Lloyd's Names Lose Compensation Case

by Katharine Streatfield

The recent Commercial Court decision in the case of *Poole and others v Her Majesty's Treasury* ((2007) 1 All ER (Comm) 255) is significant not just because of the amount of money and government reputation at stake, but also because of the wider implications it may have for public bodies responsible for implementing European law in the UK.

In a judgment handed down on 8th November 2006 by Mr Justice Langley, the claimants, consisting of over 1000 underwriting names at Lloyd's, had their case against the UK government for allegedly failing to implement the First Non-Life Insurance Directive (73/239/EEC) dismissed.

The Court ruled that the substance of what the Names were claiming was a right to have the Insurance Directive implemented into national law. Only the European Community, acting through the European Commission, has the right to require transposition of Directives. Individuals do not, therefore the Names' case failed. The claim would have been time-barred in any event: an analysis of events showed that the Names had been aware of the relevant facts, both as to the alleged regulatory failures which they argued had caused their losses and as to the European requirements, more than six years before bringing their claim.

The claimants' case

The Insurance Directive was adopted by Europe in July 1973, but according to the Names (acting by way of a Group Litigation Order granted in May 2004), it was not properly implemented by the UK until, at the earliest, 1st December 2001 when Part XIX of the Financial Services and Markets Act 2000 came into force.

The Names, all of whom underwrote insurance business at Lloyd's at various times from 1980 to 1996, argued that because the government did not properly implement the Insurance Directive by July 1976 (the Community deadline for implementation), it had failed to ensure that there was an adequate system for ensuring that the reserves of Lloyd's syndicates were sufficient to meet their liabilities. Unsatisfactory levels of reserves for liabilities Incurred But Not Reported (IBNR) inherited under reinsurance to close arrangements came under particular criticism.

The Names claimed that, had the defendants (HM Treasury) acted as it was claimed they should have done, then the existence of very substantial but unquantifiable IBNR liabilities would have been revealed. As a result, the Names further alleged

that they would either not have joined Lloyd's in the first place, or not continued as Names, or alternatively not increased their underwriting. Consequently, they would not have suffered the financial losses they did when, in the late 1980s and early 1990s, the Lloyd's market was forced to pay out billions of pounds for a series of natural disasters and asbestos insurance claims. The Names' losses were estimated at totalling over £1 billion, including their liability to make payments under the Lloyd's Reconstruction and Renewal plan.

The cause of action

The legal basis for the claim was that of state liability in damages under the principles first established by the Court of Justice of the European Communities in Cases C-6 & 9/90 *Francovich and Bonifaci v Italy* ((1991 ECR I-5357).

Those principles provide that a Member State that fails to properly implement Community legislation will incur liability for a breach of Community law where the following elements are established:

1. the rule of Community law infringed is intended to grant rights to individuals; and
2. the breach is sufficiently serious: there was a manifest and grave disregard by the Member State of its discretion; and
3. there is a direct causal link between the breach of the Member State's obligation and the damage suffered by the injured party.

The arguments in defence

The defendants denied the whole of the claim, putting forward the following points in their defence:

1. the Insurance Directive did not entail any grant of rights to individuals;
2. in the event that the Insurance Directive did grant rights to individuals, those rights were limited to a grant to insurers of a right to freedom of establishment (which could be of no use to the claimants since their losses did not arise as a result of infringement of this right);
3. the provisions of the Insurance Directive make the content of any alleged rights impossible to identify and therefore not sufficiently certain;
4. the Insurance Directive was not breached since the obligations it imposed on the UK were properly discharged by the defendants, as the competent authority responsible for implementation;

5. any breach was not sufficiently "manifest and grave" to establish *Francovich* liability in any event;
6. there was no direct causal link between the alleged breaches of the Directive and the damage the claimants claimed to have suffered; and
7. the claims were statute barred under the Limitation Act 1980.

The two key issues for determination

The fourteen day trial addressed the preliminary legal issues, leaving to one side the issue of causation (i.e. that the Directive was not properly implemented, that this was a sufficiently serious failure to justify damages and that it caused the alleged loss – points (4) to (6) above). This left two key matters for the determination of the court:

1. The grant of rights issue: was the Insurance Directive intended to confer rights on the Names?
2. The limitation issue: was the claim time-barred?

In the event, since the claimants' case was adjudged to have failed on the first point, there was no need for the court to also decide the limitation point, but (apparently out of respect for the amount of time and effort spent in preparation on it) Langley J nonetheless decided the second issue as well.

The grant of rights issue

The claimants alleged that the Directive granted them rights in two capacities:

- as insurers, the right to a properly regulated insurance market; and,
- as insureds, rights as beneficiaries of reinsurance to close, inter-syndicate reinsurances and under personal stop-loss policies.

When analysed, the right the Names claimed was, in substance, an entitlement to have the Insurance Directive correctly implemented. However, in the view of Langley J, *Francovich* liability is not about a right to implementation of a Directive *per se*, but rather it is founded on breach of a right which would have been granted as a corollary of correct implementation of the Directive. Since in this instance no such ensuing right existed, the claimants failed to establish that a right had been granted to them under the Directive and therefore there was no basis for their claim.

There were several key components to Langley J's judgment:

- Only the Community has a right to require transposition, individuals merely have the right to claim damages for rights contingent on the

implementation of Directives. As a matter of logic, if *Francovich* liability was interpreted to mean that the Names (and other individuals) had a right to have a Directive implemented, then there would potentially be state liability in damages for any failure to implement a Directive which caused sufficiently serious loss to future claimants. If the interpretation of *Francovich* were to be extended to encompass granting rights to the Names, this could lead to unjustified future results.

- The intention of the Insurance Directive was to ensure the right to freedom of establishment for insurers in Member States, not to confer an entitlement to a specific standard of regulation. It was "fanciful" to suggest that it was intended to bestow rights upon the Names, either as insurers or as insureds. This was demonstrated by the fact that the Insurance Directive proceeds on the assumption that domestic regulation was already in place and that its purpose was to facilitate the development of a single market for the provision of insurance and harmonise *existing* national supervisory provisions.
- The very notion of a grant of a "right to be regulated" is nonsensical. The aim of regulation is not to protect the regulated but rather those to whom they provide their services and / or products. Furthermore, to claim that this right might be granted to *both* insurers and insureds was particularly illogical. Although, as insurers, the Names might be entitled to the right of freedom of establishment and, as insureds, they might be entitled to compensation for failures, neither of these rights would further the Names' current claim.
- The meaning of "protection of third parties" in the Recitals to the Directive was not intended to extend the aims of the Directive beyond its remit of facilitating freedom of establishment for insurers. The reference to third parties is merely intended to ensure that those entitled to the benefit of insurance are not excluded from its scope.

Langley J drew analogies with two contemporary authorities to support his conclusions that the Insurance Directive did not grant the Names a right to implementation.

Three Rivers District Council v Bank of England (No 3)

The relevant issue in this case, ((2003) 2 AC 1), was whether or not the Banking Co-ordination Directive (77/780/EEC) granted BCCI depositors rights to enable them to

recover damages from the Bank of England regarding its supervision of BCCI. As with the Insurance Directive, this Directive was founded on the right of establishment.

In *Three Rivers* the House of Lords held unanimously that, although the Banking Directive dealt with supervisory matters, its *purpose* was to co-ordinate supervision and ensure Member States co-operated with each other. It was not intended to actually prescribe the standards of supervision to be met by the authorities in different Member States. Therefore the Directive did not go so far as to grant the individual rights claimed because this was not necessary to achieve the results intended by the Directive.

Langley J considered that although *Three Rivers* dealt with a different Directive and the Insurance Directive was more prescriptive with regard to supervision, both Directives bore an important common feature. They were both passed on the basis of an assumption that national authorities would *already* be supervising firms and that it was not necessary to prescribe the standards of supervision, merely co-ordinate it. Therefore, the Insurance Directive did not grant individuals any specific rights to be supervised. The Banking Directive did not intend to protect depositors, by analogy neither did the Insurance Directive intend to protect the regulated or insured, making the claimants' submissions that they had been granted rights by the Insurance Directive unsustainable.

Peter Paul and Others v Germany

This more recent case, ((2004) ECR I - 9425): also concerned defective supervision under the Banking Directive. Crucially, it took into account the updates to the Directive, including in particular Directive 94/19/EEC, which made banking supervision more prescriptive (and therefore more analogous to supervision under the Insurance Directive). The fact that, nonetheless the court held that the updated Banking Directive did not give rise to individual rights so as to found state liability further supports the outcome in *Poole*.

In the course of the judgment in *Peter Paul,* the court considered whether the grant of rights to depositors was necessary to achieve the harmonisation objective? Langley J held that the same question was applicable in *Poole* and resulted in the same conclusion: there was no grant of rights to the Names on either basis that they claimed. The Directive did not intend to grant rights to those who would benefit from supervision. Consequently, if those who are intended to benefit from supervision (insureds, depositors) are not granted rights in relation to the solvency of the institutions under supervision, it would be anomalous if those supervised were granted such rights.

Taking the *Three Rivers* and *Peter Paul* judgments together, the court in *Poole* held that the Names would only be granted rights under the Insurance Directive if this was necessary to achieve the result intended by the Directive. The Insurance Directive was aimed at ensuring a right to freedom of establishment. The Names' claims were based on their losses incurred as insurers and not as a result of any breach of their right to freedom of establishment and consequently they could not successfully establish a case for state liability in damages.

The limitation issue

In spite of his decision on the grant of rights point, Langley J went on to evaluate the claimants' arguments on limitation.

Langley J held that the applicable time limit was six years, as prescribed by the Limitation Act 1980, s.2, and that the Names could not rely upon s.14A to delay the point at which time began to run until the time at which they had knowledge of the potential state liability claim.

The court found that the circumstances at Lloyd's were the subject of extensive public debate and media attention and numerous action groups were formed giving the Names access to legal advice. Therefore, between 1992-1997 (more than six years before the claim was brought) the Names knew of the relevant facts and were in a position to seek advice and did so.

Langley J pointed out that the fact that the Names did not know they had a claim for state liability until later could not be used to rely upon the Limitation Act, s.14A, since knowledge of legal rights is not what determines when time begins to run under the Limitation Act. The intention behind section 14A was to prevent injustice for claimants whose claims were based on latent damage. The emphasis is on knowledge of damage, not on legal expertise. The Names had the relevant knowledge to trigger an inquiry early on, especially given the high profile nature of the situation.

In particular, Langley J held that it would be counter-intuitive if section 14A had the effect of enabling claimants with weaker, less obvious claims to have longer periods in which to pursue them. This was especially so given the rationales of certainty and the risks of injustice in trying stale claims which limitation periods exist to preserve. Furthermore, the lack of legal advice suggesting the Names had a state liability claim earlier on was further evidence to support the conclusion in relation to the grant of rights issue.

Therefore, even if the Names had established that the Insurance Directive granted them individual rights, their claims would have been out of time under domestic law and this was held not to breach any European law requirement.

Commentary

The judgment in *Poole* has significant implications for several classes of people, most notably:

1. The government and public bodies responsible for implementing and regulating under European Directives;
2. Those subject to regulation, e.g. insurance firms;
3. The intended beneficiaries of regulation e.g. consumers.

Implications for Government and regulatory authorities

For the government and HM Treasury, the judgment was of immediate importance because of the very serious nature of the allegations made against them by the Names and the very large sums of money claimed (the indicative claim was for in excess of £1 billion). Langley J's judgment vindicated the government's stance in denying liability for the losses suffered by the Names by explicitly affirming that the Department of Trade and Industry (which was responsible for insurance regulation until 1997) had neither misled the Names nor lulled them into a false sense of security. Furthermore, it was stated that this was not a case where the government could be held responsible for the Names' delay in bringing the action.

HM Treasury have welcomed the result and said that the Names' case was based on a misunderstanding of the obligations of EU Member States under European law.

Regulated firms and individuals

The decision in *Poole* also has ramifications for UK firms and individuals subject to regulation which originates in Europe. The purpose of the Insurance Directive as determined in *Poole* was not to protect those who were regulated, as was claimed by the Names. Langley J's judgment strongly suggested that this would be an illogical aim of any similar Directive. Therefore, future cases on that basis seem destined to struggle. However, the judgment did acknowledge that different rights might be granted to those subject to regulation, such as the right to establish, suggesting that future claims by regulated firms and individuals are more likely to succeed if founded on that basis.

These consequences may be limited to the Insurance Directive under consideration in *Poole* and other early European Directives. This is because in this Insurance Directive the main aim was to develop an open market and harmonise pre-existing national supervisory provisions. Other early Directives addressing other areas of regulation are likely to have similar purposes and therefore have similar limitations on the rights they may grant to those regulated.

However, this does not rule out the possibility that other Directives may in future be held to grant rights to certain standards of regulation to those regulated, but perhaps only where, for example, the Directive in question sets out specific standards of regulation that domestic authorities must meet as its intention. Whether or not this materialises will also depend on the content of and intention behind future European legislation. Directives could continue to have more general intentions of facilitating an open market or they could aim at more exacting standards of regulation.

Implications for intended beneficiaries of regulation

On the other hand, regulators should be aware of the fact that the prospects of successful claims against regulatory authorities by consumers are unlikely to have been diminished by this judgment. Langley J left open the possibility that the Insurance Directive has other intentions beyond just providing insurers with a right to freedom of establishment. He specifically distinguished the situation of insureds from that of insurers, making it possible that in future a claim (by insureds) could be founded on the basis that the Insurance Directive was also intended to protect consumers. In *Poole*, Langley J referred to the fact that this aim is mentioned in the preamble to the Directive but found that this could not help the Names, since they suffered their losses as insurers rather than as insureds, and so its existence or not was not relevant to determining the grant of rights issue.

It is therefore possible that in other cases, where a consumer claims an entitlement to protection *Poole* may be distinguishable, giving consumers better prospects of success in a claim against a Member State.

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