon Brittan) announced the appointment of a Committee of Inquiry into Regulatory Arrangements at Lloyd's under the chairmanship of Sir Patrick Neill QC. Its terms of reference were:

"To consider whether the regulatory arrangements which are being established at Lloyd's under the 1982 Lloyd's Act provide protection for the interests of members of Lloyd's comparable to that proposed for investors under Financial Services Bill."

240. On 29 January 1986 there was the usual annual meeting of auditors (now termed recognised auditors). Again they were briefed by Mr Jackson on asbestos-related claims. He described the establishment and operation of the ACF, stating that there were 46,000 known claims and new claims were running at 1000 a month. He referred to the Johns Manville settlement and also to new categories of defendants (such as railroads and manufacturers of brake linings) against whom claims were being made.

241. During June and July 1986 Mr Miller and other members of the Lloyd's hierarchy gave oral evidence to the committee of inquiry chaired by Sir Patrick Neill. The transcripts contain many candid exchanges. There was ample material on which the committee could reach its conclusion about "the absence of understanding on the part of many working members of the principles of the law of agency".

242. In 1986 an American bankruptcy court made an order ensuring wide publicity for the scheme which it was being asked to confirm. At that time the projection of 44,000 claims (made in 1984) was revised to between 83,000 and 100,000 claims. In the event 240,000 claims had been received by 1995 and over 400,000 by 2000.

243. The globals for 1985, published in September 1986, showed an overall profit for the 1983 year of account of £36m (or £179m if PCW losses were disregarded). In his Chairman's statement Mr Miller commented that the general liability account generated about 12 per cent of the premium income but 100 per cent of the losses. The pure underwriting loss on general liability business was £384m (that is about 10 per cent less than for 1982). Mr Jackson, the chairman of LUNMA, said in his statement,

"The US based liability account has yet again been the cause of most of the market's difficulties as, once again, it was necessary for underwriters to increase reserves for asbestos related losses. Although the Asbestos Claims Facility – set up with the support of Lloyd's – is making significant savings in the legal costs involved, this is to some extent offset by there being no slowing down in the number of new suits being brought.

It is also encouraging that most observers believe that, at least as far as Lloyd's is concerned, 1983 could be seen as the beginning of the end of the really bad results. Whilst I would not anticipate that my successor would be able to report an underwriting profit for 1984 I would expect an improvement over the past few years. The very badly needed premium rate increases were beginning to take effect by the middle of 1984. These increases, which have been more obviously applied on US business than in the rest of the world have become, as each successive month passed, more substantial."

244. On 2 December 1986 Mr Murray, as chairman of the SSC, wrote formally to the Chairman of Lloyd's, Mr Miller, under the heading 'Solvency & Security'. He said that his committee had not yet made formal recommendations but that he wanted to pass on his personal concerns. Having identified five areas of concern he proposed five possible changes of practice. On one of these (RITC) he observed,

"Part of the premium paid for the Reinsurance to Close may correspond with known, noted and quantified losses and therefore the element of risk assumed by the Reinsuring syndicate may be minimal. A significant part, however, of the Reinsurance to Close relates to an assessment of likely future claims or expenses which by their nature cannot be quantified within a narrow margin with any proven degree of certainty. This pure risk premium is at present assumed by Names with no requirement for related assets of any sort. I believe that a figure corresponding to 25% of the Solvency test minimum percentages would probably be an appropriate figure to deem to be Premium Income for Premium Income limit purposes when such Premium is received as Reinsurance to Close premium."

245. In 1987 the office-holders were the same except that Mr Parry replaced Mr Cockell as junior Deputy Chairman. Early in the new year Sir Patrick Neill's Committee of Inquiry presented their report, making 70 recommendations for changes in the constitutional framework and operating procedures at Lloyd's. The judge quoted the general commendation in paragraph 1.4 of the report but not the next two paragraphs:

"1.5 Progress achieved, however, is not by itself enough unless it leads to an affirmative

answer to our question – do the regulatory arrangements now in place at Lloyd's provide protection for Names comparable to that proposed for investors under the Financial Services Act? Our answer to that question is that, notwithstanding the major progress made by the Council of Lloyd's since January 1983, they do not.

1.6 We have detected a number of shortcomings in particular areas of regulation at Lloyd's. Here, Lloyd's arrangements fall below the standard that will be acceptable elsewhere in the financial services field. More fundamentally, the constitution of Lloyd's does not currently provide for that degree of involvement of independent outsiders and that degree of detached scrutiny of the activities of market practitioners that will be a feature of the regime under the Financial Services Act. The checks and balances at Lloyd's are not, in our view, so firmly in place. The balance of initiative rests too much with the working members."

246. The core recommendation, for reducing the number of working members on the Council and increasing the number of nominated members, was accepted at a special meeting of the Council on 22 January. The minutes indicate that acceptance was less than whole-hearted on the part of Mr Miller (who said that the logic of the recommendation was open to challenge) and Mr Lawrence (who said that it was a shock, but could have been very much worse).

247. At the end of January the affair of the Outhwaite run-off policies took a new turn when Mr Outhwaite announced that he was challenging the basis on which some of the policies had been effected. This led to some contentious arbitrations (and litigation which reached the House of Lords after the English arbitrator signed his final interim award in Paris: see *Hiscox v Outhwaite* [1991] 2 Lloyd's Rep 1, 435).

248. The briefing for recognised auditors took place on 4 February. Again Mr Jackson spoke and answered questions on asbestos-related claims and associated matters. He reported that there had been no drop in claims: 1500 claims had been made in each of November and December 1986. The ACE was achieving settlement of claims at a faster rate than had been expected. Known claims would account for 25 to 30 per cent increases in asbestos reserves at 31 December 1986. Much of that increase would come from reinsurance and retrocessional contracts.

249. On 12 May 1987 Mr R R S Hiscox, the senior director of Roberts & Hiscox Ltd, wrote to the Chairman protesting at the leniency of the sentence which had been imposed, in disciplinary proceedings, on Sir Peter Green. The judge quoted briefly from the letter but its raw eloquence deserves to be set out in full as the view of one very experienced Lloyd's insider:

"Thank you for your letter of the 7th May. I was stating the "outside" or Revenue view of the reinsurance to close which did appear to them an "incredible privilege". It was abused by some underwriters as the mass of rollovers demonstrated and some underwriters were carrying forward large sums of money more based on a wet finger in the wind than on any statistical basis.

However, that was not the point of my letter, neither was the alarm at the growing regulations within Lloyd's. That is a necessary result of having relatively poor Names with unlimited liability. Of course they need massive protection – especially given, as you say, the ignorance of the basic tenets of the laws of agency of some very senior agents including your predecessor in office. I find it a pity that you should preach to me on this subject considering my long opposition to the business methods of the man you used to refer to as "my illustrious predecessor" and to Posgate and others.

Just when the press was beginning to be more favourable to Lloyd's it is a tragedy that Sir Peter Green's sentence should be announced and be so light which has been very rightly criticised. I know that you will rush to state that this was the sentence of an independent

regulatory authority – but it should have been different. "No charge against Sir Peter and Peter Valentine involved dishonesty or lack of good faith or deliberate or knowing misconduct" I read in my newspapers. Why not?

We have seen people severely punished for repairing yachts at their syndicate's expense and other similar trivial offences – and yet we are seen to slap the wrist of a major offender. Clearly nobody tried to press the case against Sir Peter and when I read in my newspaper that Langton stated that such "behaviour was common practice in the 1970's and was not then regarded as serious enough to constitute discreditable or disgraceful misconduct" I am speechless. There were agents and underwriters who did not have baby syndicates or interests in off-shore reinsurance companies and I suspect that they were in the majority. But to have the fact that many were breaking the law as any form of mitigating circumstance is deeply offensive to those that chose not to break the law. I always thought that ignorance of the law was no defence.

We have this new definition of "negligence" in Lloyd's. Posgate was found guilty of "gross negligence" for removing money from one syndicate which he did not own and paying it by way of reinsurance to the syndicate in the management of which he had a significant interest, and now Sir Peter Green is similarly found guilty of "serious or gross negligence" for allowing syndicate money to line his own pocket. When will somebody say theft and press the proper charges.

Enough of that matter. You state that the Council has debated the question of unlimited liability twice and committed itself to its continuation. The Council and former Committee of Lloyd's have a track record second to none for lack of foresight which has been well illustrated by the recent debacles in Lloyd's. Radical reform is out of the question until forced by circumstances, so let us continue to raise our capital from housewives with bank guarantees on the family home and suffer from the consequences at each downturn in the market."

250. The Council of Lloyd's met on 5 August 1987 with Mr Miller in the chair and the Committee of Lloyd's met on 19 August with Mr Lawrence in the chair. The minutes of these meetings illustrate what had since 1983 become the practice as to approval of the globals. The Council considered a paper on this subject and then delegated formal approval of the globals to the Committee. The Committee received coloured proofs of the final document but was in a position to require changes (for instance on 19 August 1987 there was discussion about a passage in the Chairman's statement dealing with tort reform; we shall return to this below – paragraph 463).

251. The globals disclosed an overall profit for the 1984 year of account of £279m (or £300m excluding PCW) and a pure overall underwriting profit of £138m. But for general liability business there was a pure underwriting loss of £257m (and a net loss of £170m). In his Chairman's statement Mr Miller repeated what he had said about the account producing 12 per cent of the premiums and 100 per cent of the losses. He also observed that also exactly half of the RITC (£2,000m out of £4,000m in round figures) was for general liability claims. Mr Kellett, the chairman of LUNMA, said in his statement,

"This class of business, much of which comprises policies issued to insureds in the United States of America, continues to be adversely affected by certain features of the legal system of that country.

One such feature is the contingent fee system whereby lawyers are rewarded by sharing in the damages which they are able to secure for their clients, often leading to spurious cases being pursued. Another is the system of awards by juries in civil damages cases where they are encouraged to think of the insurance industry as having a "deep pocket" from which victims may be compensated, regardless of whether or not there is fault on the part of insured defendants."

252. At meetings of the SSC on 17 September and 12 October 1987, chaired by Mr Lawrence, there were discussions about problems with the solvency test. At the September meeting the minutes record Mr Lawrence suggesting "that almost every old non-marine syndicate would be expected to have shown inadequacies in reserves of some degree". At the October meeting the SSC were told of LUNMA's view that

" ... the Solvency Test Instructions should stress more firmly than currently that the minimum percentage reserves are the absolute minimum to be reserved and that most syndicates should be reserving at levels significantly above the minima particularly in the case of 'long' long-tail business."

253. In 1988 Mr Lawrence was Chairman with Mr Coleridge and Mr Parry as Deputy Chairmen. Mr Lord continued as Chief Executive (and was also a Deputy Chairman). This was the year in which Mrs Evans began underwriting. She had been admitted in 1987 having seen a brochure dated December 1986 and the previous two or three years' globals.

254. At a meeting of the Committee on 27 January 1988 Mr Merrett expressed concern that the AWP was reporting substantial increases in asbestos-related and pollution-related claims, but that the SSC did not have access to figures showing the overall position. It could rely only on reports of individual syndicates. Mr Merrett said that Lloyd's needed greater comfort that agents were adopting adequate figures, and that this was a problem that needed to be addressed centrally.

255. Mr Merrett spoke again about these claims at a Committee meeting on 10 February 1988. The minutes record:

"Mr Merrett reported that the Annual meeting of the recognised Auditors had recently taken place and had seemed to have proceeded satisfactorily. Mr Robin Jackson, however, had been referred to as a pessimist as regards Asbestos/Environmental pollution. Mr Merrett had tried to explain that Mr Jackson was in fact being optimistic considering the background against which he was working."

Mr Jackson's anxieties at that time appear from a paper dated 7 March 1988 which he wrote on 'Asbestos Related Claims – The Reinsurance Response'. He was concerned at the prospect of a general failure of reinsurers to honour their commitments promptly.

256. On 16 March 1988 Mr Hiscox had a meeting with the Chief Executive, Mr Lord, to express his concerns about the Outhwaite syndicate's unwillingness to meet run-off claims. Mr Hiscox suggested some form of central settlement, since in his view the Outhwaite problem was potentially far more serious than PCW. On the following day he wrote to Mr Lord:

"I enclose the latest report from the Asbestos Working Party which illustrates that that area of claims is still accelerating. You will also be aware that pollution claims are now coming in thick and fast and as further illustration I enclose a graph of our outstandings on our policy with Outhwaite.

I think these figures demonstrate that within a month or two Outhwaite's auditors must blow the whistle. I think that the Regulatory Authorities at Lloyd's should get a firm grip of this before the media does and before the solvency of the Lloyd's policy is brought into serious question."

257. The Outhwaite problem was considered at a Council Meeting on 13 April when the Chairman (Mr Lawrence) reported the Committee's unanimous view

" ... that as regards the solvency position Lloyd's should not double guess the auditors, and that there were no grounds to justify Lloyd's intervention on 'fit and proper' criteria, and that it was an unattractive option for Lloyd's itself to intervene and offer a cap on the policies."

258. On 8 June 1988 LUNMA (in the person of Mr M V Williams) made its first-ever presentation to the full Council of Lloyd's. The text of the presentation is remarkable for containing no single reference to asbestos-related claims, and only one reference to long-tail claims. Nor does there seem to have been any mention of the matters in the ensuing discussion. The minutes of the meeting also show one of the earliest mentions in Council of the possibility of switching from unlimited to limited liability. A working party was established to consider this topic.

259. On 20 June 1988 Freshfields circulated to the steering committee of members' agents a report on Outhwaite syndicates 317/661. They criticised Mr Outhwaite but expressed the view that an action against him or his agency would be unlikely to succeed. The steering committee provided a forum for members' agents and their Names, many of whom were asking questions about Lloyd's regulation (as appears, for instance, from a letter to the Chairman written on 24 June 1988 by Mr Peter Rawlins of Sturge).

260. In July 1988 the Piper Alpha oil production platform in the North Sea suffered a disastrous explosion and fire with heavy loss of life. Within days it was declared a constructive total loss and the total liability was later estimated at £1.4bn. This summary has concentrated on asbestos-related claims but it must be borne in mind that in the late 1980s the Lloyd's market had to deal with several other catastrophic losses.

261. At its meeting on 27 July 1988 the Committee had before it a paper on run-off years of account as at the end of 1987. The paper stated that (with certain exceptions) there were 76 syndicates with years in run-off, the total open years being 120. Of these 56 per cent were attributed to asbestos-related and other United States general liability business, and a further 13 per cent to Outhwaite and Merrett run-off policies. (These figures match roughly but not precisely with those at paragraph 200 above, which are taken from a detailed document in the 'Open Years' bundle prepared by Freshfields).

262. The paper on open years was fully discussed by the Committee (the minutes of the discussion occupy four closely-typed pages). The first three points noted in the minutes were as follows:

> "5.6.1 the problem of open years affected the membership as it existed at the moment. Though Names were informed when they joined the Society as to the possibility of open years it had never been considered much of a problem. However, Agents should take the problem more seriously now and make their Names aware of the likelihood of open years;
>
> 5.6.2 it was symptomatic of the Society as a whole that the Underwriters of the time did not really know the full implications of the business that they were writing and to a certain extent the whole Society was now at risk from events since the 1950s;
>
> 3. Managing Agents would continue to see open years as an easy way out provided they were allowed to continue in business whilst managing syndicates with open years. The Society may be able to live with the events of the past, but if Managing Agents were allowed to continue trading it was essentially the same as allowing Names to pay for their losses by instalments;"

263. At a Council meeting on 3 August 1988 there was discussion of adverse press publicity about the resignations of Names. During 1988 994 Names had given notice of resignation so far. The

Chairman (Mr Lawrence) and Sir Peter Miller spoke of using the forthcoming globals press conference as an opportunity to counter adverse publicity.

264. The globals for 1987 disclosed an overall profit of £211m for the 1985 year of account. General liability business showed an overall loss of £268m and a pure underwriting loss of £354m (of which the Outhwaite syndicates produced about £84m). Mr Lawrence said in his Chairman's statement:

"The difficulties associated with long tail liability business highlighted by the chairman of the non-Marine Association have resulted in both an underwriting loss and an overall loss. This business is now, however, being written at rates that better reflect the present climate and with policy wordings appropriate to the changed circumstances."

Mr Williams, the chairman of LUNMA said in his statement:

"Our two main areas of difficulty are in asbestos-related claims and environmental impairment.

The rate of new asbestos-related claims rose steeply, from an average 700 per month in 1985 to 2,000 per month in 1987, due largely to intensive publicity from the plaintiff bar and the seeking out of new industries with an "asbestos connection". There are, however, grounds for future optimism as the rate of increase has declined markedly in recent months."

Again, about half of the entire RITC of £4bn was in respect of outstanding liability claims.

265. In October 1988 Mr C W Rome, the chairman of the Lloyd's Underwriters Association, was asked to justify changes proposed by his committee to the minimum percentage reserves for the marine liability account. In a letter dated 5 October to the Members' Security and Solvency Department he wrote,

"First I should make it absolutely clear that I make no pretence whatsoever that the reserves my Committee accepted last year, or the alterations we propose now, are correct. All that can be said with certainty is that in no area of their business have Lloyd's Underwriters been so substantially and so consistently under-reserved as in the liability accounts.

Asbestos related claims have been with us for some time now, but only recently has there been a serious threat of a substantial volume of such claims falling on marine policies. At present, the P & I Clubs appear to be in the front line, but to what extent they – and their reinsurers in the marine market at Lloyd's – will eventually be involved is unknown. Asbestos was widely used in the construction of ships, but to what extent and over what policy years ship builders and ship repairers policies will be involved no one knows."

266. At a Committee meeting on 12 October 1988 Mr Merrett raised a topic minuted as 'Aggregation of Liability'. After referring to Hurricane Alicia (in 1983) the October storms (of 1987) and Piper Alpha he stated, as recorded in the minutes,

"5.13 The LMX market had made the position much worse. The basis upon which reinsurance claims were paid on Alicia and the October storms was slower than on any other claims in the market because the brokers' obligation to fund had been removed and there was practically no pressure for special settlements. Each turn of the payment cycle took at least two or three months, ie the time between payment by an underwriter and collection from his reinsurer. This operated to delay the time when the ultimate payers became aware of their obligations.

5.14 The burden of the three losses was now beginning to come together with the same syndicates, and thus the same Names, being affected. The amounts involved were immense in relation to the syndicate cash balances and those syndicates had a heavy drain upon their

resources for the three separate losses. The position had been reached where some syndicates were significantly through their reinsurance protection for three successive years and yet their Names knew nothing about it.

5.15 The answer was not to be found through the regulatory route but by managing agents establishing the position of their managed syndicates by requiring the underwriters of those syndicates to produce a worst case scenario. This information could then be passed on to the members' agencies. Agents should be made aware of the questions they needed to ask and reminded that, whilst it was natural to focus upon Piper Alpha, the same questions were relevant to Alicia and the October storms. If there was a heavy un-notified net loss to Names for three years then the Names should be told."

This was a clear warning of the 'LMX-spiral' which became an increasingly obvious problem after the end of the relevant period.

Chronological summary: since 1988

267. Events since the end of 1988 are not strictly relevant to the issue raised in this appeal. But the judge summarised the salient events in his judgment (chapter 20) and we should do the same.

268. There are some general themes which are constantly reflected in the documentary evidence from 1989 and the early 1990's. These are a rising tide of continuing losses, with direct liabilities on asbestos-related and other long-tail business being caught up or overtaken by LMX and personal stop-loss liabilities; a comparable rising tide of litigation as claims for breach of duty were made by names against managing agents (for negligent underwriting) and members' agents (for negligent portfolio selection); and increasing disquiet about the constitution and governance of Lloyd's, especially in relation to unlimited liability of names, the management of the market, and self-regulation.

269. 1989 was dominated by the continuing controversy over the Outhwaite run-off policies and there was an unusually large number of questions at the Society's general meeting on 28 June 1989. One of the most persistent questioners was Mr John Donner, whose concerns and circumstances in which the run-off policies were written led to the Council establishing a panel (chaired by the Chief Executive, Mr Lord) to investigate the allegations. We have already set out (in paragraph 128 above) the substance of Mr Donner's complaint as he explained it to the panel on 20 December 1989.

270. The panel interviewed a number of key witnesses who had been concerned with the Neville Russell and Murray Lawrence letters, including Mr Randall, Mr Lawrence, Mr Holland, Mr Mitchell and Mr Ayliffe. It concluded that no prima facie case of misconduct had been made out, and the matter was dropped. It was raised again in 1995 when there was a further inquiry by Freshfields, whose conclusions (coinciding with those of the original panel) were reviewed and upheld by Mr Gordon Pollock QC.

271. In November 1990 the outgoing Chairman, Mr Lawrence, and the incoming Chairman, Mr Coleridge, joined in asking Mr David Rowland to lead a Task Force. Its purpose was "to identify the framework within which the Society should, ideally, be trading in 5-7 years hence ... [with] regard particularly for the long-term competitive position of the Society".

272. The Task Force made its report ('Lloyd's: A Route Forward') in January 1992. It recommended far-reaching changes including the introduction of limited liability capital alongside the unlimited liability of names. It also recommended a high-level central stop-loss scheme in order to cap losses for names with unlimited liability. It recognised what it called 'the old years problem' as one of the gravest threats to the future of the Lloyd's market.

273. In the course of its deliberations the Task Force (assisted by McKinsey & Co) attempted to quantify the market's ultimate liability for asbestos- and pollution-related claims. It concluded that it would be very difficult to carry out that exercise at a market level, and that the uncertainties were too great to make a reliable estimate simply on an overview. In the event it took three years of work, and cost more than £100m, to reach a reliable estimate as part of the basis for the Reconstruction and Renewal Plan ('R&R').

274. The Task Force rejected any central solution to the old years problem. It needed the trauma of further losses and further litigation before a central solution was recognised as a necessity. By early 1992 there was a great deal of litigation on foot but most judgments were still on interlocutory points (for instance, in April 1992, that of the House of Lords in *Ashmore v Corporation of Lloyd's* [1992] 1 WLR 446 and that of Saville J in *Boobyer v David Holman & Co* [1993] 1 Lloyd's Rep 96).

275. There were several other important inquiries and reports, including the Walker Report (June 1992) into allegations about discrimination against external Names and the operation of the LMX spiral; the Morse Report (June 1992) into the future governance of Lloyd's; and the Open Years Panel Report (March 1993). The Morse Report recommended the replacement of the Committee by two boards, a Regulatory Board and a Market Board, both reporting to the Council. This recommendation was accepted and put into effect at the start of 1995.

276. The Open Years Panel (which was chaired by Mr Stockwell, who gave evidence for the claimants) identified six major causes for the ever-increasing number of open years. Latent liabilities were the single largest cause, responsible for 42 per cent of open years by number and 60 per cent by stamp capacity. 26,000 Names were exposed to open years with asbestos and pollution liabilities and (as Mr Stockwell wrote to the Chairman of the Market Board in a letter dated 15 March 1993) some 15,000 to 17,000 were by then engaged in litigation against Lloyd's agents and underwriters.

277. In April 1993 Mr Rowland (as Chairman of Lloyd's, with Mr Peter Middleton as the new Chief Executive) published a document called 'Planning for Profit: A Business Plan for Lloyd's of London'. It carried forward the Task Force's proposal for the introduction of corporate, limited liability capital into the market, and this took effect at the start of 1994.

278. The Business Plan also broke new ground in proposing to manage the old years problem by a general scheme for reinsurance of liabilities for 1985 and earlier years through an adequately capitalised reinsurance company. The plan (called the 'NewCo Project') eventually came to fruition with the establishment of Equitas as part of the R&R Plan, and with the scope of the scheme expanded to cover liabilities for 1992 and all earlier years. The necessary reserving project was not completed until May 1996. It involved many leading firms of actuaries and accountants.

279. In July 1993 the Council appointed an independent Legal Advisory Panel (consisting of Sir Michael Kerr, Mr Stewart Boyd QC and Mr Stephen Tomlinson QC) to investigate and report on 31 specific claims against agents in respect of specified syndicates and years on account. The judge quoted two paragraphs of the panel's report, made in October 1993:

"14.8 We have carefully considered all the events in 1980 to 1982 on which the Names rely in support of their contentions that 1979 should have been kept open, culminating in the Neville Russell letter in February and the Murray Lawrence letter in March of 1982. But we are not persuaded that these arguments fairly or adequately reflect the overall market perception (or lack of perception) of the likely future dimension of the asbestosis claims experienced at the time ... The choice appears to us therefore to lie between the conclusion that the entire market with long-tail US liabilities was negligent in closing 1979 or that the allegation of negligence in

this regard is based on hindsight. In our view the latter conclusion is more likely to be correct.

14.9 Looking at the matter broadly, we have therefore concluded that Names ... are unlikely to establish that the 1979 year of account ought not to have been closed into 1980 in the calendar year 1982 and we have reached the same conclusion in relation to the closure in 1983 and 1984 of the years 1980 and 1981. From the calendar year 1985 onwards the closure of earlier years for syndicates with accrued long-tail liabilities arising out of US casualty business gradually became more questionable, although the circumstances varied as between different syndicates, and the case against closure was not necessarily progressively uniform. In this connection it must be remembered that the full impact of asbestosis and pollution liabilities for the market was only felt in the late 1980s."

The judge noted that the report did not suggest that the Council or the Committee had been at fault, let alone guilty of dishonesty. (To have done so would not have been within the panel's terms of reference.)

280. The first proposal for an overall settlement was rejected early in 1994. The troubles at Lloyd's were again becoming a subject of political controversy and more and more cases were coming before the court, either at first instance or on appeal (in appendix 1 to his judgment the judge lists 13 judgments given during 1994, including the decision of the House of Lords [1995] 2 AC 145 in the *Merrett*, *Feltrim* and *Gooda Walker* cases; he lists 25 in 1995 and 16 in 1996). Early in 1995 the House of Commons Treasury and Civil Service Select Committee began hearings into regulation at Lloyd's. In May 1995 it produced a report ('Financial Services Regulation: Self-Regulation at Lloyd's of London') which was critical of Lloyd's. In particular it stated that those becoming Names from the mid-1980's were not given full information as to the nature of the risks which they were undertaking. However the report rejected the so-called conspiracy theory of a dishonest policy of recruitment adopted by the central authorities at Lloyd's.

281. After the failure of the earlier settlement plan Sir David Rowland put forward a new plan in a document entitled 'Lloyd's: Reconstruction and Renewal' published in May 1995. In the introduction he wrote,

"Unless we take radical action now to produce a solution which is acceptable to our policy holders, our regulators, and to you, our membership, I do not believe that the Society will be able to survive in anything like its present form."

282. The judge (in chapter 20) described the R&R Plan as follows:

"The key elements of the R&R Plan were providing all Names with the opportunity of "finality" through an acceleration and expansion of the Equitas project (as the NewCo project was, by then, known) and a settlement which would include an estimated £2 billion of debt credits to reduce the cost of finality. The proposals as set out in the Settlement Offer document in July 1996 were accepted by almost 95% of the Names. Between May 1995 and the making of the Offer in July 1996 various committees were established to review the proposals from the Names' standpoint. These included the Names Committee, under the chairmanship of Sir Adam Ridley (Deputy Chairman of the Association of Lloyd's Members), which considered how to achieve a fair allocation of the debt credits. The Validation Steering Group was also established under the chairmanship of Sir David Berriman, representing the Association of Lloyd's Members, and including representatives of the Litigating Names Committee and the Lloyd's Names Associations' Working Party. Its terms of reference included an evaluation of the comparative advantages and disadvantages of alternatives to the R&R Plan and an examination of the powers of Lloyd's to implement R&R and of the Council's duties to members and policyholders in so doing. The Group was independently advised by Slaughter and May."

283. The formal R&R settlement offer was sent to names on 30 July 1996 requiring acceptance by

28 August 1996 (although this time limit was subsequently extended). The value of the offer had by then been increased to £3.2bn. This total included litigation settlement funds of about £1.1bn, representing funds paid in settlement of claims against agents and E&O insurers (£981m) and claims against auditors (£156m, of which £116m was contributed by five firms of accountants). Every name who accepted R&R gave up all claims of any sort in respect of 1992 and earlier years, including claims against Lloyd's.

284. As the judge recorded (chapter 1) only 1,752 names (out of over 33,000) did not accept R&R, and since then Lloyd's has settled with others. The 216 former names interested in this litigation are the group who have resisted Lloyd's to the last, in almost all cases by counterclaiming against Lloyd's in proceedings for recovery of the Equitas premium (which is recoverable, as Lloyd's has successfully contended, even from former names who did not accept R&R).

IV THE ALLEGED REPRESENTATIONS

Recapitulation of pleaded case

285. The names' case is that the brochures and globals issued from time to time by Lloyd's contain fraudulent representations upon which they relied when deciding whether to become names. In chapter 22, the judge correctly identified the alleged representations in the brochures as representations to the effect that a name joining Lloyd's:

"(i) could have confidence in Lloyd's as an institution to safeguard his/her interests;

(ii) could trust those who were chosen by Lloyd's to regulate the Lloyd's market and manage its affairs;

(iii) because of the way in which Lloyd's regulated and monitored underwriting accounts year by year:

(a) could rely on syndicate accounts;

(b) could in underwriting and/or in deciding whether to remain a member of Lloyd's have confidence in the audited syndicate results, for results of past years;

(c) could be sure that Lloyd's as part of its regulatory duties would ensure that when prospective liabilities were reinsured by one syndicate year into another, such liabilities were being fairly assessed and quantified as between two syndicate years."

286. The judge correctly identified the alleged representations in the globals as at 31 December 1981 to 1987 as follows:

"(a) that the Lloyd's market was in a sound financial condition; and

(b) that names could safely join Lloyd's and/or continue their membership of Lloyd's and/or increase their Premium Income Limit with confidence that known and projected claims has been prudently and adequately reserved to ultimate."

287. The judge held that neither the brochures nor the globals contained any of the alleged representations, whether express or implied. It seems to us to be appropriate to consider the brochures and globals in turn. We begin with the brochures.

The brochures

288. In the 1970s the Committee of Lloyd's issued a document each year which was entitled "Notes for Applicants for Underwriting Membership". Of those, we have seen the 1975 and 1977 editions, which were in very similar terms. The first brochure was dated January 1979. We have seen both the 1979 brochure and a number of later ones, each of which is based on its immediate predecessor, although changes were made to the text from time to time. Since the high watermark of the names' case on the facts is to be found in the events of 1982, it seems sensible to focus on the brochures which were issued at about that time.

289. We refer first to the brochure dated December 1981, which was no doubt prepared for the consideration of prospective names during 1982. Those becoming members of Lloyd's in 1982 began underwriting in 1983. The 1981 brochure contains Lloyd's crest on the front and is entitled "Brochure for Applicants for Underwriting Membership". It includes the word "FIDENTIA", which we were told by Mr Goldblatt was defined by Cicero as meaning "confidence and hope in great and honourable undertakings". The brochure describes itself as follows:

"This confidential brochure is intended for the sole use of the person to whom it has been issued by the Committee of Lloyd's and may be shown by the recipient only to his personal advisers. The brochure is intended to inform the recipient and his advisers of many general facts concerning the organisation and operation of Lloyd's and is not intended to be an offer of Membership of Lloyd's nor the solicitation of an application for Membership of Lloyd's. This brochure should be read in conjunction with other materials provided to the recipient in the process of his application for Membership of Lloyd's. Any question with respect to materials contained herein should be addressed to the Agent and/or Member who is sponsoring the application for Membership of Lloyd's."

290. Section 1 sets out "Matters for Special Consideration". In paragraph 1.1 it stresses the unlimited liability of each name and paragraph 1.2 is in these terms:

"1.2 Insurance is a risk business

Although the Lloyd's market as a whole has produced an overall profit during each of the previous five closed years, there have been years in which the market as a whole has suffered an overall loss. However, even in years when the market makes an overall profit, some syndicates show losses. The insurance business is a risk business and is cyclical in nature. There can be no assurance that any Member will make a profit in any given year, and over a period of years a Member must be prepared to incur a loss in one or more of those years."

291. Section 2 sets out the "History and Organisation of Lloyd's" and, against the side note "Responsibilities of the Committee", says:

"2.4 The Committee deals with all matters affecting the general interest of Lloyd's eg the provision and maintenance of suitable premises including the Underwriting Room for the purpose of carrying on the business conducted at Lloyd's: the prescribing of conditions governing Membership: the framing of rules relating to the stringent security requirement with which all Members must comply: supervision of the overall conduct of the Annual Audit of Underwriters' Accounts: the maintenance of a system of worldwide shipping intelligence: and the monitoring of legislative, regulatory and judicial development in most countries of the world. To this end, the Committee is served by a staff of about 2,000, comprising administrative, clerical, printing, catering, liveried and artisan personnel."

292. Against the side note "Underwriting Agent" there appears:

"2.7 Whilst in the early days of Lloyd's each Underwriter underwrote his own risks, the development of Syndicates resulted in the current practice of each Member appointing an Underwriting Agent or Agents, who employ an Underwriter to write business for all the

members of the Syndicate or, alternatively, delegate the underwriting to another Underwriting Agent under a Sub-Agency Agreement. The functions of the Underwriting Agent are of vital concern to Members because the Agent is in complete control of the underwriting affairs of his Names, and has to deal with the complications of taxation, reserves, investments and the running of the Agency, in addition maintaining accounting procedures and statistical data on the current trends of underwriting. The Underwriting Agent is responsible for advising the Member as to which syndicates to join and conducting his Lloyd's business on his behalf, which involves, among other things, keeping him fully informed of the progress of his underwriting activities, as well as keeping regularly in touch with the syndicates to which the Member belongs. The Agent will also be responsible for the investment of premium income received for the Member's account. (See "Investment of Premiums" at 9). The Agent may however make arrangements for some of his duties to be carried out by another agent. The Underwriting Agent has a duty to his Names on the one hand to conduct the underwriting affairs in as efficient a manner as possible, and to the Committee of Lloyd's on the other to see that its requirements are complied with on behalf of the Names of whom he acts."

The remainder of paragraph 2 describes the underwriting agency agreement and the roles of syndicates and Lloyd's brokers.

293. Section 3 contains a description of the business being carried on by Lloyd's, section 4 gives statistics as to the size of the Lloyd's market and section 5 simply states that underwriters are subject to regulation in the United Kingdom and elsewhere. Section 6 contains information about becoming a member of Lloyd's. Paragraphs 6.1, 6.3, 6.5 and 6.6, which appear against the side notes "Application for Membership", "Means Test", "Rota Committee" and "Choice of Underwriting Agent" respectively include the following:

"6.1 In order to be eligible to underwrite insurance at Lloyd's, an individual must apply and be accepted as a Member of Lloyd's. An application is made through an Underwriting Agent with the sponsorship of an existing Member of Lloyd's, to whom the potential Member is well known. The potential Member must also be known to at least one other Member, who may be his proposed Agent. Not all those who seek to become Members of Lloyd's are admitted. Applications for Membership must be completed by a date set each year, generally in the early summer ...

6.3 The Means Test is a continuing requirement during the time a Member remains active in underwriting at Lloyd's and the Member is required to confirm his means every four years and to notify the Committee of Lloyd's should his net worth fall below the required level as a result of his own voluntary act. ...

6.5 If the Means Test is passed and the other aspects of the potential Member's application are in order, he will be asked to travel to London to be interviewed by members of the Committee of Lloyd's who form the "Rota Committee". Among other things, the Rota Committee inquire as to, and assure themselves of, the applicant's awareness and understanding of the concept of unlimited liability. They request the applicant to reaffirm that he is possessed of the assets set forth in his application. Additionally, the Rota Committee will assure themselves that the applicant appreciates that there is no guaranteed return and that he understands that underwriting is a high risk business which can bring losses instead of profits. They will also stress the importance the Committee attaches to the applicant meeting the active underwriters of the syndicates he is joining before he commences underwriting. Those applicants who are approved by the Rota Committee must thereafter be elected by the full Committee of Lloyd's.

6.6 In applying for Membership of Lloyd's it is most important that a potential Member should choose an Underwriting Agent whose view of the manner in which he should conduct his insurance business is compatible with that of the potential Member. Each Underwriting Agent at Lloyd's will provide a potential Member with a description of his agency as well as the syndicates which he is considering recommending to the potential Member and the policy for

the investment of premium income which is adopted by the syndicate's Managing Agent. Once an Underwriting Agent is chosen he will help the potential Member through the application procedure. He will also advise the potential Member on which syndicates to join for his first year at Lloyd's and the maximum premium income to accept on each syndicate. These syndicates must be named during the application procedure and their financial results for the past seven closed years provided in the form set out at the end of this brochure. Although the Agent is in complete control under the terms of the Underwriting Agency Agreement and must have a free hand in order to conduct the business efficiently and, to the best of his ability, profitably, the Member is always free to raise with him any questions about his Underwriting affairs."

Section 6.2 deals with sponsorship and section 6.4 defines what are readily available assets for the purposes of the means test.

294. Section 7 is concerned with fees and deposits required by the Committee of Lloyd's, section 8 describes the security to be provided by names, including the premium trust fund, reserves deposits and section 9 relates to investment of premiums.

295. Sections 10, 11 and 12 contain what, in our view, are the crucial paragraphs of the brochure for present purposes. Section 10 describes Lloyd's system of accounting. It includes the following:

"10.3 The Lloyd's system of accounting is on a three-year basis. This means that the profit or loss with respect to a given syndicate's year of account is determined only as at the end of the third year of its life when a reasonable estimate can be made of the ultimate income, claims and expenses which will be received or incurred with respect to policies signed during the year of account. The year of account is opened on January 1st. Insurance policies are then signed on behalf of the syndicate during the entire year. Premiums on these policies may be received during the first year or they may be received during the second, the third or future calendar years. They will then be allocated back to the appropriate open year of account provided they are received before the account is closed at the end of the third year. Regardless of when they are collected they are considered income for that year of account. Likewise, expenses and payment of claims with respect to the policies written during that year of account are allocated to the year of account, provided this has not been closed. At the end of each of the first and second calendar years of an account, an estimate is made of the anticipated liabilities (see "Lloyd's Audit" 12.3), in order to determine whether the account concerned is projecting a surplus or deficiency based on the income received and claims made at those stages. A similar exercise is carried out in respect of the account which is at the end of its third calendar year.

10.4 The estimated outstanding liability is calculated in accordance with the provision of the Audit Instructions. The estimate must provide for liabilities in respect of claims reported but not settled, and claims, which may have been incurred but have not yet been reported with respect to policies attaching to the year of account. Once this liability has been estimated on the account at the end of its third calendar year, it must be reinsured by a valid policy of reinsurance before the account can be closed. The reinsurance will normally be accepted by the syndicate's next year of account, but provision can be made for the reinsurance to be placed in the market or the account to remain open for a further year or years. Once the closing reinsurance is effected, the profit or loss for the year of account is determined and, if there is a profit, it is credited to the members of the syndicate, but if there is loss, members are debited with their share of the loss.

10.5 During the three-year period before the profit or loss with respect to a year of account is determined and before all liabilities are paid on behalf of the syndicate for such year of account, the premiums are held or invested on behalf of the members of the syndicate. Such investments generally earn capital appreciation and income which is taken into account in determining the profit or loss for the year of account."

296. Section 11 provides:

"11. CLOSING REINSURANCE

When the estimated outstanding liability on a year of account is determined at the end of the third year pursuant to the provisions of the Lloyd's audit, a syndicate will usually close the account by reinsuring such liability into a later year of the syndicate. This is accomplished by the members of the old syndicate paying a reinsurance premium to the new syndicate. The new syndicate then assumes any further liability which may be incurred as a result of claims on the policies written by the old syndicate. Being an estimate of future liability, the reinsurance premium may or may not eventually be proven accurate. In certain cases it has been inadequate and the new syndicate has suffered losses in excess of the reinsurance premium received; in such cases Members in the new syndicate would suffer a loss on the reinsurance to close."

297. Section 12 is entitled "LLOYD'S AUDIT" and includes the following:

"12.1 Pursuant to the United Kingdom Insurance Companies Act under which Lloyd's operates, each Member's underwriting accounts must be submitted annually as at each December 31 to a rigorous audit conducted by a member of a panel of chartered accountants approved by the Committee of Lloyd's. This audit is carried out in accordance with the "Instructions for the Guidance of Lloyd's Auditors" (referred to as the "Audit Instructions") issued annually by the Committee of Lloyd's with the approval of the British Department of Trade. If, after taking into account all assets including those referred to in "Description of Security" at 8 (but excluding the Central Fund and Guarantee Policies), a Member's accounts do not conform to the standard of solvency required, he will be obliged to provide additional funds, or to cease underwriting. In conducting the annual audit, the Managing Agent and active underwriter of the Syndicate together with the panel auditor, determine the reserves necessary to be created on the syndicate's accounts including the amount required to close the account at the end of its third year. Once this latter amount is determined, the account may be closed and reinsured into a later year of the syndicate, as described under "Closing Reinsurance" at 11.

12.2 The Audit Instructions, the provisions of which are reviewed each year by the Committee of Lloyd's, set out the basis upon which the syndicate auditor must carry out the annual audit of Underwriters' accounts. The Lloyd's Audit is primarily a test of solvency and the Audit Instructions deal, in particular, with the method to be adopted in calculating the outstanding liabilities as at the year end (i.e. the audit reserves) and the assets which may be taken into account to meet those estimated liabilities.

12.3 For the purpose of estimating liabilities, Underwriting accounts are divided into audit categories representing subdivisions of the business underwritten in the four main markets (i.e. Marine, Non-Marine, Motor and Aviation) and scales of audit reserves, expressed as percentages of premium income, are set out in the Audit Instructions for each of the audit categories. These percentage reserves, which are based on the general claims experience of the markets, are an absolute minimum requirement and if the claims experience of a syndicate demonstrates that a higher provision is needed, it must reserve that higher figure. In addition, an alternative audit test based on the syndicate's estimate of the outstanding liabilities as at December 31 (which must include a provision for unknown and unnoted losses) is prescribed in respect of the third and subsequent years of an account should this prove to be higher than the percentage reserves.

12.4 The Audit Instructions require that the assets taken into account for the solvency test are valued at the year end. In the case of the Premiums Trust Fund, these may include cash with approved Banks or Discount Houses, certain types of investment specified in the British Trustee Investment Act and their equivalent where the funds are invested in the non-U.K.

obligations. Premiums Trust Fund moneys may also be invested in other securities which are readily realisable. These latter securities may not, however, exceed 40% of the Trust Fund, plus net amounts due from Lloyd's Brokers. Other assets which may be taken into account include balances due from Lloyd's Brokers and the Members' personal funds, e.g. Special Reserve Fund, personal reserves and Lloyd's deposits, but, in the case of the Lloyd's deposit, subject to the restrictions referred to under "Description of Security" 8.3."

The judge's reasoning

298. The judge rejected all the representations based on the brochures which were advanced on behalf of the names. He gave these reasons.

"(i) The whole of each brochure must be considered.

(ii) The starting point is the actual words used in the brochures.

(iii) A useful question is as follows: what would a reasonable applicant for membership of Lloyd's or name understand when reading the brochure as a whole?

(iv) The alleged representations are not contained in any of the express words used in the brochures.

(v) The alleged representations (a) are not necessary to give business efficacy; (b) do not represent the obvious, but unexpressed, intentions of the parties; and (c) are inconsistent with the express words used in the brochures.

(vi) In [*Clementson*] the names argued that their contract with Lloyd's was subject to implied terms, such as

(1) that Lloyd's would regulate and direct the business at Lloyd's with care and diligence and/or lawfully;

(2) that Lloyd's would manage and superintend the affairs of the Society with care and diligence;

(3) that Lloyd's would advance and protect the interests of members of Lloyd's in connection with the business carried on by them with care and diligence and/or lawfully.

The alleged (derived) representations are re-workings of the implied terms rejected in *Clementson*."

299. The judge then quoted from the judgments of Saville J at first instance and of Sir Thomas Bingham MR and Steyn LJ in this court in *Clementson* and, as we understand his judgment, he rejected the implied representations alleged by the names for essentially the same reasons as the names' case based on the implied terms was rejected in *Clementson*.

300. The judge continued:

"(vii) As to the first alleged representation ("could have confidence as an institution to safeguard his/her interests") it is (a) unclear in its terminology; (b) does not accord with the administrative structure and governance of the Lloyd's market and the regulatory background for the auditing and accounting regime at Lloyd's; and (c) is inconsistent for example with the following express statements in the brochures."

The judge then quoted from paragraph 2.7 of the 1980 brochure, which described the functions of the underwriting agent and was in almost identical terms to paragraph 2.7 of the

1981 brochure quoted above. The judge concluded subparagraph (vii) as follows:

"See further for example "Membership -- The Issues" December 1986 under the heading "Key Membership Issues.

See also Gatehouse J in *Ashmore (No 2)*."

The reference to the 1986 document is a reference to the 1986 brochure, by which time rather more elaborate brochures were issued by the Council of Lloyd's but had the same purpose as the earlier brochures, which was to provide information to potential new members. They contained much the same information. Although the judge did not quote from the 1986 brochure, it seems to us that he probably had in mind in particular a similar passage about the role of the members' agent as appears in the earlier brochures.

301. The judge continued:

"(viii) Similarly the second alleged representation ("could trust those who were chosen by Lloyd's to regulate the Lloyd's market and manage its affairs") and the third alleged representation ("because of the way in which Lloyd's regulated and monitored underwriting accounts year by year, (a) could rely on syndicate accounts; (b) could in underwriting and/or in deciding whether to remain a member of Lloyd's have confidence in the audited syndicate results, for results of past years; and (c) could be sure that Lloyd's as part of its regulatory duties would ensure that when prospective liabilities were reinsured by one syndicate year into another, such liabilities were being fairly assessed and quantified as between two syndicate years") are (a) unclear in their terminology; (b) do not accord with the administrative structure and governance of the Lloyd's market and the regulatory background for the auditing and accounting regime at Lloyd's; and (c) are inconsistent for example with the following express statements in the brochures."

302. The judge then quoted section 11 of the 1979, 1980 and 1981 brochures with regard to the RITC process which we have quoted above. He also set out the similar section of the 1983 brochure, which is in similar but not identical terms as follows:

"11. CLOSING REINSURANCE

Whilst paid claims will, of course, be known and information available on known (but unpaid) claims, it will also be necessary to estimate the value of any unknown claims which may arise in the future and be attributable to that year of account. The computation of the overall figure of outstanding claims is a major exercise for the managing agent and his underwriter and will be a crucial element in determining whether that year of account shows a profit or a loss. Once this liability has been estimated it must be reinsured by a policy of reinsurance in order that the account can be closed. The reinsurance will normally be accepted by the syndicate's next year of account, but provision can be made for the reinsurance to be placed with other syndicates or for the account to remain open for a further year or years. The latter course will be adopted where the agent and his underwriter feel that it is not practicable, at that time, to predict with any reasonable degree of certainty the future claims which will arise on that year of account ... The quantification of the reinsurance to close is an estimate of future liability and the reinsurance premium may or may not eventually be proved accurate. In certain cases it has been found to have been inadequate and Members participating on the account which has accepted the reinsurance have suffered a loss on the reinsurance to close."

Finally the judge set out similar parts of the December 1986 brochure to which we refer briefly below.

303. The judge held that the alleged representations could not be spelled out of the express words of the brochures, that it followed that the names had to show that the allegations were to be

implied from the brochures and that there was no room for any of the implied representations alleged. In deciding whether representations should be implied, the judge appears to have adopted the same test as is used for deciding whether a term is to be implied into a contract.

304. That can be seen from the passages which he quoted from the judgments in *Clementson*. His quotation from the judgment of Saville J at first instance included the following, reported at [1994] CLC 71 at 76:

"... it seems to me that whatever test is applied, there is no need for the implication of any of the suggested terms. The undertaking is wholly efficacious as it is expressed and wholly carries through its object, namely contractually to bind the individual to the rules etc of the Society. Since this was the bargain that the parties were making, they could not on any sensible view have regarded the suggested implied terms as a necessary part of the individual's promise to comply with the rules. The contract is not incomplete; its nature does not require that further unexpressed rights and obligations should be implied into it."

The judge quoted a further passage in Saville J's judgment in which, albeit *obiter*, he rejected what he called the unfounded assumption that Lloyd's was in some way responsible for a name's underwriting.

305. The judge also quoted from the judgments in this court, which are reported at [1995] CLC 117. The judge's quotations included the following from the judgment of Sir Thomas Bingham MR at p 122:

"... I would be content to accept the judge's reasoning as my own. ... It was in no way necessary to the efficacy of the contract that Lloyd's should regulate and direct the business in its market with reasonable care ... Mr Mason was subjecting himself to the regulatory jurisdiction of a body of which he was becoming a member and consisting of his fellow members. For the management of his underwriting business he would look to his own agents and not to Lloyd's. In contractual terms there was no more to it than that ..."

The judge's quotation from the judgment of Steyn LJ included the following at pp 132-3:

"... I take the view that there are four reasons which cumulatively make it impossible to imply any of the suggested implied terms ... Thirdly, the Lloyd's system operates on the fundamental premise that a name entrusts his affairs, and in the process his fortune, to his managing agents. The name has remedies both in contract and in tort against the managing agent: *Henderson v Merrett Syndicates Ltd* ... Names assume substantial risks but at all material times names have done so in return for the advantage of their money, by way of underwriting and investment, "working twice", added to which there have been the prospects of substantial taxation advantages. Historically becoming a name at Lloyd's proved very profitable business. But the negative side of the bargain has always been that the name relies on, and assumes the risk of, the honesty and skill of his managing agent. Manifestly in the Lloyd's system there is no assumption of responsibility by Lloyd's to supervise the investment or underwriting decisions of managing agents That does not mean that Lloyd's has a licence to act in bad faith, for improper purposes or otherwise in an unlawful manner. But that merely means that such action would be ultra vires ...

... I would reject the argument that any of the terms put forward in this case are capable of being implied. I am driven to this conclusion by three distinctive features of the relationship between a name and Lloyd's: namely (1) that the sole purpose of the general undertaking is to commit a name to the regulatory system of Lloyd's; (2) that it is prima facie inappropriate to imply such terms in a relationship between names inter se; and (3) that the Lloyd's system operates on the basis that names look for protection of their interests solely to their managing agents and not Lloyd's. While the Council and Committee of Lloyd's are empowered to regulate the market Lloyd's does not assume any responsibility to protect names from the breaches of

duty of their agents. The suggested implied terms are not needed. On the contrary, the Lloyd's system, as underpinned by the Lloyd's Act, would be rendered unworkable if such terms were to be implied."

306. Mr Goldblatt submitted that the legal tests governing the implication of a term in contract, with which the court was concerned in *Clementson*, are irrelevant to the question whether the brochures contain the representations alleged. We agree. As already stated under the head of the tort of deceit, in our view the question is not, for example, whether it is necessary to imply the representation alleged, but simply whether, fairly read and in all the circumstances, the brochure contains (whether explicitly or implicitly) the representation alleged.

307. We agree with the judge that the starting point is the actual words used in the brochure and that the whole of each brochure must be considered because each statement in the brochure must be considered in its context, which includes the brochure as a whole. We further agree that it is useful to ask what a reasonable applicant for membership of Lloyd's would understand when reading the brochure as a whole. That will of course involve a consideration of the surrounding circumstances, which include the role of the applicant's underwriting agent.

308. Mr Aldous correctly accepted in the course of argument on behalf of Lloyd's that the brochures were intended to be read and relied upon by prospective names because each brochure expressly so states at the beginning: see paragraph 289 above. It is, we think, important to observe that each brochure (including the 1981 brochure, which we take throughout this discussion as an example) stresses, as did the court in *Clementson* in the passages quoted above, the distinction between the regulatory role of Lloyd's and the role of the name's underwriting agent: see eg paragraphs 2.4, 2.7 and 6.6 of the brochure quoted in paragraphs 291-293 above.

Representations as to the audit system

309. The question is what role in the audit system the brochures attributed to Lloyd's. In our view the way in which the names' case can best be put in this regard is along the following lines. Lloyd's knew that prospective names would rely upon Lloyd's itself as well as upon their agents. The purpose of the brochures was to spell out the role of Lloyd's in some detail. While Lloyd's was not responsible in any way for the underwriting, which was left to the names' agents, it made clear in the brochures that it had responsibilities for supervising the market, including the approval and monitoring of the accounting system. Moreover it made specific representations of fact relating to the accounting and auditing system, including in particular the way the RITC operated, which is central to the names' case and to this appeal.

310. Thus, for example, in paragraph 2.4 the role of the Committee of Lloyd's includes "supervision of the overall conduct of the Annual Audit of Underwriters' Accounts". The system of accounting is described in paragraphs 10.3, 10.4 and 10.5 of the brochure, quoted in paragraph 295 above. In paragraph 10.3 it is stated that an estimate is made of the "anticipated liabilities" at the end of each of the three calendar years of account and in paragraph 10.4 it is stated that "the estimated outstanding liability is calculated in accordance with the provisions of the Audit Instructions".

311. Paragraph 10.4 states what must be (and by implication is) included in the estimate of outstanding liability, namely "liabilities in respect of claims reported but not settled, *and* [our emphasis] claims, which may have been incurred but have not yet been reported with respect to policies attaching to the year of account". Those are the claims said to be "IBNR", incurred but not reported. It is implicit, if not explicit, in those statements that the system in place for identifying the IBNR claims is a satisfactory one because of the obvious potential importance to new names of underestimating such claims. It is true that the RITC system is described in section 11 (see paragraph 296 above) and that it is there stated that, since the RITC premium

is an estimate of future liability, it may or may not prove accurate and that in certain cases in the past it has proved inadequate with the result that the new syndicate has suffered loss. However, that underlines the importance of the accuracy of the estimated future liabilities and therefore the importance of putting in place a reliable system of estimating them with reasonable accuracy. It thus strengthens the inference to be drawn from the brochure that there was such a reliable system in place.

312. Those conclusions are reinforced by the express statements in section 12, under the heading "LLOYD'S AUDIT". Paragraphs 12.1, 12.2 and 12.3 (quoted in paragraph 297 above) include these express representations:

(1) "Pursuant to the ... Act ... each Member's underwriting accounts must be submitted annually as at each December 31 ... to a rigorous audit conducted by a member of a panel of chartered accountants approved by the Committee of Lloyd's."

(2) "This audit is carried out in accordance with ... the "Audit Instructions" issued annually by the Committee of Lloyd's with the approval of the ... Department of Trade."

(3) "In conducting the annual audit, the Managing Agent and active underwriter of the Syndicate together with the panel auditor, determine the reserves necessary ... including the amount required to close the account at the end of the third year."

(4) "The Audit Instructions, the provisions of which are reviewed each year by the Committee of Lloyd's, set out the basis on which the syndicate auditor must carry out the annual audit of Underwriters' accounts."

(5) "The Lloyd's Audit is primarily a test of solvency and the Audit Instructions deal, in particular, with the method to be adopted in calculating the outstanding liabilities as at the year end (ie the audit reserves) and the assets which may be taken into account to meet those outstanding liabilities."

(6) Percentage reserves are "an absolute minimum requirement and if the claims experience of a syndicate demonstrates that a higher provision is needed, it must reserve that higher figure."

(7) "An alternative audit test based on the syndicate's estimate of the outstanding liabilities as at December 31 (which must include a provision for unknown and unnoted losses) is prescribed in respect of the third and subsequent years of an account should this prove to be higher than the percentage reserves."

313. Although paragraph 12.2 of the brochure stresses that the Lloyd's Audit is primarily a test of solvency, and there are indeed a number of statements making it clear that its purpose is to identify whether each particular name has personal assets and reserves which are sufficient to meet his or her prospective liabilities, it is not a fair reading of the brochure, considered in context, that the brochure states that that is the sole reason for or basis of the audit. On the contrary the brochure makes clear that the audit forms the basis upon which each syndicate's accounts are to be signed off each year and that one of the principal purposes of such an audit is to ascertain the premium to be required for the next year's syndicate in order to close the relevant year of account. The brochure further makes it clear that the whole Lloyd's accounting system depends upon closing one year's account into the next year, which in turn depends upon having a reliable system in place for estimating outstanding liabilities, including claims which are IBNR.

314. That conclusion is underlined by representation (7), which is derived from paragraphs 12.1 to 12.3 of the brochure, namely that an estimate of the outstanding liabilities as at December 31 including unknown and unnoted losses must be made every year. Those unknown and unnoted

losses must be the same potential liabilities as the "claims, which may have been incurred but have not yet been reported with respect to policies attaching to the year of account" referred to in paragraph 10.4 of the brochure.

315. In short a central representation in the brochure is that there was in existence a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses. The brochure further contained a representation that Lloyd's believed that that was the case. Furthermore those at the centre of Lloyd's must have intended it to be understood in that way, and it was material. In these circumstances the judge should have held that that the brochure contained representations by Lloyd's to that effect.

316. As we have said under the heading the tort of deceit, the question is how the ordinary prospective name would reasonably understand the brochure. In our view, in deciding that question it is not relevant to consider the evidence as to how the brochures came into existence since prospective names would not know that. Nor is it necessary or helpful in deciding what representations were made to analyse the documents referred to in the brochures. Thus it does not seem to us to be appropriate to consider the terms of the Audit Instructions. The brochures must be considered through the eyes of those by whom they were intended to be read, namely prospective names. It is unrealistic to suppose that most prospective names would obtain copies of the Audit Instructions and consider them, or indeed take advice from an accountant or other expert as to the strengths and weaknesses of the Audit Instructions. Such documents would not be included within the "other materials provided to the recipient in the process of his application for Membership of Lloyd's" contemplated in the introduction to the brochure. That is in our view so, even though the introduction makes it clear that "any question with respect to the materials contained herein should be addressed to the Agent and/or Member who is sponsoring the application".

317. It will be observed that the case which we have summarised above is not quite that pleaded and considered by the judge. The representations considered by the judge are set out in paragraph 285 above. As to the first two, we entirely agree with the judge that they are not contained in any of the brochures. They are in very wide terms and, in our judgment, there is no warrant for the conclusion that the brochures contained representations that a name could have confidence in Lloyd's as an institution to safeguard his interests or that he or she could trust those chosen by Lloyd's to regulate the market and to manage its affairs. Those suggested representations are very vague and in our view insufficiently precise to support a claim for deceit. Moreover, we accept Lloyd's submission that they are not statements of fact.

318. If the names are to succeed in establishing the tort of deceit based on the brochures they must identify specific representations of fact in the brochures. In our view the third alleged representation, or more accurately set of representations, set out in paragraph 285 above comes nearer to satisfying the relevant test. However, they also are in our view much too widely drawn. Moreover, they also are expressed in terms of what names "could" do, ie in the future. There is nowhere a statement that names could rely upon their syndicate accounts if, by that, is meant that names could rely upon the accuracy of syndicate accounts. The brochures make it clear that the syndicate accounts are prepared by the syndicate and that it is the managing agent and the active underwriter together with the panel auditor who conduct the annual audit. We do not think that the brochures can fairly be read as containing the kind of promise alleged in each of the pleaded representations set out in paragraph 285 and considered by the judge.

319. It appears to us, on the other hand, that the brochures do contain a number of statements of fact including statements as to the system of accounting in operation at Lloyd's. Indeed, the purpose of the brochure was to describe the system in operation and an important part of that system was the accounting system. The system of accounting included three year accounting

and the closing of one year into the next. It follows that the RITC premium and the way it was calculated were central to the system and, since the premium depended upon a fair assessment of future liabilities, the system required a workable method of calculating not only liabilities in respect of claims which had been notified, but also the IBNR liabilities or, in the words of paragraph 12.3 of the brochure "unknown and unnoted losses".

320. In all these circumstances we have reached the conclusion that the case set out in paragraphs 309 to 315 above should be accepted. In our view the 1981 brochure does contain the representation set out in paragraph 315, namely that there was in existence a rigorous system which involved the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses. It seems to us that an ordinary person applying to become a name would reasonably reach that conclusion by reading the 1981 brochure. The language of the brochure would lead the prospective member to conclude that Lloyd's, who (as Bowen LJ put it) knew the facts when the prospective member did not, knew facts which justified the statement that the accounts were submitted annually to a rigorous audit in accordance with appropriate instructions approved by Lloyd's which included proper provision for unknown and unnoted losses. To answer the question posed by Lord Evershed, that is the effect that the language of the 1981 brochure would have had upon the mind of a potential name.

321. We stress that we are not saying that the 1981 brochure contained representations that syndicates accounts were, as a matter of fact, all prepared in accordance with the Audit Instructions. Our conclusion is simply that the brochure contained a representation that there was in place a rigorous system which involved the making of a reasonable estimate of outstanding liabilities which, as it was put in paragraph 10.4 of the 1981 brochure, "must provide for liabilities in respect of claims reported but not settled, and claims, which may have not yet been reported with respect to policies attaching to the year of account". Thus we would express the representation as being that there was in existence a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses. The brochure further contained a representation that Lloyd's believed that that was the case.

322. Although all the brochures were not in precisely the same terms, we do not think that any different view would be taken by a prospective name reading any of the others. We therefore refer to them only briefly. From 1986 the brochures were in a somewhat different format, although their substance was much the same.

323. There was a brochure issued in February 1986 and a further similar, but slightly different, document issued in December 1986. The judge quoted some extracts from it. It no longer referred to the audit as rigorous but stated that the purpose of the audit was to produce a "true and fair" view of the profit and loss in respect of a closed year. It included the following statements:

> "MAJOR FINANCIAL ASPECTS
>
> ...
>
> Occasionally, an account is left open at the end of the third year and is not closed by reinsurance. This may happen for a number of reasons, but will primarily result from major uncertainty as to future levels of liability. Full liability remains with the members participating in such accounts even if they resign from Lloyd's or die, until the accounts are closed by reinsurance: this may take years.
>
> MARKET RESULTS

The past results of the market and of individual syndicates must be regarded as a historic record and may be a poor guide to future prospects. Previously profitable business may subsequently lose money and vice versa; the nature of business written changes; reserves created against future claims may prove inadequate, as may a syndicate's reinsurance protection."

ACCOUNTING AND INFORMATION TO NAMES

A package of detailed rules has been established by the Council of Lloyd's governing the form and manner in which managing the members' agents are required to account and report.

Each calendar year, managing agents must produce financial statements in respect of each syndicate they manage. These financial statements comprise a syndicate annual report made up of :

- underwriting accounts covering the closed year and each open year,
- a balance sheet,
- a seven year summary of results,
- accompanying notes including disclosure of interest information;
- a personal account for each member showing his own result;
- a managing agent's report; and
- an underwriter's report covering closed and open years and future developments.

Lloyd's requires that the syndicate annual report shall give a true and fair view of the profit or loss for a closed year of account and that a Name's personal account shall give a true and fair view of the member's net result. The requirement to report in true and fair terms does not extend to the open years' accounts because the figures showing the open years merely reflect cumulative cash transactions to date.

Syndicate annual reports are subject to independent audit. The syndicate auditors – who must be approved by Lloyd's – are appointed by the managing agent to act on behalf of the Names.

The reinsurance to close represents a premium payable under contract by Names in one year of account to a succeeding, usually the next, year of account of the same syndicate or (rarely) some other syndicate. The contract transfers by reinsurance all outstanding risks and benefits relating to the closing year and all previous years of account to the succeeding year, in consideration for which an equitable premium is paid.

The calculation of the premium for the reinsurance to close involves the exercise of significant professional judgment and draws on the full experience of the active underwriting in assessing the outstanding known claims, claims incurred but not reported to the syndicate any further claims which are likely to arise. Each year the Council of Lloyd's sets minimum percentages of premium income which must be reserved for each category of business and which are approved

by the Department of Trade and Industry.

In determining the reinsurance to close, the managing agent and active underwriter must have regard to the interests of the Names paying the premium and those of the Names accepting the premium: the premium must be equitable between the different groups of members. The syndicate auditor is required to pay particular attention to the calculation of the reinsurance to close in drawing up his report."

324. It is not necessary to set out any further extracts from that brochure because we have formed the view that, although the language was not identical to that quoted from the 1981 brochure, the substance of the representations contained in the December 1986 brochure was the same. We do not think that the removal of the adjective "rigorous" or the introduction of the concept of "true and fair" would affect the construction which a prospective name would put on the brochures. We therefore proceed on the basis that throughout Lloyd's was making the representations which we have identified in paragraph 321 above, that they intended them to be understood and acted upon in that sense. We should add that the representations were also material in the sense used by Hobhouse LJ in *Downs v Chappell* at p.433 in the passage quoted in paragraph 60 above.

325. It is true that, so stated, those representations are much more limited than the representations considered by the judge, even representation (iii). Nevertheless, they are representations which in our judgment were espoused in the various ways in which the names' argument was advanced in this court and was in effect addressed in argument by both sides.

The globals

326. What have been described as the globals are global results which Lloyd's published from time to time in various ways. As stated in paragraph 286 above, the representations relied upon were said to be contained in various reports relating to the position as at the end of each year between 1981 and 1987. The reports typically included statements by the Chairman of Lloyd's and by the chairmen of each of the market associations, namely marine, non-marine, aviation and motor. They also included the three year accounts and a five year business summary.

327. The judge held that the globals did not contain the alleged representations. He gave a number of particular reasons for his view. The first five reasons were *mutatis mutandis* the same as in the case of the brochures, as quoted in paragraph 298 above. He added two further reasons as follows:

"(vi) The alleged representations are (a) unclear in their terminology; (b) do not accord with the administrative structure and governance of the Lloyd's market and the regulatory background for the auditing and accounting regime at Lloyd's; and (c) are inconsistent with express statements in the documents. By way of example I refer to the passages quoted in chapter 19 from the Aggregate Results/Global Reports and Accounts as at 31.12.81 to 31.12.87.

(vii) As to the second alleged representation, Lloyd's accepts that a representation was made that such figures represented an accurate aggregate of the audited trading results of all syndicates in the market. The Notes to the Accounts in the Globals made it quite clear that the figures were no more than an aggregate of such syndicate results."

328. In paragraph (vi) the judge was, as we understand it, responding to the submission that the globals contained representations that the Lloyd's market was in a sound financial condition throughout the period. The point he was making is that there are important qualifications in the globals which show that it is too simplistic to say that the globals contained

representations that Lloyd's was in a sound financial condition. The particular parts of the globals to which the judge was referring were those set out in chapter 19 of the judgment.

329. The Lloyd's Log of October 1982 contained a report from the Chairman of Lloyd's, Mr Peter Green, entitled "Lloyd's Announce Profit of £172.9m on 1979 account". An accompanying report from Mr Richard Ballantyne, the Chairman of LUNMA, included the following:

"Asbestosis

Probably no report of this nature would be complete without some reference to the serious problems which have arisen and which are likely to persist arising from asbestosis.

Many commentators have tried to put a figure on how much this will actually cost but in my opinion it is totally impossible to quantify. Policy wordings have been construed in many different ways, most of them to the detriment of insurers. Many of the syndicates in Lloyd's started underwriting after the asbestosis losses had become apparent and so should be unaffected, whilst others may well have seen the danger coming and have taken steps to minimise the total impact.

One thing is certain and that is the fee bills will be enormous; for instance, in respect of one of the assureds, for every $1.5m being paid in indemnity, $2.4m is being paid in fees. There is some indication, however, of a slowdown in advice of new claims, so we are hoping that the peak has passed."

330. In his statement as Chairman of Lloyd's in Lloyd's Global Accounts 1982, which was published in August 1983 but related to the 1980 year of account, Mr Peter Green said:

"I am pleased to say that this year we are presenting Lloyd's Global figures in a much improved and more comprehensive form...

Another important innovation is the inclusion in the underwriting accounts of separate figures for the reinsurance provision made to close the 1980 and previous accounts. At £2113 million, this is the underwriting agents' best assessment of the outstanding liabilities of the syndicates under their management. ...

The figures show that for the 1980 year of account Lloyd's made a profit of £264 million. ...

It will be noted ... that the known assets of Lloyd's at present exceed the statutory requirement by more than five times. ...

One aspect of the Lloyd's figures which is indicative of confidence in Lloyd's is the ratio of membership to premium income. In 1970, 6,000 members earned premiums worth just over £786 million. Ten years later, although the membership has tripled, Lloyd's premium income had gone up by nearly five times. ..."

331. An accompanying report by Mr. Michael Cockell (Chairman of LUNMA) included the following:

"...

I look at 1980 as the worst non-maritime underwriting result since the mid-1960s, brought about by the gradual decline since those days in commercial sanity bolstered by the insidious buffer of historically high interest rates. ...

It may prove in time that 1980 was the year when many syndicates were able to reserve for their asbestos and trauma-related potential. It would be appropriate if I explained how difficult it is to comment on the asbestos situation in a way that would be useful. It must be

understood that extremely onerous and sensitive discussions and negotiations are continually taking place. There is always the potential danger of punitive damages, so I cannot helpfully comment in detail on these subjects. It takes a brave man, or a foolish one, to forecast the outcome of the open years. For what it is worth I would personally expect the bottom line on each to show a deterioration on the preceding one."

332. In his statement as Chairman of Lloyd's in Lloyd's Global Accounts 1983, which was published in August 1984 and related to the 1981 year of account, Mr Peter Miller said:

"I am pleased to report Lloyd's Global results for 1981... it is pleasing to be able to record a substantial profitable result for 1981 of almost £152 million ... the reinsurance to close increased from £2.1 billion to £2.7 billion. ... It is easy to be pessimistic in today's insurance world. I remain an unrepentant optimist ... I believe that while we still have to go through the troughs of 1982 and 1983, Lloyd's will emerge having avoided the worst of the losses now being reported by so many of its competitors, particularly in the US market. I predict a future in which Lloyd's will maintain and improve its position in the insurance industry.

333. An accompanying report from Mr Ralph Rokeby-Johnson (Chairman of LUNMA) included the following:-

"We who underwrite at Lloyd's have certain advantages over our competitors – for instance our business is truly international and we have the ability to change the content of our account swiftly. Nevertheless, it is impossible for most of us to perform entirely differently from others in our market place with the exception of small specialists. It is well known that non-marine underwriting has been very difficult and over-competitive in the early 1980s and our results demonstrate this. I will be surprised if my successors have better results to show for the underwriting years 1982 and 1983 when they are closed ...

It is rapidly becoming apparent that the potential claims arising from asbestos will dwarf any claim in the history of our industry. It is very sad that in the United States to date under half of the money paid by our industry has ended in the hands the injured party, the balance is in the capacious coffers of the more rapacious lawyers: for this reason we support, and I very much hope all our industry will support, the concept of a claims handling facility set up by the insurers and manufacturers to look after the interests of the injured. ...

All these subjects require a re-appraisal of the reserve set up in the past to deal with future claims and it will not have escaped your notice that these reserves are constantly being strengthened by Lloyd's underwriters and the more prudent members of our industry.

I believe we are on the threshold of a time of opportunity for sensible underwriting: the ignorant or innocent capacity has been taught its lesson again. I only hope that this time we will not see the usual peaks and troughs and that common sense will have greater longevity. I fear that my hopes will not be well founded."

334. In his statement as Chairman of Lloyd's in Lloyd's Global Report and Accounts 1984, which was published in September 1985 and related to the 1982 year of account, Mr Peter Miller said:

"...

Of the seven major classes of business, three show a substantial improvement as compared with last year, three show a substantial deterioration and one a modest deterioration. While the marine account is the best for some years and four of the other six major accounts show reasonable profits, the general (non-marine) liability account shows an enormous loss. One wonders what Mr Micawber, with his nose for which side of the financial line happiness lay, would have made of that particular result. Certainly his recipe for putting things to rights by

waiting "in case anything turned up" cannot commend itself to the underwriters whose duty it is to correct this disastrous state of affairs. Figures such as these make it obvious that underwriters must take stringent remedial action as indeed they are. It is worth repeating that a combination of three things is needed, particularly in the all important American casualty business; first, a realistic rating level; second, a reformed policy wording embracing, where needed a claims made basis for claims and overall limit, including legal costs; and third, a measure of tort law reform. Without real progress in all three areas, it is hardly to be wondered at if underwriters increasingly withdraw from this class of business, with the result that certain industries will be left without the insurance coverage which they need to continue in business, to the detriment of society in general. ..."

335. An accompanying report from Mr Richard Hazell (Chairman of LUNMA) included the following:

"The figures produced for the close of the 1982 Account do not make happy reading from the non-marine market's viewpoint, producing an overall loss of £219m after taking into account substantial investment earnings. It must be remembered when reviewing these figures that they relate to the experience of the insurance market of three years ago when the insurance industry generally was at it lowest ebb for very many years, if not in its entire history.

Undoubtedly, much of the blame for these poor results can be attributed to the need for underwriters to increase reserves for outstanding losses in the light of the more liberal attitudes adopted by the American courts, very often in pursuit of the deep pocket theory. This is particularly apparent, but is not unique, in relation to those claims affecting asbestosis and pharmaceutical products. New laws regarding liability following pollution and other forms of environmental impairment could also produce problems for underwriters as these new laws appear to apply retroactively, thus making it very difficult to underwrite against such circumstances. It is to be hoped that the newly formed asbestosis facility, which after many years of being discussed has now been established, will enable settlement of claims to be made as a faster rate with a consequent saving of legal expenses. ..."

A document entitled 'ALM. 1982 Lloyd's Syndicate Results' published in September 1985 stated that Lloyd's Global Report and Accounts 1984 "have been distributed to all Names this year for the first time".

336. In his statement as Chairman of Lloyd's in Lloyd's Global Report and Accounts 1985, which was published in August 1986 and related to the 1983 year of account, Mr Peter Miller said:

"While 1983 is still within the trough of poor results ... it is nevertheless pleasing to be able to report at least an overall profit of £36 million or £179 million excluding the PCW syndicates..

For 1983, of the nine statutory categories in which we make our returns, eight show an overall profit ranging from the modest to the satisfactory. The ninth tells a different story. As last year, the general liability account generates approximately 12 per cent of the total premium income for 1983 – and, for the same year, produces 100 per cent of our losses. Were the underwriting environment for this class of business not to have improved it would be inconceivable that any underwriter would remain in the class."

337. An accompanying report from Mr Robin Jackson (Chairman of LUNMA) included the following:

"It is disappointing to report that, once again, the non-marine market has produced an overall loss after taking account of investment earnings. The loss of £231 million is somewhat higher than 1982 and represents a loss of 21 per cent on a total non-marine premium income of £1,074 million. Although the overall market results of the year 1983 on its own were thoroughly unsatisfactory, they have been exacerbated by the need of a number of syndicates to set aside additional reserves in respect of latent disease claims such as asbestos for the prior closed years of account. The year also suffered a number of catastrophes including winter

weather losses and Hurricane 'Alicia' in the United States. ... Hurricane 'Alicia' ...may untimely turn out to be the largest loss yet suffered by the market from one storm.

The US based liability account has yet again been the cause of most of the market's difficulties as, once again, it was necessary for underwriters to increase reserves for asbestos-related losses. Although the Asbestos Claims Facility – set up with the support of Lloyd's – is making significant savings in the legal costs involved, this is to some extent offset by there being no slowing down in the number of new suits being brought. ...

In summary, after some very gloomy reports from my predecessors, I genuinely believe I can be considerably more optimistic than has been possible for a long time. I hope that over the next few years the non-marine market will be able to return to the kind of results of which underwriters may be proud. It should not be assumed, however, that non-marine underwriting has suddenly become easy: it is just that some badly needed corrections have been made and will continue to be made enabling underwriters to be more in control of their own destinies."

338. In his statement as Chairman of Lloyd's in Lloyd's Global Report and Accounts 1986, which was published in August 1987 and related to the 1984 year of account, Mr Peter Miller said:

" ... the overall results for 1984, constitute a record profit for the Lloyd's market of almost exactly £300 million, excluding PCW, while the outlook for 1985, at least overall, looks likely to improve on that figure and 1986 is spoken of, almost reverently, as a vintage year ...

However, there is one factor which continues to dominate the whole Lloyd's market and indeed it is perhaps no exaggeration to say it continues to dominate the whole world insurance scene. I refer, of course, to the general liability account. I have in previous years drawn attention to the enormous losses made in this area and I must do so again. The overall loss on this account shows a welcome reduction from last year's figure. However, I have to say that the problems facing those underwriting this account, while perhaps reduced as a result of the reforms in the law of tort in the United States, are nevertheless far from solved. Two facts seem to me to stand out; first, that this account produces 12 per cent of Lloyd's premium income and almost 100 per cent of our losses. Second, almost exactly 50 per cent of our reinsurance to close (£2,000 million out of £4,000 million in round figures) has to be devoted to the claims outstanding within this account; on a premium income base of some £400 million any under-reserving must have a sharply disadvantageous effect. In spite of all the efforts that have been made, quite extraordinary court awards and judicial interpretations continue to come from, in particular, the American scene.

There are two quite different problems in the whole of this area. First, whether the amounts put aside to meet these claims will be sufficient, a problem of the past which underwriters must do their best to solve. Second, how far it is prudent to commit underwriting resources in the future to a class of business hedged about with such dangers and uncertainties. The problem extends beyond the insurance industry; society, that is to say the general public and its political leaders, will have to reflect and should, sooner rather than later act to clarify how they feel that their damaged citizens should be fairly compensated."

339. An accompanying report from Mr Bryan Kellett (Chairman of LUNMA) included the following:

"The results of the non-marine market are, once again, dominated by the loss in the general liability section, which for the 1984 year of account amounts to £170 million on a premium income of £365 million. A substantial proportion of that loss results from the need, as in previous years, to add to the reinsurance to close item as the result of reassessment of liabilities on business written in prior closed years of account. This class of business, much of which comprises policies issued to insureds in the United States of America, continues to be adversely affected by certain features of the legal system of that country. One such feature is the contingent fee system whereby lawyers are rewarded by sharing in the damages which

they are able to secure for their clients, often leading to spurious cases being pursued. Another is the system of awards by juries in civil damages cases where they are encouraged to think of the insurance industry as having a "deep pocket" from which victims may be compensated, regardless of whether or not there is fault on the part of insured defendants.

The problems are considerably compounded by the time which may elapse between the occurrence giving rise to injury and an eventual court ruling that this was in some way due to the negligence of the policyholder. Thus, underwriters of this class of business are faced with two problems. Firstly, they are being called upon to indemnify insureds in respect of losses for which they had not expected to be held liable. Secondly, the computations of the amounts – which will be needed to pay losses already incurred and which should be charged as premium on new business – will be based on an inadequate and unreliable data ..."

340. In his statement as Chairman of Lloyd's in Lloyd's Global Report and Accounts 1987, which was published in August 1988 and related to the 1985 year of accounts, Mr Murray Lawrence said:

"Over the past twelve months, two events have served to emphasis the vital role played by insurance and by the Lloyd's market in particular. The devastation created by the storm of October 1987 which cut a swathe across southern England and Western Europe is being described as the world's largest insured loss, estimated to be 3 billion US dollars. More recently, in July this year, the dangers inherent in offshore oil production were brought into stark focus by the explosion which destroyed the North Sea oil production platform, Piper Alpha, involving tragic loss of life. ... The deterioration in the claims experience over the past twelve months, together with the need to provide for the development of past year claims, especially in relation to long-tail liability business in the United States, have particularly affected the 1985 account results. This emphasises the crucial need to provide for future liabilities by way of full and appropriate reinsurance to close at the end of each year. The same problems are also reflected in the number of syndicates with years of account left open at the end of 1987. At the end of December 1987 there were 76 syndicates with a total of 120 years of account left open. Problems associated with asbestosis and pollution risks, together with other US liability business appear to account for the vast majority of the run-off years. To have so many syndicates left open must be considered unacceptable to underwriters, members and agents alike. Consideration is, therefore, being given by the Council of Lloyd's to ways of dealing with this problem. ...

The difficulties associated with long-tail liability business highlighted by the Chairman of the Non-Marine Association have resulted in both an underwriting loss and an overall loss. This business is now, however, being written at rates that better reflect the present climate and with policy wordings appropriate to the changed circumstances. ...

It is clear that Lloyd's faces an abundance of opportunities in the years ahead...

I am, therefore, optimistic for the future of Lloyd's market place. ..."

341. An accompanying report from Mr Michael Williams (Chairman of LUNMA) included the following:

"The 1985 result is, disappointingly, a deterioration on 1984, showing an overall loss of £5.3 million equivalent to 0.4 per cent on an income of some £1,331 million and an underwriting loss of £84.2 million. The result includes the well-publicised Outhwaite syndicates 317/661 for the 1982 account in run-off, accounting for some £85.4 million of losses without which the 1985 results would have shown a profit. ...

Our two main areas of difficulty are in asbestos-related claims and environmental impairment.

The rate of new asbestos-related claims rose steeply from an average 700 per month in 1985 to 2.000 per month 1987, due largely to intensive publicity from the plaintiff bar and the seeking out of new industries with an "asbestos connection". There are, however, grounds for future optimism as the rate of increase has declined markedly in recent months. The second major factor in the development of back years is the incidence of environmental pollution claims in the US. Claims for clean-up costs of dump sites are being made for circumstances in which it was never the intention of the insurer or the expectation of the insured that coverage should apply; in many cases insureds deliberately dumped waste knowing it to be harmful to the environment; in other cases dumping occurred at sites licensed for the purpose at the time. Depressing though this may sound, I should point out that underwriters are confident that there are excellent defences to these claims and they will oppose them with the utmost vigour. ... "

342. It is, in our judgment, apparent from those extracts that the judge was correct to hold that the globals did not contain the first representation asserted by the names, namely that the Lloyd's market was in a sound financial condition. The reports, especially those from successive chairmen of LUNMA, contained a series of warnings about the problems associated with asbestos related claims.

343. As to the second allegation (that names could take up or continue membership with confidence that known and projected claims were reserved for), it is apparent that the judge was right in his conclusion on this also. We have reached the firm conclusion that, if the names cannot succeed on the basis of the representation as to the auditing system in the brochure, they cannot succeed on the basis of the contents of the globals. The most that could be said is that the globals did not correct any misrepresentation about the audit system which had been made in earlier brochures.

V THE AUDIT SYSTEM: WAS THE REPRESENTATION TRUE?

Introduction

344. In this section we consider the question raised by the first representation which we have identified, namely was there in existence a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities, including unknown and unnoted losses. We also consider whether the answer to that question would be different if the word 'rigorous' were removed. We thus address the third ingredient of the tort of deceit identified in paragraph 49 above. We do not address here the question whether the second representation was true because that involves a consideration of the question whether Lloyd's believed that such a system was in place, which we consider in section VI.

Reserves and RITC

345. There undoubtedly was a regulated audit system dealing with such matters as the production of annual accounts, the RITC and solvency. In considering the RITC and solvency, outstanding liabilities were a key feature to be assessed. In making the relevant assessments a syndicate's active underwriter and its auditors each had a role.

346. Before the judge the names, represented by Mr Goldblatt, appear to have run a case that there could be no "audit" as such until 1985, when following the Fisher Report and the 1982 Act, auditors were obliged to certify that syndicate accounts showed a true and fair view. They relied on material which suggested that it had been appreciated that the word 'audit' was a misnomer. On that basis in so far as any representation was to the effect that an audit was taking place, it was said to be untrue for that reason and that reason alone. But that over simplistic case is not the case made on appeal. The fact that the word audit was used is not unimportant however because it indicates that the system was one (as the quotation in paragraph 312(3) above makes clear) under which the underwriter "together with the panel

auditor" would determine the reserves.

347. The regulation by statute, instructions and later bye-law relating to the audit as a whole changed from time to time over the relevant period, but so far as making the assessment of what were termed "audit reserves" the principles seem to have remained much the same. The full history of regulation, instruction and bye-law over the period is set out in the agreed statement of facts (D2, 3, 4 and 4A) and has been summarised by the judge in chapter 11 of his judgment. For our purposes we have thought it convenient to attempt to trace how the system operated as at a fixed point in time, indicating the part we understand the underwriter and the auditor would have played. We can then indicate in broad terms any relevant changes that there may have been either from the previous period or in the period thereafter. We have chosen 31 December 1982.

348. For each year Lloyd's issued a solvency letter and audit instructions. It was standard to include in the audit instructions clause 3:

"3. The Syndicate Auditor is required to examine the settlements on the Underwriting Accounts for 1981 and each previous year in relation to the reserves previously created to wind up such Accounts. If the result of that examination shows that the general pattern of claims experience on the Underwriting Accounts for the years in question is such as to demonstrate that the reserves previously created are likely to prove inadequate to meet the cost of winding up those Accounts, or if there are any other factors which affect or may affect the adequacy of the reserves, then the Auditor must report to the Council and obtain their instructions before issuing his Syndicate Solvency Report.

The Syndicate Auditor should take such steps as he considers requisite to obtain the authority of those interested to make any reports which may become necessary by reason of this instruction.."

349. This clause was expanded on in standard terms in the solvency letter which was sent out to auditors and underwriters as a covering letter to the audit instructions. Thus the solvency letter relating to 31 December 1982 expanded on clause 3 in the following terms:

"Clause 3.

(i) This Clause, the provisions of which apply to the reserves to be created on all years, is regarded by the Council as being one of paramount importance and syndicate auditors are therefore requested to pay particular attention to its provisions.

(ii) Syndicate auditors are required, in addition, to report all cases where it appears at 31st December, 1982 that the reinsurance premium charged to close the 1979 Account (and all previous years reinsured therein) at 31st December, 1981 has been inadequate. Similar reports are also required where it appears at 31st December, 1982 that the audit reserve created as at 31st December, 1981 on an Account which has not been closed, has been inadequate. In order to demonstrate the extent of the apparent inadequacy, such reports are to be supported by figures showing – (a) the reinsurance to close the 1979 and previous years' Accounts at 31st December, 1981; or, in the case of an Account which has not been closed, the reserve created as at 31st December, 1981; (b) the settlements on those Accounts during 1982 and (c) the reserve created on those years at 31st December, 1982.

Such reports, which are for the information of the Council, are on a purely mathematical basis and in no way remove any responsibility from the Auditor in carrying out his examination under Clause 3 of the Audit Instructions and making whatever reports he considers necessary under that Clause.

(iii) Underwriters and Underwriting Agents must bring to the attention of their Auditors any factors which affect or may affect the adequacy of the reserves to be applied as at the 31st December, 1982 including:-

(a) Risks which include liability for latent diseases and products liability.

(b) Cases where a Syndicate has taken over the run-off of another Syndicate's accounts.

(c) Any reinsurance recoveries in dispute where credit has been taken for the recovery and where there is any doubt over the collectability of reinsurance claims submitted."

350. It also contained clause 6 which provided for the creation of audit reserves. The agreed statement of facts summarises conveniently the effect of clause 6 at paragraph 7.3:

"7.3 The tests for the audit reserves in relation to each category of business were set out in clause 6 of the Audit Instructions. For the year then in its third year of account at 36 months of development and any years of account in run-off, including, in each case, all years reinsured into it, the audit reserves were required (for most categories of business, including non-marine "all other" business) to be the greater of the following:

(i) the application of a specified multiple to the net premium income for the respective year of account. The multipliers were known as the minimum percentage reserves [MPRs]. (For the oldest year of account specified in the Audit Instructions, which was expressed to include all previous years of account, there was an alternative test of outstanding liabilities, including IBNR);

(ii) the total of the outstanding liabilities on each year of account in question as at the year end for the solvency audit, including IBNR; or

(iii) the amount of the RITC for the closing year of account, including any previous years reinsured into that account. (This test did not apply to years of account in run-off).

It is to be noted that:

(i) there was little practical distinction between tests (ii) and (iii);

(ii) the calculation of the reserve figure under test (ii) (or the amount of the RITC under test (iii)) required consideration of the ultimate cost of settling the syndicate's liabilities; and where a year was not being closed, because it was considered that an equitable RITC could not be set, audit (i.e. solvency) reserves nonetheless had to be calculated. "

351. MPRs were reviewed each year. All agents were required to see that run-off statistics were kept for each syndicate in which their names underwrote. They had to be kept for the fourth and subsequent years of each year of account until such times as the settlements ceased to be material.

352. Between May and July agents would supply settlement statistics to Lloyd's. These statistics would then be passed by Lloyd's to the DTI and the market associations (and by the DTI to Government Actuaries Department (GAD)). During October and November comments would be received by the Audit Department at Lloyd's who would make recommendations to the Audit Committee as to the MPRs, and as to the audit instructions which were to be sent to underwriters and auditors.

353. The Review of Audit Instructions and Regulations for 31 December 1982 provides an example of the procedures. It proposed setting the date for the completion of that year's audit as 30 April 1983, and solvency by the end of May 1983. It continued the requirement under the

audit instructions that auditors should report all cases where the reinsurance to close an account (or the reserves created at the end of the third year of an account) had appeared, after 12 months, to have been inadequate; and it noted that as to 31 December 1981 audit there was an increase in the number of cases where after 12 months the RITC was apparently inadequate (a point to which we will return). It referred in relation to clause 3 of the Audit Instructions to the fact that particular matters had been referred to in previous audit instructions as matters to which underwriters should draw the attention of auditors as factors which might affect reserves and suggested that some Panel auditors thought it misleading to point to particular problems (thereby encouraging auditors to rely on those problems rather than make their own inquiries). It made a recommendation as regards MPRs including a suggestion that a different scale might be used for non-marine "All Other" business (which included long-tail business) depending whether the business was U.S. dollar or non-U.S. dollar.

354. These recommendations were considered by the Audit Committee and then dealt with by the full Committee on 9 December 1982. It approved the date for completion of audit as 30 April 1983 and for completion of solvency as the last day of May. It recommended that there should be a review in June 1983, following completion of the solvency test, of those accounts where an inadequacy in the RITC had been demonstrated. It recommended that a number of specific items should be excluded as matters to which the auditors' attention should be drawn under clause 3, but it maintained the reference that the underwriter should bring to the auditors' attention "Risks which include liability for latent diseases and products liability".

355. Clause 6 was in fact later amended to provide more precisely for the respective roles of the managing agent and the auditor, although no suggestion was made during the appeal that these roles were not already the reality. The amendment was in the following terms:

"6. It is the responsibility of the Management Agent to establish reserves in respect of both the Open and Closed years in order to ensure that adequate funds are maintained to discharge all liabilities. The Auditor must ensure that the Agent has discharged his responsibility in this regard in a reasonable manner consistent with available information on outstanding losses, statistics of underwriting performance, market experience and any relevant information and explanations."

356. As regards MPRs, since the U.S. dollar MPRs involved a considerable increase Mr Nelson was asked to address the Committee and he explained:-

"Mr. Nelson advised the Committee that, with regard to Direct business, there was now a sophisticated and meaningful computer system for all asbestosis business written on a Direct basis. This information was available to both Underwriters and Auditors. With regard to the number of cases being advised this had risen from the original estimate of 15,000 to approximately 25,000 but the average cost, whilst being eroded due to inflation was still within the original estimate of $125,000 plus $10,000 expenses. He also advised the Committee that the controversy as to whether claims will be settled on an exposure or manifestation basis had still not been resolved.

With regard to reinsurance business, due to time constraints, there was little information at present available from the computer but it was hoped that more meaningful figures would be produced next year."

357. There was some protest because it was said that the new scales impacted on rather shorter-tail business and the minutes record the following:-

"The Audit Committee had recommended large increases in the U.S. Dollar scale of reserves and whilst a number of Committee Members considered these increases to be realistic, Mr. Murray pointed out that it could pose problems to Underwriters who wrote a "short" "All Other"

Account. Mr. Chester said that the Audit Committee had spent a considerable time looking at the division of the "All Other" Account but that until further audit codes were available there was little likelihood of further divisions. He said that the Audit Committee would need the assistance of the Non-Marine Association in progressing this matter."

358. Between January and April work on the audit would be carried out by syndicates and their auditors. The Manual paragraph 4 and paragraph 8(i) and (ii) at this stage provided:

> "4. The date decided on by the Committee for the completion of the Audit will be given in the Audit Instructions. Agents should see that everything is done to enable their Auditors to sign the Audit Certificate by the prescribed date. This involves the Agent ensuring –
>
> (i) that the Books of Account are written up and balanced.
>
> (ii) that the information required by Auditors to enable them to satisfy themselves as to the proposed Reinsurance to close on Account is available by early April.
>
> (iii) that in the case of a Composite Group Syndicate, all information required by Agents and Auditors to sections of the Group is made available well in advance of the Audit date.
>
> (iv) that, where necessary, Names' Audit surpluses in other syndicates under the same Agency are taken into account.
>
> (v) that in the likelihood of a loss or Audit deficiency, reserves have been valued well in advance of the prescribed date.
>
> (vi) that Names are given adequate notice of any additional moneys which may be required for Audit purposes. Whilst it is desirable that a request for additional funds should be accompanied by audited Accounts, this is often impracticable. In the circumstances, a Certificate of Loss, signed by the Auditor, will serve as a temporary substitute for the Accounts. The Accounts, or the Certificate of loss, must be sent to the Name well in advance of the published Audit date.
>
> 1. During the course of the Audit, ...
>
> (i) the Certificate of Outstanding Liabilities (other than unknown and unnoted losses) at the previous year end. This Certificate is needed to calculate the Audit Reserves; it will be supplied to the Agent by the Auditor and must be completed and returned to the Auditor by the end of March each year.
>
> (ii) the Certificate regarding the adequacy of the Audit Reserves which are being created. This document is of great importance. Before signing it, the Agents should examine the Audit Reserves in the light of past run-off statistics and other relevant facts available to them."

359. The audit reserves had thus to be calculated so far as the 1980 account (which as at 31 December 1982 would be expected to be closed into the 1981 account) at the greatest of the MPRs, RITC premium or total estimate of outstanding liabilities. This would be calculated by the underwriter and put on a form and provided to the auditor. Our understanding is that as at 31 December 1982 the underwriter would use an AU form 17.

360. The underwriter had to calculate a premium which was equitable to the names on the year being closed and equitable to the year which was to take on the liabilities. This was ultimately made explicit in Bye-Law no 7 of 1984, but it had always been the requirement, and would have been the requirement as at 31 December 1982. Known claims had to have a proper estimate put on them, and the underwriter had to exercise his judgment in determining the IBNR element. In assessing the IBNR he would take into account the size and relative importance of the IBNR element, the syndicate's loss experience, and its reinsurance protection. These factors appeared expressly in the Explanatory Notes to Bye-Law no 7 of 1984. From November 1980 onwards, underwriters at interest had available to them the information of the AWP in the form of (inter alia) attorneys' reports; market letters from the AWP; (from late 1981) computer print-outs produced from the database created in the United States; and other information contained at (initially) the offices of Elborne Mitchell, and subsequently the offices taken by the AWP and then Toplis and Harding (Asbestos Services) Ltd. So far as the history of the business was concerned the underwriter would have the statistics demonstrating how each year of account had progressed.

361. In *Henderson v Merrett*, Cresswell J, in considering the duties of auditors, said this ([1997] LRLR 265, 315):

"(vii) the auditor would need to be satisfied that the premium for the reinsurance to close a year of account was equitable as between the Names on that account and those on the accepting year of account. The determination of the premium for the reinsurance to close involved the exercise of significant professional judgment and drew on the full experience of the underwriter.

(viii) since, from at least 31 December 1985, the audit report on syndicate financial statements was to be expressed in true and fair terms, the auditor would need to ensure that he had gathered evidence of sufficient quality to support such an opinion.

(ix) in relation to the reinsurance to close, the audit approach should recognise that the objective was to ensure that the reinsurance to close was within a zone of reasonableness rather than an arithmetically accurate figure;

(x) the auditor would need to consider such matters as the nature of the syndicate's business, the overall size of the syndicate, the impact of the reinsurance protection programme, and the accuracy of previous estimates as a part of his assessment of the appropriate range within which he would expect the premium for the reinsurance to close to fall;

(xi) the results derived from statistical techniques should be treated with a degree of caution, since historically derived date might not be an accurate guide to uncertain future events. The auditor should, therefore, ascertain from the underwriter the underlying basis for his estimate of claims incurred but not reported (IBNR), so that appropriate additional evidence could be collected to support the computation; and

(xii) other matters the auditor might consider as a part of the audit of the reinsurance to close included matters specific to the particular syndicate's business, for example, the syndicate might have reinsured the run-off of other syndicates or companies and the auditor must satisfy himself that due account had been taken of the liabilities which were likely to arise under such contracts. This evidence would usually take a similar form to that relating to the syndicate's own business. "

It was the duty of the auditor to satisfy himself as to the adequacy of the RITC.

362. Sir Henry Fisher in his report at paragraph 23.14 and paragraph 23.15 also commented on this aspect in the following terms:

"23.14 Valuations of this nature depend to a very great extent upon commercial judgments, as to such matters as the volume and value of claims to be expected and as to the quality of reinsurances placed by the Syndicate. A particularly important aspect is the Reinsurance to Close and, although the "audit reserves" laid down in the Lloyd's Audit Instructions provide minimum percentages, the Managing Agent and Underwriter have to make a proper commercial estimate of the outstanding liabilities to arrive at the premium. Even though the membership of the Syndicate in any two consecutive years may be to a great extent the same, the reinsurance must be regarded as an arm's length transaction.

23.15 All these judgments can only be made by the Managing Agent or Underwriter. They have the primary responsibility and it cannot be delegated to, or assumed by, the Auditor. However, the Auditor is bound to form his own view on all these matters. He will take account of the particular circumstances relevant to that year and will draw on his own experience and judgment. He will make his own tests as to the adequacy and basis of the provision which has been made by the Reinsurance to Close. In doing so he should have regard to the past history of the Syndicate so far as settlements are concerned and the adequacy or otherwise of past Reinsurances to Close. In addition, he will consider the history of the Syndicate and any changes in Underwriter or underwriting policy."

Solvency

363. Section 73(4) of the Insurance Companies Act 1974 was by this time section 83(4) of the Insurance Companies Act 1982. This section provided:

> "83(4) The accounts of every underwriter shall be audited annually by an accountant approved by the Committee of Lloyd's and the auditor shall furnish a certificate in the prescribed form to the Committee and the Secretary of State.
>
> 1. The said certificate shall in particular state whether in the opinion of the auditor the value of the assets available to meet the underwriter's liabilities in respect of insurance business is correctly shown in the accounts, and whether or not that value is sufficient to meet the liabilities calculated.
>
> (a) in the case of liabilities in respect of long term business, by an actuary; and
>
> (b) in the case of other liabilities, by the auditor on a basis approved by the Secretary of State."

364. The certificate which had to be signed by the auditor provided:

"UNDERWRITING ACCOUNTS

IN THE NAMES OF

Through the agency of

To the Council of Lloyd's and to the Secretary of State

INSURANCE COMPANIES ACT 1982

We have examined the accounts relating to the insurance business carried on by the above-mentioned Underwriters through the above-named Agency during the year ended 31st December 19....., in accordance with the current Instructions for the guidance of Lloyd's auditors drawn up by the Council of Lloyd's and approved by the Secretary of State.

In connection with our examination, we have relied upon a report in respect of the underwriting accounts from accountants approved by the Council of Lloyd's as auditors of each syndicate in which each underwriter has participated during that year stating that in their opinion all assets have been valued and all liabilities have been calculated in accordance with the said Instructions (liabilities in respect of long term business having been calculated by an actuary) and that the profits or losses arising on the closed accounts and the surpluses or deficiencies arising on the open accounts have been allocated to each Underwriter in accordance with the arrangements for his participation in each such account.

In our opinion the value of the assets, valued in accordance with the said Instructions (in the case of each Underwriter's Lloyd's Deposit, as certified by the Council of Lloyd's), available to meet each Underwriter's liabilities in respect of his insurance business is correctly shown in the accounts and is sufficient to meet his liabilities in respect of that business.

Dated this.. .. .. day of .. ..19.. ..

Accountants approved by the Council of Lloyd's."

365. A syndicate Solvency Report also had to be produced which it is unnecessary to quote, but which confirmed the position as it related to the syndicate in similar terms. On the basis of the certificates produced in relation to each name and each syndicate, Lloyd's was able to satisfy the "global test" pursuant to section 84(1). It is unnecessary to go into the details either of that test, or the statutory statement of business which became mandatory as at 31 December 1982. That is not to belittle their importance. Full details appear in the agreed statement at D2. The key point so far as this appeal is concerned is that a critical element in the calculation of the RITC and in assessing solvency was the assessment of outstanding liabilities including IBNRs.

366. It is important to stress that the auditor also checked the adequacy of the previous year's RITC, which would be an important factor in considering the likelihood of the adequacy of that for the year under consideration. Clause 3 of the instructions, as expanded on in the solvency letter, has already been quoted. Ultimately this information was recorded on forms AU 38 and AU 38(A) to which reference will be made hereafter.

367. The agreed statement in D3 contains details of changes over the years. The most significant change was the requirement for accounts of syndicates to show a true and fair view. That became a requirement as from 31 December 1984 although many syndicates had adopted the standard voluntarily for the previous year. In a letter dated 8 April 2002, received after completion of submissions, Mr Adams sought to make something of a change in the wording of the audit certificate in March 1983. He suggested that the change was intended to reduce the obligation on auditors in assessing audit reserves. Freshfields, on behalf of Lloyd's, responded by letter dated 23 April 2002. The point sought to be made by Mr Adams has apparently not been made before. It appears to be contrary to the agreed statement of facts, and, in any event, the evidence simply does not support the view that there was any change in the role of the auditor in relation to the calculation of reserves by virtue of any change in the wording of the audit certificate. Save for this letter from Mr Adams it has not been suggested on this appeal that the approach to reserving or the RITC or solvency altered in any fundamental way. It is therefore possible to refer to the changes quite shortly.

368. Prior to the 1982 Act (which received the Royal Assent on 23 July 1982 and came into force on 1 January 1983) Lloyd's statutory duties in relation to the solvency audit and the preparation of the SSOB were exercised by the Committee of Lloyd's. The audit department supported the Audit Committee which in turn supported the full Committee.

369. Sir Henry Fisher in his Report published in May 1980 had made certain recommendations for improving the accounting regime and recognition of auditors. Pursuant to his

recommendations certain Task Groups were set up including Task Group 4 in September 1980, whose terms of reference were directed towards considering the provision of information to existing names, with particular reference to syndicate accounts and accounting standards.

370. In November 1982, Lloyd's , with the approval of the Bank of England and the DTI, set up a working party under Mr Ian Hay Davison, to review the requirements of the Lloyd's solvency audit with particular attention to both the information which should be sought by auditors and the information which underwriting agents and underwriters should provide to their syndicate auditors. The working party was also required to review the audit instructions for the solvency audit. It was intended that the working party should consider urgently what changes should be implemented for the solvency audit as at 31 December 1982; it was announced that the working party hoped to provide some input for the 1982 audit while completing its study during 1983. Mr Ian Plaistowe replaced Mr Davison in February 1983, and the work of that working party was built upon by the Accounting and Auditing Standards Committee (AASC). In October 1983 the Audit Department and Audit Committee were replaced by the Members' Solvency and Security Department and Committee, which took over the definition of the accounting and related auditing requirements. On 2 December 1983 Lloyd's published a Provisional Accounting Manual, which relied heavily on a draft manual produced by Task Group 4 in December 1982, and the work done by the Plaistowe working party.

371. It was the changes adopted during this period which led to auditors having to certify from 31 December 1984 that accounts of syndicates showed a true and fair view. Many auditors had already adopted that as the standard, but it was from the above date that it was compulsory to do so.

372. We should add that solvency certificates could only be produced by an auditor on a panel approved by Lloyd's. In practice the panel auditors were also those who audited syndicate accounts. On 10 December 1984 the Council passed The Syndicate Audit Arrangements Bye-law (no 10 of 1984) which set out arrangements for a new list of registered auditors, containing all persons entitled to act as syndicate auditors. Again the change from panel to registration has little significance. The important point is that throughout the relevant period auditors were essentially Lloyd's approved.

373. There was thus a regulated audit system. It is of some interest to see the way that Mr Outhwaite viewed the system particularly as regards assessing reserves. It is true that we take this description from a document (his witness statement dated 24 June 1991 in *Stockwell v RHM Outhwaite (Underwriting Agencies) Ltd*) in which Mr Outhwaite was seeking to defend himself against claims that he was negligent in the writing of run-off policies, and he thus had an axe to grind, but we do not think this overall description of the basics will be far from how the system was intended to operate.

"The expression ("IBNR") was current at least by the 1970's; before, people talked about "loadings". The Underwriter calculates the IBNR required, having regard to the type of business he engages in and the length of time experience has shown it takes for claims of that description to taper off to extinction. Having thus ascertained the reserve necessary to pay for outstandings and IBNR claims, the Underwriter is in a position to carry out the reinsurance to close. This involves the Underwriter paying the reserve so established as premium to the next open year of the Syndicate, which in return accepts the prior year's "run off liabilities" to extinction. Any balance is allocated to the closing Syndicate as profit (or loss). The process is repeated 12 months later for the next year, and so on. In performing the RITC the Underwriter is monitored by Auditors appointed by the Agency to safeguard the interest of the Syndicate's Names. The processes that I have described in this paragraph and will describe later in this section have been followed by Underwriters at least back to the early years of this century.

Having said that, there were no rules as such as to the calculation of RITC in 1981 and the approach of the Auditors was to seek to ensure that the Syndicate's reserve was not going to

prove inadequate to deal with the liabilities transferred to the open year. In practice, the RITC was closely linked with the Solvency Test. The Auditors were obliged to certify the solvency of each Name on the open years and this test relied in part on the assumption that the RITC of the closing year was adequate. These alternative tests were therefore laid down in the Audit Instructions issued annually by Lloyd's. I append at RHMO 6 a bundle of instructions from 1979 – 1982. At the relevant time (1981/1982) the tests were

(i) the aggregate of different percentages calculated on net premium income. These percentages varied according to the type of business written and year of account and were known as "Lloyd's minima". These were set on the basis of general market experience with the knowledge of the DTI.

(ii) Estimated outstanding claims including an element to take care of IBNR.

(iii) The amount of the RITC.

The tests were designed inter alia to establish solvency by a comparison between the assets of the Syndicate and cost of winding it up (represented by the highest of the three tests above).

It was feasible to apply to Lloyd's for leave to undercut even the Lloyd's minima where it produced an unrealistically high result. This could happen on, for example, yachting risks.

However, as will be apparent, the Solvency Test and RITC, while theoretically distinct, were in practice closely linked.

The underwriter has an unusual form of dual responsibility as Agent to both the closing Syndicate and the Syndicate reinsuring it to close, which is commented upon elsewhere. His duty is to gauge the reserves as accurately as possible, so that the reserves are sufficient to pay losses but no more. However, on behalf of the new Syndicate he should ensure that the premium they receive does not fall below the required sum. Before 1984, I would have said that the Underwriter had a duty to err on the side of caution in his reserving. In practice, of course, most of the Names on the incoming Syndicate were also on the previous year and the objective was to avoid having to top up those reserves when reserving them in future RITCs. Since 1984, with the introduction of Accounting Bye Law No.7, "the true and fair test" demands that premium and run off liabilities be as nearly matched as possible. This has not really changed the objectives of those concerned as much as caused the Auditors to discharge their role more rigorously. However, although technically this was the Underwriters' duty, it was for many years the practice at Lloyd's to build up reserves. Names by definition are likely to pay the highest rate of tax and especially in the days when that rate was high there was some resistance to distributing high profits most of which went to the Exchequer. A means of avoiding this was to make a generous assessment of the RITC premium, thus carrying forward the profit into the open year in the form of reserves. Therefore there was a distinct tendency to err on the side of caution in assessing the RITC premiums.

In 1982 and 1983, this practice was very widespread but as income tax was reduced the practice became less prevalent. In April 1984 the Inland Revenue set its face against what they considered the practice of over conservative reserving, particularly where a "rollover" (which permitted the return of those reserves at will) was concerned. The current attitude and methodology requires very specific calculation of reserves necessary.

The RITC process described above will not apply only if the run off of the would be closing Syndicate is too uncertain to enable the Underwriter to estimate it. In those circumstances, although as the Agent of the closing Syndicate, the Underwriter devoutly wishes the year to be closed, he cannot in conscience accept on behalf of the incoming year liabilities for which a safe premium (i.e. one which he believes should ensure at least that no loss is sustained by the incoming Syndicate) cannot be assessed. Furthermore, as Agent for the ceding Syndicate he would know that a closing could not be fairly achieved. Accordingly, instead of closing after

36 months, such a year would have to be left open until the outcome became sufficiently certain to allow an RITC to take place.

The point cannot be too strongly emphasised: an Underwriter who does not believe that he can estimate the premium for his RITC (i.e. that he cannot estimate liabilities due on notified claims and the IBNR claims for the ceding year) cannot properly close that year. Conversely, if he does close it, that means that he has, to the satisfaction of himself and his auditors, been able to assess and to provide for all future liabilities, including those not yet known to him, and has been able to arrive at a figure that properly reflects all such liabilities."

Conclusions

374. It is clear that detailed consideration was given each year by the audit department at Lloyd's, the Audit Committee, and the Committee as to the instructions to be given to underwriters and auditors. All this was intended to produce a system that enabled proper RITCs to be produced and proper certification of solvency. But was the system actually producing a result where audit reserves were being calculated in a way that involved the making of a reasonable estimate of outstanding liabilities including IBNRs?

375. We have felt obliged to consider the system in detail but we can answer these questions quite shortly because the facts simply speak for themselves. The mere fact that ultimately, when the R&R was carried out, so many syndicates were shown to be massively under-reserved demonstrates that the system simply had not been producing reasonable estimates of outstanding liabilities over the years. The liabilities which ultimately had to be paid had in fact been incurred before the period with which this litigation is concerned. With the benefit of hindsight it is clear that IBNRs were grossly underestimated throughout the relevant period. This is not an indictment of particular underwriters or particular auditors. We have not explored the way in which estimates were made by individual syndicates or individual auditors. The simple fact is that as it turned out most syndicates were under-reserved. Mr Murray in his evidence said there was no doubt he was under-reserved, and all those involved in the writing of business which included asbestos would, unless they were covered by reinsurance, have to accept the same.

376. In short, through the relevant period the system did not involve the making of a reasonable estimate of outstanding liabilities including unknown and unnoted losses. It follows that the answer to the question posed in paragraph 344 above, namely whether there was in existence a rigorous system of auditing which involved the making of a reasonable estimate of outstanding liabilities, including unknown and unnoted losses, is no. Moreover, the answer would be no even if the word 'rigorous' were removed. The first representation which we found to exist in paragraph 321 above is therefore untrue.

377. In these circumstances the critical question in this appeal is whether Lloyd's had the relevant state of mind. In the case of the first representation Lloyd's state of mind arises in deciding whether the fourth of the ingredients of the tort of deceit set out in paragraph 49 above is established. In this regard the names must establish that when it made the representation Lloyd's knew or believed that the representation was untrue or made it recklessly, careless whether it be true or false.

378. The second representation identified in paragraph 321 above, is that Lloyd's believed that such a system of auditing was in place. Lloyd's state of mind is therefore relevant to the question whether that representation was true. That is essentially the same state of mind as just identified in relation to the first representation. In order to decide whether Lloyd's had that state of mind, it is convenient to consider first the state of mind of those close to the centre of Lloyd's at the relevant time.

VI LLOYD'S STATE OF MIND

Introduction

379. It is clear that there did come a stage when those at the centre of Lloyd's must have appreciated that it was impossible to assess outstanding liabilities for US$ long-tail business including the IBNR factor. Sir David Rowland in his evidence when talking of the dilemma of establishing correct reserves said "And it is obvious to all of us looking backwards that it was not possible". The question is whether the impossibility was appreciated at any stage during the relevant period with which this appeal is concerned. This part of our judgment must be read in conjunction with the summary of facts, and in particular undisputed contemporaneous documents, in Part III above. Some key documents are referred to again and some others are cross-referenced. In addition we have referred to further material, especially from the audit files.

Before the Neville Russell letter

380. The main plank of the names' case is the Neville Russell letter dated 24 February 1982 (see paragraph 157 above). That letter from auditors refers to the "impossibility of determining the liability in respect of asbestosis". Before that date and receipt of that letter there is, as we see it, no sufficient evidence that anyone at the centre of Lloyd's appreciated that the system was not capable of working properly. Salient parts of the evidence relating to this period are mentioned at paragraphs 124 to 148 above.

381. One of the most striking pieces of evidence, if accepted, was Mr Bradley's alleged conversation with Mr Rokeby-Johnson (paragraph 125 above) as to how asbestos was going "to change the wealth of nations". The judge did not accept that evidence. Sir William Jaffray sought to persuade us to reverse the judge's findings relating to the evidence of Mr Bradley. He indeed sought leave to have fresh evidence admitted including a further statement from Mr Bradley supported by statements from Mr Donald Chandler, Mr Alan Richards and Mr Rosenblatt. It was also on this aspect that Sir William put in a detailed attack on the statements of Mr Rokeby-Johnson and Mr Hitchcock which had been admitted at the trial. Reading Mr Bradley's evidence on the transcript we think it is inconceivable that any judge would have placed any weight on what Mr Bradley said. Any attempt to persuade this court to reverse the judge's rejection of Mr Bradley was doomed to failure. We have read the further statements of Mr Bradley, Mr Chandler, Mr Richards and Mr Rosenblatt. Nothing they say would lead us to alter our view as to Mr Bradley's evidence, even if such statements were to be admitted in evidence in the Court of Appeal. It is in any event clear that on the principles in *Ladd v Marshall* [1954] 1 WLR 1489 as now applied under the Civil Procedure Rules these statements ought not to be admitted in the Court of Appeal. The evidence could have been obtained with reasonable diligence for use at the trial.

382. It is true that in 1979 the Committee was advised that auditors had advised that as at 31 December 1978, there were 57 cases where the reinsurance premium charged to close the 1975 and previous years' accounts as at 31 December 1977 had been inadequate; in 1980 the report was of 40 such cases in relation to the next year, but also at the end of 1980 in the context of a discussion at a meeting of the Panel of Auditors in relation to the "outstanding liability test", it was reported that

> "Auditors were confident, however, that with their overall knowledge of the run-off experience of the market as a whole, adequate reserves could be calculated"

At the Audit Committee Meeting on 11 December 1980 discussion is recorded of suggestions by Mr Lawrence, Mr Skey, and Mr Barber concerning reserving for asbestosis, and indeed their concerns (inconsistent it should be emphasised with any lack of good faith) about reserving, and the recommendation was that "Auditors' attention should be drawn to the effect on

reserves of very long-tail business ....".

383. This led to Mr Randall's letter dated 2 February 1981 quoted at paragraph 143 above, and the beginning of exchanges between the Panel and the Committee. The build up of concern during 1981 is recorded in the chronology. It is sufficient for us in this context to draw attention to the following. As at 31 December 1981 it was reported that

" ... as at 31 December 1980 Audit, there was an increase in the number of cases reported, there being 48 cases where the reinsurance premium charged to close the 1977 and previous years' accounts appeared to be inadequate after 12 months; this compared to the 40 cases reported at the audit as at 31st December 1979. Where the deficiencies have been substantial, the Deputy Chairman will be writing to the syndicates concerned to obtain explanations for the inadequacies."

It was also at this stage that in relation to clause 3 of the Audit Instructions it was recommended that the solvency letter should contain specific mention "of the current problem with regard to "latent diseases" (including asbestosis) and "products liability", although the decision ultimately was to refer to latent diseases but make "no specific mention of asbestosis".

384. The decision not to make specific mention of asbestosis in the Audit Instructions has caused suspicion amongst names, and we can understand why. However, there simply cannot have been any doubt in any underwriter's mind or any auditor's mind that latent diseases included asbestosis. During this period auditors sent a questionnaire to their syndicates expressly referring to asbestosis. That demonstrates that the decision not to confine consideration to asbestosis was intended to make sure that underwriters and auditors examined latent diseases generally and did not just concentrate on asbestosis.

385. Thus during the period before 1982 it is clear that the Audit Committee was monitoring inadequacies in the RITCs, and considering the impact of asbestosis on reserving for very long-tail business. To this should be added that although some years had been left open by this stage (see paragraph 200 above) there was nothing to indicate that any unusual number had been left open because of latent liabilities. We accordingly conclude that there is no case that anyone at the centre of Lloyd's appreciated, prior to the receipt of the Neville Russell letter, that even if the system was followed, reasonable estimates of outstanding liabilities simply could not be made. There were undoubtedly concerns about asbestos-related risks, but it was thought that the reserving system would be able to cope

After the Neville Russell letter

386. The background and terms of the Neville Russell letter have been set out at paragraphs 153 to 157 above. It will be in mind that its last paragraph contained an unqualified reference to "the impossibility of determining the liability in respect of asbestos". It was a formal communication sent to the manager of the audit department. The names' case is that from receipt of the Neville Russell letter those who read the letter did realise that there was no way in which the system would allow for a proper estimate of outstanding liabilities because the assessment was simply impossible. In relation to this case they have to say (and do say) that the Murray Lawrence letter of 18 March 1982 to agents (and also the Randall letter to auditors) were written without any honest belief that by following it underwriters and auditors could make proper decisions as to estimating outstanding liabilities, or closing or leaving open accounts or assessing solvency. That would be (and is) an attack on the honesty not only of Mr Lawrence and Mr Randall but of others who attended the Committee meeting on 17 March 1982 and took a decision to send the letters (see paragraphs 168 and 171 above).

387. At the trial the names sought to support the case of dishonesty by suggesting that in fact the Murray Lawrence letter had a limited circulation; that aspect was examined in detail by the

judge and rejected on the facts. Some effort has been made to revive the point. It was dealt with in Mr Goldblatt's written submissions, but not pursued by him orally with much enthusiasm. It was also pursued by Sir William Jaffray and Mr Adams. We are unpersuaded that the judge's findings on this aspect can be attacked, but in any event do not feel that the allegation goes to the nub of what is the names' case. Their case has to be that even though the letter was sent to underwriting agents, those sending it appreciated that even if followed, the result would not be the production of reasonable estimates of outstandings, would not be the taking of proper decisions on the RITC and would not lead to the production of accurate solvency certificates.

388. A further point sought to be made by the names was that a decision was taken at this time that Lloyd's should be kept afloat at all costs, and that the policy should be not to deal with the asbestosis problem once and for all by fixing reserves by reference to the very high figures being suggested by some, but that reserves should be increased progressively over the years – "stairstepping", and that in the meanwhile new recruits should be sought – "recruit to dilute". Some support for the "stairstepping" was obtained from the plain fact that on many syndicates reserves were increased from year to year and from some evidence given by Mr Posgate in *Hongkong Bank of Canada v Levin* on 27 September 1994. Support for the recruit to dilute theory was said to be provided by simply looking at the figures of new names joining and to certain passages in documents where Lloyd's were talking of achieving targets for new names, or seeking to persuade names to join. For instance in an address given by Mr Peter Miller to the General Meeting of Members on 26 June 1985 he is recorded as saying:

"The current turn in the market and our new regulatory regime will be seen by many as compelling reasons for participating in this market. Indeed it seems that is how most perceive the matter. The latest figures show that new applications for membership for 1986 continue to run 20 per cent above the numbers for 1985. At the same time, about 9,000 existing members are asking to increase their premium income limits for next year. It is, as we all know, almost impossible to speak of the "right" time to join the market. That said I believe that this is one of those times."

389. These allegations if right would suggest some form of conspiracy amongst those at the centre. They were rejected by the judge, and on the appeal the conspiracy allegation has not been pursued (at any rate, by the represented names). It is of course right as a matter of fact that if the letters sent by Mr Lawrence and Mr Randall were dishonest in the sense we have suggested, the object would have been to attempt to keep the market going and that would have led to new names being recruited and to the very real possibility that new names would take on the liabilities from the very long-tail business. If there were some separate evidence of a conspiracy, that might go to support the view that the Murray Lawrence letter was written without an honest belief that the system if followed would work. But if there is no such evidence, it adds little to suggest some conspiracy with the objects alleged. If the letter was dishonest it would not matter whether it was sent for good motives i.e. to seek to save the market, and those names already caught by the asbestosis problems in the past years, or whether the motive was to deceive prospective names and so bring in more names to share the burden.

390. Is there any support for the names' case that when the Murray Lawrence letter and the Randall letter were sent, those authorising them did not have an honest belief that the system would work? It is important not to confuse the case on the sending of the Murray Lawrence letter with what the case becomes once that letter is sent. The second aspect of the names' case which relates to the period after March 1982 can accept that the letter was sent in good faith, but involves an examination of how the years then progressed. The question in relation to later years is whether following the sending of the two key letters, further events demonstrated that the system was not working. Thus reliance on what people said or did during the years following March 1982 is of little assistance in answering the question whether the Murray Lawrence letter was sent in good faith or in bad faith.

This letter is being sent to all Panel Auditors."

172. One immediate reaction from a panel auditor appears from an internal memorandum made on 19 March by Mr Holland of Ernst & Whinney:

"Herewith the latest epistle on Asbestosis. I cannot believe that at some stage we are not going to find a Syndicate where this is a major problem. If any partner is unhappy about a particular situation I suggest he lets me know and we will try and organise a PSP type meeting so that a view can be formed and the partner can then talk to his client knowing that he has the full backing of his colleagues.

Of the Syndicates I have seen so far I am pleased at the very responsible manner shown by our clients in dealing with this problem and I am even more delighted at the amount of reinsurance protection that is available."

173. On 2 April 1982 Mr Lawrence wrote an internal memorandum, marked private and confidential, to senior staff at his agency. He referred to the problems of asbestosis and (without going into detail) to the reinsurance protection which he and his colleagues had recently arranged. He wrote,

"We regard these reinsurances very much as 'sleep at night' cover as, in spite of the complexity of the situation (21 major assureds with identifiable insurers into 3 figures) we feel our reserving is conservative in light of the information available to us at this moment in time."

174. On 6 April there was a meeting of the Audit Committee. Mr Randall reported that

" ... a letter had been sent to all Underwriters with regard to Asbestosis. Since that letter had been circulated there had been little or no reaction from the Market."

However the statement of agreed facts (as to the chronology of asbestos-related claims) cites numerous syndicate reports, published during May 1982, which give information as to asbestos-related claims and reserves. Some refer to the advice given by the Committee of Lloyd's in the Murray Lawrence letter.

175. On 28 June 1982 attorney H wrote a long letter to Mr Tayler (as chairman of the AWP) referring to the "enormity" of the asbestos problem. The letter stated that there were about 15,000 pending lawsuits and that they were increasing at the rate of 500 a month. Most of these lawsuits had multiple defendants (the average number of defendants was twenty, according to a later letter). All the correspondence from attorneys at this time reflected the difficulty and expense of managing the claims, especially because of uncertainties as to the principles on which liability and coverage were to be determined. Efforts to resolve these difficulties eventually led (although only after long and complex negotiations) to the establishment of the Asbestos Claims Facility under the so-called Wellington Agreement (see paragraph 230 below).

176. In August 1982 Johns Manville, an industrial company which was facing more claims than any other assured, sought protection under Chapter 11 of the United States federal bankruptcy law. In the following month Conning & Company, an American investment analyst, published a report 'The Potential Impact of Asbestos on the Insurance Industry'. This was a detailed study which appears to have been read, and highly regarded, by many members of the Lloyd's community.

177. The Conning report estimated the entire insurance industry's ultimate liability at

" ... between $4 bn and $10 bn with the lower end of this range appearing most probable at the present time"

It stated,

"Our work suggests that the primary companies which are involved have already done significant reserve strengthening on currently known claims and have also established loss reserves for incurred-but-not-reported claims. In the light of emerging knowledge on the business, we anticipate that additional reserve strengthening may be required in the future. On the other hand we believe that there is a possibility that numerous excess and reinsurance carriers may be greatly understating their potential liabilities for this exposure at the present time."

It identified the American insurance companies thought to be the primary carriers with the largest exposure and added that on an excess basis Lloyd's might have a potentially large exposure. It predicted that claims would peak during the 1980's and would be minimal by 2010.

178. On 1 October 1982 Mr Rokeby-Johnson succeeded Mr Tayler as chairman of the AWP. At about the same time Mr Lawrence made a speech in Chicago to the American Management Association. The speech (as reported in the Lloyd's Log for November 1982) contained an ambiguous reference to

" ... under-reserving – particularly due to the problems of latent disease and other late developing problems"

as one of 'various scenarios' which 'we can all dream up'. He referred to the risk of major insolvencies among insurers as being likely to lead to

" ... increased regulation of our business, which I believe would be extremely harmful to our industry."

179. On 9 December 1982 the Committee of Lloyd's considered the wording of the instructions to auditors. The minutes record,

"The Committee was informed that, for a number of years, comment had been received from Panel Auditors that it was inappropriate to draw their attention to specific Market problems thereby encouraging Auditors to rely upon these advices rather than their own auditing enquiries with their clients. In view of these comments, the Audit Committee had recommended that a number of the items which appeared under Clause 3 of the "White Regulations" should be either deleted or amended."

Certain of the relevant subparagraphs were amended or deleted but that referring to latent diseases was left unaltered.

180. On 10 and 11 December there was a conference at Leeds Castle attended by all or most of those who were to form the first Council of Lloyd's on the coming into force of the 1982 Act on 1 January 1983. The conference appears to have been concerned largely with questions of governance and procedure. There seems to have been no formal discussion of asbestos-related problems.

The Lloyd's Act 1982

181. In this section we cover, with some deviation from chronological sequence, the enactment of the Lloyd's Act 1982 and associated matters. At the beginning of the 1980's the statutory

framework regulating Lloyd's was under review. The Society of Lloyd's traced its origins to the 17th century and was formally established by a deed of association in 1811. Before the enactment of the 1982 Act it was regulated by the Lloyd's Act 1871 as supplemented and amended by three later Acts. Its affairs were managed by its Committee, subject to the ultimate control of the Society in general meeting. The constitution and operation of Lloyd's and its insurance market have been the subject of three inquiries and reports by committees chaired by eminent persons, namely Lord Cromer (1969), Sir Henry Fisher (1980) and Sir Patrick Neill (1987). There have also been numerous internal inquiries, reviews and disciplinary proceedings. The Cromer report (which was not published generally until 1986) was the precursor to a significant increase in the number of external names. The Fisher report was delivered in May 1980 and was the precursor to the 1982 Act, following on an extraordinary meeting of Lloyd's held on 4 November 1980.

182. It is convenient to mention here two topics discussed in these reports which, while not directly relevant to the issues in the appeal, recur frequently in the documentary evidence. These are 'divestment' and 'divorce', as they were often referred to (see paragraphs 8.5 to 8.22 of the Neill report, in a chapter headed 'Conflicts of Interest'). Divestment referred to the separation of ownership and control of managing agents from ownership and control of Lloyd's brokers, and divorce referred to the separation of managing agents and members' agents (whose functions were often combined in a single firm).

183. As regards brokers and managing agents, Cromer had noted conflicts of interest which could not be ignored, but made no firm recommendation for divestment. Fisher discussed the matter at length (chapter 12) and made firm recommendations to achieve, within five years, that no managing agency company should be recognised if there were direct or indirect shareholding links between it and non-Lloyd's insurance interests. Neither Cromer nor Fisher dealt with divorce of managing and members' agents.

184. The Neill report recorded (paragraphs 8.6 and 8.7) the outcome of the Fisher recommendations. When the Bill which became the Lloyd's Act 1982 was before the House of Commons Sir Peter Green argued for the issue of divestment to be left to the new Council, which might be able to avoid conflicts of interest without complete divestment. But that was not accepted and a mandatory provision for divestment within five years was included.

185. As regards divorce Neill did not make any specific recommendation. But the report made a general recommendation which is very pertinent to this appeal (paragraph 8.22):

"Nevertheless, the principle that Names should be able to make fully informed decisions, on the basis of full disclosure by agents of the limits of their independence, is a vital one. We dealt at some length in chapters four and five with the improvements we would like to see in the recruitment process."

186. Those chapters had repeatedly stressed the need for prospective names, and external names after admission, to have access to information and advice. It was stated in paragraph 4.8:

> "From the evidence submitted to us, however, we have identified six aspects of the current system about which there is concern on the part of Names and others closely associated with the Lloyd's market. These are:
>
> (i) the effectiveness of the existing controls over commissions in relation to those introducing new Names:
>
> (ii) the quality of the basic introductory information about membership provided by Lloyd's to prospective Names:

(iii) the sufficiency of the information available to assist Names in making informed choices between agents:

(iv) the level of the means test set by Lloyds':

(v) the absence of any formal 'know your client' rules: and

i. the efficacy of the Lloyd's procedures (and in particular the Rota committee interview) in ensuring that prospective Names are fully aware of the consequences of their decision to join the Society."

187. The 1982 Act (which came into force on 1 January 1983) made extensive changes in the constitution of Lloyd's. It provided for a Council to manage the Society's affairs and to regulate the business of insurance at Lloyd's. The Council was empowered to make byelaws for the proper and better execution of the Society's statutory functions (subject to challenge at a general meeting). The Council at first consisted of 16 working names, 8 external names and 3 names nominated by the Council and confirmed by the Governor of the Bank of England. The 1982 Act also provided for the continuation of the Committee, which consisted of the working names on the Council and to which the Council could delegate certain of its functions.

188. There were also numerous specialised committees whose responsibilities broadly reflected the departmental organisation of the Society's staff. Until 1983 Lloyd's had a department for membership services, whose responsibilities included the introduction of new names, brokers and underwriting agents, and audit. After 1983 these responsibilities (together with regulation) became those of the head of regulatory services. The specialised committees with responsibilities in these areas were as follows:

i. The Audit Committee was a policy and advisory committee reporting to the Committee of Lloyd's on matters affecting the solvency of members and the security of policies. It existed from 1960 until 1983 when it was replaced by the Members' Solvency and Security Committee (renamed in 1986 as the Solvency and Security Committee).

ii. The Membership Committee existed from 1977 until the end of 1985 as a policy and advisory committee on matters relating to membership requirements.

iii. The Accounting and Auditing Standards Committee was set up in 1983, effectively taking over the work of two bodies known as the Fisher task groups 4 and 15. Its functions included defining required standards for accounting and auditing, for reporting of information to names. It was also concerned with the introduction of manuals.

189. There was also an unofficial committee or group known as the 'O' group consisting of the Chairman, the Deputy Chairman, the Chief Executive and heads of departments. It met from time to time and its meetings seem not to have been minuted. Some witnesses suggested that important and confidential matters were considered at its meetings.

190. Section 14 of the 1982 Act conferred on Lloyd's a qualified immunity from suit which has had an important impact on all the litigation against Lloyd's. The relevant provisions of section 14 are as follows:

"(1) This section shall only exempt the Society from liability in damages at the suit of a member of the Lloyd's community.

(2) [defines 'Lloyd's community' so as to include current and past members]

(3) Subject to subsections (1), (4) and (5) of this section, the Society shall not be liable for

damages whether for negligence or other tort, breach of duty or otherwise, in respect of any exercise of or omission to exercise any power, duty or function conferred or imposed by Lloyd's Acts 1871 to 1982 or any byelaw or regulation made thereunder –

(a) in so far as the underwriting business of any member of the Society or the costs of his membership or the business of any person as a Lloyd's broker or underwriting agent may be affected; or

(b) in so far as relates to the admission or non-admission to, or the continuance of, or the suspension or exclusion from, membership of the Society; or

(c) in so far as relates to the grant, continuance, suspension, withdrawal or refusal of permission to carry on business at Lloyd's as a Lloyd's broker or an underwriting agent or in any capacity connected therewith; or

(d) in so far as relates to the exercise of, or omission to exercise, disciplinary functions, powers and duties; or

(e) in so far as relates to the exercise of, or omission to exercise, any powers, functions or duties under byelaws made pursuant to paragraphs (21), (22), (23), (24) and (25) of Schedule 2 to this Act;

unless the act or omission complained of –

(i) was done or omitted to be done in bad faith; or

(ii) was that of an employee of the Society and occurred in the course of the employee carrying out routine or clerical duties, that is to say duties which do not involve the exercise of any discretion.

(4) [no exemption for death or personal injury]

(5) [no exemption for defamation]

(6) ['the Society' includes its officers, employees and delegates]"

191. The position of the Lloyd's market under the general law regulating the conduct of insurance business was covered by special provisions (sections 15(4) and 83 to 86) in the Insurance Companies Act 1982, replacing comparable provisions in the Insurance Companies Act 1974 (which remained in force until 28 January 1983). The most important provisions, so far as now relevant, were in section 83, subsections (4) to (6) of which (as in force during the relevant period) provided as follows:

"(4) The accounts of every underwriter shall be audited annually by an accountant approved by the Committee of Lloyd's and the auditor shall furnish a certificate in the prescribed form to the Committee and the Secretary of State.

(5) The said certificate shall in particular state whether in the opinion of the auditor the value of the assets available to meet the underwriter's liabilities in respect of insurance business is correctly shown in the accounts, and whether or not that value is sufficient to meet the liabilities calculated –

(a) in the case of liabilities in respect of long term business, by an actuary; and

(b) in the case of other liabilities, by the auditor on a basis approved by the Secretary of State.

(6) Where any liabilities of an underwriter are calculated by an actuary under subsection (5) above, he shall furnish a certificate of the amount thereof to the Committee of Lloyd's and to the Secretary of State, and shall state in his certificate on what basis the calculation is made; and a copy of his certificate shall be annexed to the auditor's certificate."

Section 84(1) provided for the general solvency requirements in sections 32, 33 and 35 to apply to "the members of Lloyd's taken together" subject to modifications made by statutory instrument (from January 1983 the Insurance (Lloyd's) Regulations 1983). This was sometimes referred to as the global annual solvency test. Section 86 required an annual statutory statement of business (SSOB) to be filed.

192. Throughout the 1970s and 1980s the number of underwriting names increased year by year. The following figures give a general picture of the increase.

year	number of names
1970	6,001
1976	8,565
1978	14,134
1981	19,137
1985	26,050
1988	33,532

193. By the beginning of the 1980s the Committee of Lloyd's had some concerns about the manner in which external names were recruited. That is reflected in the revised version of its Manual for Underwriting Agents published in 1980:

"The Committee of Lloyd's has been gravely concerned in the past when organisations unconnected with Lloyd's have distributed literature relating to Underwriting Membership and offered to introduce the recipients to Underwriting Agents. There can be no objection to the publication of articles about Lloyd's, provided that the information given is factually correct, but the Committee considers that any attempt to introduce applicants for Membership of Lloyd's other than by the traditional method of personal recommendation by existing Members can do Lloyd's nothing but harm.

.....

It is very important that prospective Members are correctly advised from the time when they first show an interest in Membership. The attention of Underwriting Agents is drawn to the danger of legal action if a Member maintains subsequently that he or she was misinformed at the time of making application."

This part of the Manual also drew attention to regulatory requirements in other jurisdictions.

194. The procedure for candidates' admission as names had always included a personal interview, called a Rota interview (although increasing numbers of candidates led to this procedure being abbreviated at one period). The general purpose of the interview was to ensure that the candidate understood what he or she was undertaking, and to assist in this process Lloyd's

produced an official brochure (the terms of which, in successive editions, are relied on by the appellants). Many names referred in their evidence to the formality and solemnity of the interviews; some described them as intimidating.

195. In 1980 there had been discussion as to whether computer leasing problems should be specifically mentioned to candidates who were proposing to join non-marine syndicates, and the practice was changed so as not to mention them. In 1982 a similar question arose in relation to asbestos risks, and it was a subject of discussion early in 1982, in particular at a meeting of Lloyd's Membership Committee held on 16 March 1982. We will return to this episode.

196. Soon after the 1982 Act had received the Royal Assent, and before it came into force, Lloyd's was shaken by the first two of a series of scandals which came to light between 1982 and 1986. One was the scandal concerning the Alexander Howden group which led to claims for breach of fiduciary duty and misrepresentation against Mr Kenneth Grob and Mr Allan Page (the Chairman and Finance Director respectively of Howden) and other colleagues of theirs. The other, even more notorious, and generally referred to as 'PCW', was concerned with the activities of Mr Peter Dixon and Mr Peter Cameron-Webb and dealings (ostensibly by way of reinsurance) with offshore companies in which they and their associates were interested. It was estimated that at least £29m was misappropriated in this way.

197. The Neill report recorded the investigations established by Lloyd's and commented (paragraph 3.22)

"Apart from these particular matters, however, the investigations drew attention to an absence of understanding on the part of many working members of the principles of the law of agency. The Lloyd's investigators into PCW told the Corporation (in a letter dated 20 January 1984) that it was apparent to them that many members of the Lloyd's community in senior positions 'were not even vaguely aware' of the legal obligations on agents to act at all times in the best interests of their principals, not to make secret profits at their principals' expense and to disclose fully all matters affecting their relationship with their principals."

198. These matters, and the negligence and mismanagement of many Lloyd's agents, are covered in some detail in chapter 24 of the judgment. The Howden and PCW scandals are not directly in issue in these proceedings. But it is easy to understand that the indignation of non-working names who have been ruined should have been further inflamed by the very large sums misappropriated by a handful of Lloyd's insiders. Moreover dealing with these scandals may have made it easier for the authorities at Lloyd's to overlook other problems, and the adverse publicity may have made them preoccupied with their public image.

199. As the judge described in chapters 13 and 14 of his judgment and as we describe below in more detail, insurance business at Lloyd's is undertaken on an annual basis, and the accounts for each year are normally kept open for the next two years and then closed by the process of RITC. If at the end of those two years it is decided not to close the account (normally because it is impossible to make any reasonable estimate of the outstanding risk) the year remains open and the account is said to go into run-off. The traditional Lloyd's system was therefore well-adapted to 'short-tail' business but not well adapted to 'long-tail' business, as asbestos-related risks showed themselves to be.

200. The number of open years increased steadily during the relevant period, especially for non-marine syndicates subject to asbestos-related liabilities. That appears from the following figures (which would need various qualifying footnotes for complete accuracy, but give the general picture without the need for footnotes):

	number of syndicates	total open years	total open years for non-marine syndicates
1978	17	22	7
1979	26	35	20
1980	23	34	20
1981	25	35	20 (6)
1982	33	41	18 (15)
1983	27	40	21 (28)
1984	58	90	43 (53)
1985	65	110	54 (68)
1986	66	102	58 (70)
1987	65	107	62 (75)
1988	71	119	68 (83)

( ) denotes minimum with known latent liability

201. The same trend was reflected in the global results for 1981 to 1985, which (in the same format as at paragraph 133 above) can be summarised as follows (with a repeated caveat as to the time-lag before the results were known):

	overall		general liability	
	underwriting profit (or loss)	investment income & gains	underwriting loss	investment income & gains
	£000	£000	£000	£000
1981	(43.5)	361.4	(195.6)	111.4
1982	(187.9)	442.0	(425.1)	142.7
1983	(114.7)	416.9	(384.4)	143.6
1984	137.7	432.5	(256.9)	134.9
1985	190.5	373.1	(353.7)	123.8

Thus for each year of account the market as a whole made a profit, after inclusion of investment income and gains, but general liability business produced a substantial loss even

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[IRC] [Regulations] [CCH Annotations] [Related Topics -- Federal (for online/internet subscribers)]

Certain Fringe Benefits: Working Condition Fringes: Club dues

Although Code Sec. 274 generally prohibits an employer from deducting club dues paid or incurred after December 31, 1993, the dues disallowance provisions do not apply to dues paid to business leagues, trade associations, chambers of commerce, boards of trade, real estate boards, professional organizations and civic or public service organizations (see ¶14,408A.035).

Often, employers pay the dues of professional organizations on behalf of its employees. If an employer treats the amount paid or incurred for membership in any club organized for business, pleasure, recreation or other social purpose as compensation to the employee, the expense is deductible by the employer as compensation, and the employee may not exclude the amount from his gross income as a working condition fringe benefit (Reg. §1.132-5(s)(1)).

> ***Example (1):*** Loaded Bank provides one of its Vice Presidents, Rich Fortunate, with a country club membership for which it paid $15,000. Loaded Bank treats the $15,000 it paid to the country club on behalf of Rich as compensation to Rich. No portion of the $15,000 is considered as a working condition fringe benefit.

If an employer's deduction for dues paid or incurred for membership in any club organized for business, pleasure, recreation or other social purpose is disallowed under Code Sec. 274(a)(3), the amount of the working condition fringe relating to an employer-provided membership in the club is determined without regard to the application of the deductibility rules of Code Sec. 274 to the employee (Reg. §1.132-5(s)(1)). To be excludable from the employee's gross income, however, the working condition fringe benefit rules must be satisfied. Thus, the cost of the membership dues paid by an employer on behalf of an employee must qualify as a ordinary and necessary business expense by the employee in order for the employee to exclude such amount from his or her gross income. The rules also apply to tax-exempt employers (Reg. §1.132-5(s)(2)).

> ***Example (2):*** Assume the same facts as in Example (1), except that Rich Fortunate substantiates his use of the country club and Loaded Bank does not treat the $15,000 as compensation to Rich. Rich Fortunate keeps detailed records that show the club was used 50% for business purposes. The value of the business use of the club (50%) is considered a working condition fringe benefit. Thus, Rich Fortunate may exclude $7,500 from his gross income. Loaded Bank must report the value of the non-business use of the club, $7,500, as wages subject to withholding for income and employment tax purposes, and Rich must include $7,500 in his gross income.

[Regulations] [CCH Annotations] [CCH Explanations] [Committee Reports] [Current Developments] [Related Topics -- Federal (for online/internet subscribers)]

SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

[Regulations] [CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(a) ENTERTAINMENT, AMUSEMENT, OR RECREATION. —

274(a)(1) IN GENERAL. —No deduction otherwise allowable under this chapter shall be allowed for any item —

274(a)(1)(A) ACTIVITY. —With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

274(a)(1)(B) FACILITY. —With respect to a facility used in connection with an activity referred to in subparagraph (A).

In the case of an item described in subparagraph (A), the deduction shall in no event exceed the portion of such item which meets the requirements of subparagraph (A).

274(a)(2) SPECIAL RULES. —For purposes of applying paragraph (1) —

274(a)(2)(A) Dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

274(a)(2)(B) An activity described in section 212 shall be treated as a trade or business.

274(a)(2)(C) In the case of a club, paragraph (1)(B) shall apply unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business.

274(a)(3) DENIAL OF DEDUCTION FOR CLUB DUES. —Notwithstanding the preceding provisions of this subsection, no deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

[Regulations] [CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(b) GIFTS. —

274(b)(1) LIMITATION. —No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds $25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include —

274(b)(1)(A) an item having a cost to the taxpayer not in excess of $4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer, or

274(b)(1)(B) a sign, display rack, or other promotional material to be used on the business premises of the recipient.

274(b)(2) SPECIAL RULES. —

274(b)(2)(A) In the case of a gift by a partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.

274(b)(2)(B) For purposes of paragraph (1), a husband and wife shall be treated as one taxpayer.

[Regulations] [CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(c) CERTAIN FOREIGN TRAVEL. —

274(c)(1) IN GENERAL. —In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under

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family (within the meaning of section 267(c)(4)). This paragraph shall not apply for purposes of subsection (a)(3).

274(e)(5) EMPLOYEE, STOCKHOLDER, ETC., BUSINESS MEETINGS. —Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

274(e)(6) MEETINGS OF BUSINESS LEAGUES, ETC. —Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under section 501(a).

274(e)(7) ITEMS AVAILABLE TO PUBLIC. —Expenses for goods, services, and facilities made available by the taxpayer to the general public.

274(e)(8) ENTERTAINMENT SOLD TO CUSTOMERS. —Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth.

274(e)(9) EXPENSES INCLUDIBLE IN INCOME OF PERSONS WHO ARE NOT EMPLOYEES. —Expenses paid or incurred by the taxpayer for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient of the entertainment, amusement, or recreation who is not an employee of the taxpayer as compensation for services rendered or as a prize or award under section 74. The preceding sentence shall not apply to any amount paid or incurred by the taxpayer if such amount is required to be included (or would be so required except that the amount is less than $600) in any information return filed by such taxpayer under part III of subchapter A of chapter 61 and is not so included.

For purposes of this subsection, any item referred to in subsection (a) shall be treated as an expense.

[Regulations]

274(f) INTEREST, TAXES, CASUALTY LOSSES, ETC. —This section shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity). In the case of a taxpayer which is not an individual, the preceding sentence shall be applied as if it were an individual.

[Regulations] [CCH Annotations]

274(g) TREATMENT OF ENTERTAINMENT, ETC., TYPE FACILITY. —For purposes of this chapter, if deductions are disallowed under subsection (a) with respect to any portion of a facility, such portion shall be treated as an asset which is used for personal, living, and family purposes (and not as an asset used in the trade or business).

[CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(h) ATTENDANCE AT CONVENTIONS, ETC. —

274(h)(1) IN GENERAL. —In the case of any individual who attends a convention, seminar, or similar meeting which is held outside the North American area, no deduction shall be allowed under section 162 for expenses allocable to such meeting unless the taxpayer establishes that the meeting is directly related to the active conduct of his trade or business and that, after taking into account in the manner provided by regulations prescribed by the Secretary –

274(h)(1)(A) the purpose of such meeting and the activities taking place at such meeting,

274(h)(1)(B) the purposes and activities of the sponsoring organizations or groups,

274(h)(1)(C) the residences of the active members of the sponsoring organization and the places at which other meetings of the sponsoring organization or groups have been held or will be held, and

274(h)(1)(D) such other relevant factors as the taxpayer may present,

it is as reasonable for the meeting to be held outside the North American area as within the North American area.

[CCH Explanations]

274(h)(2) CONVENTIONS ON CRUISE SHIPS. —In the case of any individual who attends a convention, seminar, or other meeting which is held on any cruise ship, no deduction shall be allowed under section 162 for expenses allocable to such meeting, unless the taxpayer meets the requirements of paragraph (5) and establishes that the meeting is directly related to the active conduct of his trade or business and that –

274(h)(2)(A) the cruise ship is a vessel registered in the United States; and

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274(h)(2)(B) all ports of call of such cruise ship are located in the United States or in possessions of the United States.

With respect to cruises beginning in any calendar year, not more than $2,000 of the expenses attributable to an individual attending one or more meetings may be taken into account under section 162 by reason of the preceding sentence.

274(h)(3) DEFINITIONS. —For purposes of this subsection —

274(h)(3)(A) NORTH AMERICAN AREA. –The term "North American area" means the United States, its possessions, and the Trust Territory of the Pacific Islands, and Canada and Mexico.

274(h)(3)(B) CRUISE SHIP. — The term "cruise ship" means any vessel sailing within or without the territorial waters of the United States.

274(h)(4) SUBSECTION TO APPLY TO EMPLOYER AS WELL AS TO TRAVELER. —

274(h)(4)(A) Except as provided in subparagraph (B), this subsection shall apply to deductions otherwise allowable under section 162 to any person, whether or not such person is the individual attending the convention, seminar, or similar meeting.

274(h)(4)(B) This subsection shall not deny a deduction to any person other than the individual attending the convention, seminar, or similar meeting with respect to any amount paid by such person to or on behalf of such individual if includible in the gross income of such individual. The preceding sentence shall not apply if the amount is required to be included in any information return filed by such person under part III of subchapter A of chapter 61 and is not so included.

[CCH Explanations]

274(h)(5) REPORTING REQUIREMENTS. —No deduction shall be allowed under section 162 for expenses allocable to attendance at a convention, seminar, or similar meeting on any cruise ship unless the taxpayer claiming the deduction attaches to the return of tax on which the deduction is claimed -

274(h)(5)(A) a written statement signed by the individual attending the meeting which includes -

274(h)(5)(A)(i) information with respect to the total days of the trip, excluding the days of transportation to and from the cruise ship port, and the number of hours of each day of the trip which such individual devoted to scheduled business activities,

274(h)(5)(A)(ii) a program of the scheduled business activities of the meeting, and

274(h)(5)(A)(iii) such other information as may be required in regulations prescribed by the Secretary; and

274(h)(5)(B) a written statement signed by an officer of the organization or group sponsoring the meeting which includes —

274(h)(5)(B)(i) a schedule of business activities of each day of the meeting,

274(h)(5)(B)(ii) the number of hours which the individual attending the meeting attended such scheduled business activities, and

274(h)(5)(B)(iii) such other information as may be required in regulations prescribed by the Secretary.

274(h)(6) TREATMENT OF CONVENTIONS IN CERTAIN CARIBBEAN COUNTRIES. —

274(h)(6)(A) IN GENERAL. – For purposes of this subsection, the term "North American area" includes, with respect to any convention, seminar, or similar meeting, any beneficiary country if (as of the time such meeting begins) —

274(h)(6)(A)(i) there is in effect a bilateral or multilateral agreement described in subparagraph (C) between such country and the United States providing for the exchange of information between the United States and such country, and

274(h)(6)(A)(ii) there is not in effect a finding by the Secretary that the tax laws of such country discriminate against conventions held in the United States.

274(h)(6)(B) BENEFICIARY COUNTRY. —For purposes of this paragraph, the term "beneficiary country" has the meaning given to such term by section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act; except

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that such term shall include Bermuda.

274(h)(6)(C) AUTHORITY TO CONCLUDE EXCHANGE OF INFORMATION AGREEMENTS. —

274(h)(6)(C)(i) IN GENERAL. —The Secretary is authorized to negotiate and conclude an agreement for the exchange of information with any beneficiary country. Except as provided in clause (ii), an exchange of information agreement shall provide for the exchange of such information (not limited to information concerning nationals or residents of the United States or the beneficiary country) as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares. The exchange of information agreement shall be terminable by either country on reasonable notice and shall provide that information received by either country will be disclosed only to persons or authorities (including courts and administrative bodies) involved in the administration or oversight of, or in the determination of appeals in respect of, taxes of the United States or the beneficiary country and will be used by such persons or authorities only for such purposes.

274(h)(6)(C)(ii) NONDISCLOSURE OF QUALIFIED CONFIDENTIAL INFORMATION SOUGHT FOR CIVIL TAX PURPOSES. —An exchange of information agreement need not provide for the exchange of qualified confidential information which is sought only for civil tax purposes if —

274(h)(6)(C)(ii)(I) the Secretary of the Treasury, after making all reasonable efforts to negotiate an agreement which includes the exchange of such information, determines that such an agreement cannot be negotiated but that the agreement which was negotiated will significantly assist in the administration and enforcement of the tax laws of the United States, and

274(h)(6)(C)(ii)(II) the President determines that the agreement as negotiated is in the national security interest of the United States.

274(h)(6)(C)(iii) QUALIFIED CONFIDENTIAL INFORMATION DEFINED. —For purposes of this subparagraph, the term "qualified confidential information" means information which is subject to the nondisclosure provisions of any local law of the beneficiary country regarding bank secrecy or ownership of bearer shares.

274(h)(6)(C)(iv) CIVIL TAX PURPOSES. —For purposes of this subparagraph, the determination of whether information is sought only for civil tax purposes shall be made by the requesting party.

274(h)(6)(D) COORDINATION WITH OTHER PROVISIONS. —Any exchange of information agreement negotiated under subparagraph (C) shall be treated as an income tax convention for purposes of section 6103(k)(4). The Secretary may exercise his authority under subchapter A of chapter 78 to carry out any obligation of the United States under an agreement referred to in subparagraph (C).

274(h)(6)(E) DETERMINATIONS PUBLISHED IN THE FEDERAL REGISTER. —The following shall be published in the Federal Register —

274(h)(6)(E)(i) any determination by the President under subparagraph (C)(ii) (including the reasons for such determination),

274(h)(6)(E)(ii) any determination by the Secretary under subparagraph (C)(ii) (including the reasons for such determination), and

274(h)(6)(E)(iii) any finding by the Secretary under subparagraph (A)(ii) (and any termination thereof).

274(h)(7) SEMINARS, ETC. FOR SECTION 212 PURPOSES. —No deduction shall be allowed under section 212 for expenses allocable to a convention, seminar, or similar meeting.

[Regulations] [CCH Annotations] [CCH Explanations]

274(i) QUALIFIED NONPERSONAL USE VEHICLE. —For purposes of subsection (d), the term "qualified nonpersonal use vehicle" means any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes.

[Regulations] [CCH Explanations]

274(j) EMPLOYEE ACHIEVEMENT AWARDS. —

274(j)(1) GENERAL RULE. —No deduction shall be allowed under section 162 or section 212 for the cost of an employee achievement award except to the extent that such cost does not exceed the deduction limitations of paragraph (2).

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274(j)(2) DEDUCTION LIMITATIONS. —The deduction for the cost of an employee achievement award made by an employer to an employee —

274(j)(2)(A) which is not a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year which are not qualified plan awards, shall not exceed $400, and

274(j)(2)(B) which is a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year (including employee achievement awards which are not qualified plan awards), shall not exceed $1,600.

274(j)(3) DEFINITIONS. — For purposes of this subsection —

274(j)(3)(A) EMPLOYEE ACHIEVEMENT AWARD. — The term "employee achievement award" means an item of tangible personal property which is —

274(j)(3)(A)(i) transferred by an employer to an employee for length of service achievement or safety achievement,

274(j)(3)(A)(ii) awarded as part of a meaningful presentation, and

274(j)(3)(A)(iii) awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.

274(j)(3)(B) QUALIFIED PLAN AWARD. –

274(j)(3)(B)(i) IN GENERAL. —The term "qualified plan award" means an employee achievement award awarded as part of an established written plan or program of the taxpayer which does not discriminate in favor of highly compensated employees (within the meaning of section 414(q)) as to eligibility or benefits.

274(j)(3)(B)(ii) LIMITATION. —An employee achievement award shall not be treated as a qualified plan award for any taxable year if the average cost of all employee achievement awards which are provided by the employer during the year, and which would be qualified plan awards but for this subparagraph, exceeds $400. For purposes of the preceding sentence, average cost shall be determined by including the entire cost of qualified plan awards, without taking into account employee achievement awards of nominal value.

274(j)(4) SPECIAL RULES. – For purposes of this subsection —

274(j)(4)(A) PARTNERSHIPS. – In the case of an employee achievement award made by a partnership, the deduction limitations contained in paragraph (2) shall apply to the partnership as well as to each member thereof.

274(j)(4)(B) LENGTH OF SERVICE AWARDS. —An item shall not be treated as having been provided for length of service achievement if the item is received during the recipient's 1st 5 years of employment or if the recipient received a length of service achievement award (other than an award excludable under section 132(e)(1)) during that year or any of the prior 4 years.

274(j)(4)(C) SAFETY ACHIEVEMENT AWARDS. —An item provided by an employer to an employee shall not be treated as having been provided for safety achievement if –

274(j)(4)(C)(i) during the taxable year, employee achievement awards (other than awards excludable under section 132(e)(1)) for safety achievement have previously been awarded by the employer to more than 10 percent of the employees of the employer (excluding employees described in clause (ii)), or

274(j)(4)(C)(ii) such item is awarded to a manager, administrator, clerical employee, or other professional employee.

[CCH Explanations]

274(k) BUSINESS MEALS. –

274(k)(1) IN GENERAL. —No deduction shall be allowed under this chapter for the expense of any food or beverages unless —

274(k)(1)(A) such expense is not lavish or extravagant under the circumstances, and

274(k)(1)(B) the taxpayer (or an employee of the taxpayer) is present at the furnishing of such food or beverages.

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274(k)(2) EXCEPTIONS. —Paragraph (1) shall not apply to —

274(k)(2)(A) any expense described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e), and

274(k)(2)(B) any other expense to the extent provided in regulations.

[CCH Explanations]

274(l) ADDITIONAL LIMITATIONS ON ENTERTAINMENT TICKETS. —

274(l)(1) ENTERTAINMENT TICKETS. —

274(l)(1)(A) IN GENERAL. —In determining the amount allowable as a deduction under this chapter for any ticket for any activity or facility described in subsection (d)(2), the amount taken into account shall not exceed the face value of such ticket.

274(l)(1)(B) EXCEPTION FOR CERTAIN CHARITABLE SPORTS EVENTS. —Subparagraph (A) shall not apply to any ticket for any sports event --

274(l)(1)(B)(i) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),

274(l)(1)(B)(ii) all of the net proceeds of which are contributed to such organization, and

274(l)(1)(B)(iii) which utilizes volunteers for substantially all of the work performed in carrying out such event.

274(l)(2) SKYBOXES, ETC. --In the case of a skybox or other private luxury box leased for more than 1 event, the amount allowable as a deduction under this chapter with respect to such events shall not exceed the sum of the face value of non-luxury box seat tickets for the seats in such box covered by the lease. For purposes of the preceding sentence, 2 or more related leases shall be treated as 1 lease.

[Regulations] [CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(m) ADDITIONAL LIMITATIONS ON TRAVEL EXPENSES. —

[CCH Explanations]

274(m)(1) LUXURY WATER TRANSPORTATION. —

[Related Topics -- Federal (for online/internet subscribers)]

274(m)(1)(A) IN GENERAL. —No deduction shall be allowed under this chapter for expenses incurred for transportation by water to the extent such expenses exceed twice the aggregate per diem amounts for days of such transportation. For purposes of the preceding sentence, the term "per diem amounts" means the highest amount generally allowable with respect to a day to employees of the executive branch of the Federal Government for per diem while away from home but serving in the United States.

274(m)(1)(B) EXCEPTIONS. —Subparagraph (A) shall not apply to —

274(m)(1)(B)(i) any expense allocable to a convention, seminar, or other meeting which is held on any cruise ship, and

274(m)(1)(B)(ii) any expense described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e).

[CCH Annotations] [CCH Explanations]

274(m)(2) TRAVEL AS FORM OF EDUCATION. —No deduction shall be allowed under this chapter for expenses for travel as a form of education.

[Regulations] [CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(m)(3) TRAVEL EXPENSES OF SPOUSE, DEPENDENT, OR OTHERS. —No deduction shall be allowed under this chapter (other than section 217) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless —

274(m)(3)(A) the spouse, dependent, or other individual is an employee of the taxpayer,

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274(m)(3)(B) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and

274(m)(3)(C) such expenses would otherwise be deductible by the spouse, dependent, or other individual.

[CCH Annotations] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

274(n) ONLY 50 PERCENT OF MEAL AND ENTERTAINMENT EXPENSES ALLOWED AS DEDUCTION. —

274(n)(1) IN GENERAL. —The amount allowable as a deduction under this chapter for —

274(n)(1)(A) any expense for food or beverages, and

274(n)(1)(B) any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity,

shall not exceed 50 percent of the amount of such expense or item which would (but for this paragraph) be allowable as a deduction under this chapter.

274(n)(2) EXCEPTIONS. —Paragraph (1) shall not apply to any expense if —

274(n)(2)(A) such expense is described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e).

274(n)(2)(B) in the case of an expense for food or beverages, such expense is excludable from the gross income of the recipient under section 132 by reason of subsection (e) thereof (relating to de minimis fringes),

274(n)(2)(C) such expense is covered by a package involving a ticket described in subsection (l)(1)(B),

274(n)(2)(D) in the case of an employer who pays or reimburses moving expenses of an employee, such expenses are includible in the income of the employee under section 82, or

274(n)(2)(E) such expense is for food or beverages —

274(n)(2)(E)(i) required by any Federal law to be provided to crew members of a commercial vessel,

274(n)(2)(E)(ii) provided to crew members of a commercial vessel —

274(n)(2)(E)(ii)(I) which is operating on the Great Lakes, the Saint Lawrence Seaway, or any inland waterway of the United States, and

274(n)(2)(E)(ii)(II) which is of a kind which would be required by Federal law to provide food and beverages to crew members if it were operated at sea,

274(n)(2)(E)(iii) provided on an oil or gas platform or drilling rig if the platform or rig is located offshore, or

274(n)(2)(E)(iv) provided on an oil or gas platform or drilling rig, or at a support camp which is in proximity and integral to such platform or rig, if the platform or rig is located in the United States north of 54 degrees north latitude.

Clauses (i) and (ii) of subparagraph (E) shall not apply to vessels primarily engaged in providing luxury water transportation (determined under the principles of subsection (m)). In the case of the employee, the exception of subparagraph (A) shall not apply to expenses described in subparagraph (D).

[Related Topics -- Federal (for online/internet subscribers)]

274(n)(3) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE. —

274(n)(3)(A) IN GENERAL. —In the case of any expenses for food or beverages consumed while away from home (within the meaning of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (1) shall be applied by substituting "the applicable percentage" for "50 percent".

274(n)(3)(B) APPLICABLE PERCENTAGE. —For purposes of this paragraph, the term "applicable percentage" means the percentage determined under the following table:

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For taxable years beginning in calendar year	The applicable percentage is --
1998 or 1999	55
2000 or 2001	60
2002 or 2003	65
2004 or 2005	70
2006 or 2007	75
2008 or thereafter	80

274(o) REGULATORY AUTHORITY. -The Secretary shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, including regulations prescribing whether subsection (a) or subsection (b) applies in cases where both such subsections would otherwise apply.

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[IRC] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

Disallowance of Certain Entertainment, etc., Expenses: Entertainment Facilities: Facility, defined

Beach-front property owned by the taxpayer was used as an entertainment facility and therefore could not be depreciated. Using an objective test, the court stated that even though the taxpayer conducted business discussions on the property, the fact that the families of his associates accompanied him and his associates to the property rendered the home an entertainment facility and disallowed all claimed deductions.

T.S. Ireland, 89 TC 978, Dec. 44,314.

Property leased by a corporation which held exclusive hunting rights and that had unfettered access to the property was a "facility" within the meaning of Code Sec. 274(a)(1)(B). The corporation was not entitled to deduct its lease payments as business expenses because the payments were an expense for the continuing use of the property that related more to the facility than to the recreational activity. Furthermore, the lease payments were an "item with respect to" a facility within the meaning of Code Sec. 274(a)(1)(B).

Harrigan Lumber Co., Inc., 88 TC 1562, Dec. 43,993.

A corporation was denied deductions for the cost of leasing a ranch for hunting purposes because the ranch constituted an entertainment facility, rather than an activity. The taxpayer's argument that the lease payments were activity costs because the ranch owner's friends occasionally hunted on the property was rejected. The taxpayer dominated the use of the hunting rights and, in substance, enjoyed exclusive rights under the lease.

On Shore Quality Control Specialist, Inc., 71 TCM 2283, Dec. 51,201(M), TC Memo. 1996-95.

A hot air balloon used by a salesperson exclusively for entertaining business professionals constituted a "facility" used in connection with entertaining; thus, deductions claimed "with respect to" the facility were disallowed. The balloon passengers' participation in the flight and the pilot's inability to completely control the flight path did not change the recreational nature of the activity. Therefore, deductions for depreciation, insurance, fuel, and repairs were not upheld. However, expenses for drinks, food and other items were allowed, subject to the percentage limitation.

J.L. Dodd, 63 TCM 3141, Dec. 48,285(M), TC Memo. 1992-341.

Alleged use of a home as an entertainment facility was not substantiated, so the taxes, utility bills and depreciation were not allowable.

A.E. Luetzow, 32 TCM 272, Dec. 31,896(M), TC Memo. 1973-63.

The taxpayer-corporation was denied a loss deduction on the sale of residential vacation property not used in its trade or business because the property was used in connection with an activity generally considered to constitute recreation, entertainment or similar activity under Code Sec. 274. The court also held that Code Sec. 274 applies to losses as well as expenses, and that because the loss was not a deductible item, it could not be offset against other capital gains.

W.L. Schautz Co., CtCls, 78-1 USTC ¶9122, 567 F2d 373.

A cabin on a tract of near wilderness used as a hunting lodge was an entertainment facility, its use was not directly related to the taxpayer's trade or business and the taxpayer was not entitled to deduct miscellaneous items relating to the use of the property. Property on which the cabin was situated, however, was held for the production of income and deductions for road cuts, fire lanes and aerial surveys were allowable. A house and lot owned by the taxpayer corporation and used by its president as a vacation home was an entertainment facility and all deductions relating to the home were properly disallowed.

Oleander Co., Inc., DC, 82-1 USTC ¶9395.

A funeral home corporation was not entitled to deduct expenditures for lake property used at the discretion of the corporation's sole owner for wedding reception costs paid on behalf of its sole shareholder's two daughters. The lake property was used primarily for the benefit of the sole shareholder, not employees, funeral home business was not conducted at the reception, and any goodwill generated was incidental.

W.L. McReavy, 57 TCM 133, Dec. 45,622(M), TC Memo. 1989-172.

Expenses incurred by a family-owned corporation in connection with the use of an island resort for business meetings were deductible because the taxpayer did not own or have exclusive use of the resort during the tax year at issue. Further, the meetings were part of a continuing effort to resolve disputes between its employees and those of its subsidiaries.

IRS Letter Ruling 200041001, October 13, 2000.

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[IRC] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

Contributions and Dues as Business Expenses: Proof of business purpose, club membership

Note: The cases below were decided prior to the repeal of the deduction for club dues by P.L. 103-66 (1993). See ¶8853.025. —CCH.

A retail shoe company was entitled to deduct contributions and dues paid to local clubs and fraternal orders, representation in which resulted in business contacts.

Buck's Booterie, DC, 51-2 USTC ¶9449.

Dues paid to the Cleveland Ad Club by a publishing executive, whose membership was a business proposition, were deductible.

D.R. Hanna, Jr., 10 TCM 566, Dec. 18,381(M).

Dues paid by a lawyer to the following organizations were allowed as business deductions: International Association of Insurance Counsel, Kiwanis Club, American Legion and 40/8, Executive Club, and Junior Chamber of Commerce.

R.R. Williams, Jr., 14 TCM 373, Dec. 20,991(M), TC Memo. 1955-109.

A dentist was denied deductions for Elks Club dues as ordinary and necessary business expenses because he failed to prove that the club was used primarily for the furtherance of his trade or business and that the club membership was directly related to the active conduct of such trade or business.

G.T. Swindle, Jr., 35 TCM 1, Dec. 33,599(M), TC Memo. 1976-1.

Dues paid to two civic associations were not sufficiently related to the conduct of the taxpayer's business of selling industrial lubricants and cleaners as to be considered ordinary or necessary business expenses. There was no evidence to show that the taxpayer's employer required him to belong to the organizations or that he acquired new customers through such memberships.

J.J. Siragusa, 39 TCM 1196, Dec. 36,816(M), TC Memo. 1980-68. Aff'd, CA-2 (unpublished opinion 5/18/81).

Taxpayer, an abstract company, was denied deduction for club dues for its officers belonging to Kiwanis, Rotary, and Fort Worth Clubs. No proof was made that the clubs were joined for business reasons, or, except as to one club, resulted in any particular business.

Home Guaranty Abstract Co., 8 TC 617, Dec. 15,682.

Similarly.

R.L. Simmons, 9 TCM 734, Dec. 17,833(M).

Friedlander Corp., 19 TC 1197, Dec. 19,548.

Utter McKinley Mortuaries, 12 TCM 814, Dec. 19,811(M).

Dues paid to the Kiwanis by taxpayer conducting an office machine business were nondeductible.

P. McWilliams, 9 TCM 866, Dec. 17,901(M).

Payments to the Georgia Motor Club were nondeductible personal expenses.

C.L. Wilson, 22 TCM 914, Dec. 26,217(M), TC Memo. 1963-188. Aff'd on other issues, CA-5, 65-1 USTC ¶9179, 340 F2d 609. Cert. denied, 382 US 108.

Dues paid to the Optimist Club by an insurance agent, who claimed that membership was useful in promoting his business, were deductible.

A.A. Churukian, 40 TCM 475, Dec. 37,012(M), TC Memo. 1980-205.

Air force association dues paid by an Air Force officer are not deductible.

C.A. Harris, 12 TCM 42, Dec. 19,434(M).

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Dues paid by members of the Armed Forces to an officers' or a noncommissioned officers' club are not deductible. Rev. Rul. 55-250, 1955-1 CB 270.

A Marine Corps officer was not allowed to take business deductions for dues or contributions to either an elite flying association or the Officers' Club.

J.R. Fogg, 89 TC 310, Dec. 44,123.

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[IRC] [CCH Explanations] [Related Topics -- Federal (for online/internet subscribers)]

Taxation of fringe benefits

[CCH Explanations]

(a) ***Fringe benefits***

[CCH Explanations]

(1) ***In general.*** —Section 61(a)(1) provides that, except as otherwise provided in subtitle A of the Internal Revenue Code of 1986, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. For an outline of the regulations under this section relating to fringe benefits, see paragraph (a)(7) of this section. Examples of fringe benefits include: an employer-provided automobile, a flight on an employer-provided aircraft, an employer-provided free or discounted commercial airline flight, an employer-provided vacation, an employer-provided discount on property or services, an employer-provided membership in a country club or other social club, and an employer-provided ticket to an entertainment or sporting event.

(2) ***Fringe benefits excluded from income.*** —To the extent that a particular fringe benefit is specifically excluded from gross income pursuant to another section of subtitle A of the Internal Revenue Code of 1986, that section shall govern the treatment of that fringe benefit. Thus, if the requirements of the governing section are satisfied, the fringe benefits may be excludable from gross income. Examples of excludable fringe benefits include qualified tuition reductions provided to an employee (section 117(d)); meals or lodging furnished to an employee for the convenience of the employer (section 119); benefits provided under a dependent care assistance program (section 129); and no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes (section 132). Similarly, the value of the use by an employee of an employer-provided vehicle or a flight provided to an employee on an employer-provided aircraft may be excludable from income under section 105 (because, for example, the transportation is provided for medical reasons) if and to the extent that the requirements of that section are satisfied. Section 134 excludes from gross income "qualified military benefits." An example of a benefit that is not a qualified military benefit is the personal use of an employer-provided vehicle. The fact that another section of subtitle A of the Internal Revenue Code addresses the taxation of a particular fringe benefit will not preclude section 61 and the regulations thereunder from applying, to the extent that they are not inconsistent with such other section. For example, many fringe benefits specifically addressed in other sections of subtitle A of the Internal Revenue Code are excluded from gross income only to the extent that they do not exceed specific dollar or percentage limits, or only if certain other requirements are met. If the limits are exceeded or the requirements are not met, some or all of the fringe benefit may be includible in gross income pursuant to section 61. See paragraph (b)(3) of this section.

(3) ***Compensation for services.*** —A fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services. Refraining from the performance of services (such as pursuant to a covenant not to compete) is deemed to be the performance of services for purposes of this section.

[CCH Explanations]

(4) ***Person to whom fringe benefit is taxable***

(i) ***In general.*** —A taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. If a fringe benefit is furnished to someone other than the service provider such benefit is considered in this section as furnished to the service provider, and use by the other person is considered use by the service provider. For example, the provision of an automobile by an employer to an employee's spouse in connection with the performance of services by the employee is taxable to the employee. The automobile is considered available to the employee and use by the employee's spouse is considered use by the employee.

(ii) ***All persons to whom benefits are taxable referred to as employees.*** —The person to whom a fringe benefit is taxable need not be an employee of the provider of the fringe benefit, but may be, for example, a partner, director, or an independent contractor. For convenience, the term "employee" includes any person performing services in connection with which a fringe benefit is furnished, unless otherwise specifically provided in this section.

(5) ***Provider of a fringe benefit referred to as an employer.*** —The "provider" of a fringe benefit is that person for whom the services are performed, regardless of whether that person actually provides the fringe benefit to the recipient. The provider of a fringe benefit need not be the employer of the recipient of the fringe benefit, but may be, for example, a client or customer of the employer or of an independent contractor. For convenience, the term "employer" includes any provider of a fringe benefit in connection with payment for the performance of services, unless otherwise specifically provided in this section.

(6) ***Effective date.*** —Except as otherwise provided, this section is effective as of January 1, 1989 with respect to

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fringe benefits provided after December 31, 1988. See §1.61-2T for rules in effect from January 1, 1985, to December 31, 1988.

(7) ***Outline of this section.*** —The following is an outline of the regulations in this section relating to fringe benefits:

§1.61-21(a) *Fringe benefits.*

(1) In general.

(2) Fringe benefits excluded from income.

(3) Compensation for services.

(4) Person to whom fringe benefit is taxable.

(5) Provider of a fringe benefit referred to as an employer.

(6) Effective date.

(7) Outline of this section.

§1.61-21(b) *Valuation of fringe benefits.*

(1) In general.

(2) Fair market value.

(3) Exclusion from income based on cost.

(4) Fair market value of the availability of an employer-provided vehicle.

(5) Fair market value of chauffeur services.

(6) Fair market value of a flight on an employer-provided piloted aircraft.

(7) Fair market value of the use of an employer-provided aircraft for which the employer does not furnish a pilot.

§1.61-21(c) *Special valuation rules.*

(1) In general.

(2) Use of the special valuation rules.

(3) Additional rules for using special valuation.

(4) Application of section 414 to employers.

(5) Valuation formulae contained in the special valuation rules.

(6) Modification of the special valuation rules.

(7) Special accounting rule.

§1.61-21(d) *Automobile lease valuation rule.*

(1) In general.

(2) Calculation of Annual Lease Value.

(3) Services included in, or excluded from, the Annual Lease Value Table.

(4) Availability of an automobile for less than an entire calendar year.

(5) Fair market value.

(6) Special rules for continuous availability of certain automobiles.

(7) Consistency rules.