**BRITISH EQUITABLE ASSURANCE COMPANY**

***V.***

**BAILY**

HOUSE OF LORDS

 15TH DAY OF DECEMBER, 1905

**LEX (1905) – UKHL 578**

OTHER CITATION(S)

[1905] UKHL 578

43 SLR 578

**BEFORE THEIR LORDSSHIP**

MACNAGHTEN, ROBERTSON, AND LINDLEY

**BETWEEN**

BRITISH EQUITABLE ASSURANCE COMPANY – Appellant

AND

BAILY – Respondent

**ORIGINATING COURT**

THE COURT OF APPEAL IN ENGLAND

HIGH COURT (Kekewich, J., Presiding)

**REPRESENTATION**

LEVETT, K.C.—WHINNEY – For Appellants

P. O. LAWRENCE, K.C. For the Respondent

GATEY. AGENTS— H. GOVER & SON, Solicitors for all Parties

**ISSUES FROM THE CAUSE(S) OF ACTION**

INSURANCE AND ASSURANCE LAW:- Subject Company — Life Assurance Company — Assurance Policy — Construction — Effect of Prospectus on Terms of Policy — Participation in Profits — Change of Regulations.

**CASE SUMMARY**

ORIGINATING FACTS

The deed of settlement of an insurance company founded in 1854 provided that its profits were to be divided as directed by its bye-laws, and that its bye-laws could be altered by other byelaws.

In 1886 the bye-laws provided that the whole profits made in the mutual branch were to be divided among the policy-holders in that branch. In that year the company issued to the respondent a policy entitling him to £400 on death, and “all such other sums, if any, as the said company by their directors may have ordered to he added to such amount by way of bonus or otherwise according to their practice for the time.” There was nothing further in the policy or the proposal which could be construed into a contract by the assurance company to pay anything beyond the £400, and the respondent's proposal for insurance was made on a form in which he expressly agreed to “conform to and abide by the deed of settlement and bye-laws, rules, and regulations of the company in all respects.”

The respondent, however, had taken his policy relying upon a prosspectus issued by the company, which stated:—“The entire profits made by the company in the mutual department, after deducting the expenses, are divided among the policy-holders without any deduction for a reserve fund.” In 1902 the assurance company proposed under the Companies Act 1890 to alter its constitution by becoming registered as a company with limited liability, with a memorandum and articles of association which provided that 5 per cent. of the profits of the mutual department were to be carried to a reserve fund. The proposed change was perfectly competent, looking to the constitution of the company as set forth in the original deed of settlement.

**DECISION APPEALED AGAINST**

Appeal from a judgment of the Court of Appeal ( Williams, Stirling, and Cozens Hardy, L. JJ.), who had affirmed a decision of Kekewich, J.

**MAIN JUDGMENT**

The facts of the case appear sufficiently from the rubric and the judgments of their Lordships.

At the conclusion of the arguments their Lordships took time to consider their judgment.

LORD MACNAGHTEN—

This case raises a question between an insurance company and the holders of participating policies in the company's office. At the suit of a plaintiff suing in a representative character, Kekewich, J., declared that the company ought to continue to distribute the entire profits coming from the participating ranch of its business, after making certain deductions which it is not necessary to specify, among the holders of participating policies. The Court of Appeal has affirmed that order. The judgment of the Court was delivered by Cozens Hardy, L.J. The ground of the decision is expressed in a single sentence—“A company cannot by altering its articles justify a breach of contract.” No one, I should think, would be inclined to dispute the proposition. But, with all deference, that is not the question. The simple question is, what was the contract between the parties? The distribution of profits in this company is governed by a bye-law duly passed in accordance with the provisions of its deed of settlement made in 1854, when the company was competently registered under the Acts then in force.

The deed of settlement contains a clear and distinct provision empowering an extraordinary general meeting to make bye-laws for the government of the company, subject to a proviso that such bye-laws shall not be valid until confirmed by a subsequent extraordinary meeting. It was under this article that the bye-law relating to the allocation of profits in favour of participating policy-holders was made. There is a subsequent article declaring that “the provisions of the deed of settlement and any bye-law of the company may be altered, repealed, or suspended by a bye-law or bye-laws, but not otherwise.” The plaintiff's proposal for insurance was made on a printed form in which the proposer expressly agreed to “conform to and abide by the deed of settlement and bye-laws, rules, and regulations of the company in all respects.” The proposal was accepted. A policy which refers to the proposal was executed. It provides for the payment of the sum assured, and “all such other sums, if any, as the company by their directors may have ordered to be added to such amount by way of bonus or otherwise, according to their practice for the time being.”

The conditions indorsed on the policy provide that the corporate funds, property, and effects of the company as mentioned in the policy, after satisfying all prior claims and charges “according to the provisions of the deed of settlement and the bye-laws of the company for the time being,” shall alone be liable for the payment of the moneys payable under the policy. If there were nothing more it would be absurd to suggest a doubt as to the right of the company to alter its bye-laws in accordance with the provisions of the deed of settlement, however long the practice of the company as to the application of profits might have continued undisturbed. It appears, however, that this company, like all other insurance companies, has been in the habit of publishing a series of tables applicable to participating policies and other policies issued by the office. As usual those tables are prefaced by an attractive prospectus enlarging on the peculiar and extraordinary advantages offered to those who are willing to insure in the office.

Now, the prospectus, under the head of “Mutual Life Assurance Department,” points out the objections to ordinary mutual societies—objections, as it seems to me, mainly, if not entirely, applicable to such societies at starting. It then states that in the British Equitable Assurance Company, which is not a mutual office any more than any other proprietary office which grants participating policies, these defects are avoided. Then follows the statement—“The current expenses of working the company are assessed rateably on the premiums received in the mutual life assurance department”—that is the participating department—“and the general premiums and the entire profits made by the company in the mutual department, after deducting the expenses, are divided among the policy-holders.” It was stated on behalf of the plaintiff, and admitted by the company, that the plaintiff insured in the company in reliance upon the statement contained in the prospectus, and was induced thereby to apply to the company for the grant of the policy in question, and “accepted such policy on the faith thereof, and would not have done so in the absence of such statement.” It is not clear to my mind what is meant by this allegation and admission. Probably it means no more than this—that the plaintiff was attracted to this particular office by its prospectus.

Now the statement in the prospectus was an accurate statement of the position of affairs at the time when the prospectus was brought to the notice of the plaintiff. It will be observed that the prospectus does not purport to give an assurance of any sort that the allocating of profits would never be altered, or to indicate that the system then in use and the practice existing at the time were essential features or fundamental conditions of the constitution of the company. Nobody, I should imagine, would effect an insurance in the belief that the laws and regulations of the office which he selects are immutable. What an insurer relies upon is the character and reputation of the company, and the certainty that no office which hopes to keep its business would think of altering the distribution of its profits to the prejudice of its policy-holders. Such a step would ruin the most flourishing company. It would be suicide. I am at a loss to understand how the Court of Appeal came to the conclusion that the statements in this prospectus constituted a collateral contract, or are to be treated as incorporated in the contract of insurance and so limiting the powers of the company in the full and free exercise of which the plaintiff bound himself to acquiesce. I have not troubled your Lordships by referring to changes in the constitution of the company consequent upon the Act of 1862, or to the proposal now on foot to substitute a memorandum and articles of association for the deed of settlement and bye-laws of the company. The question would, I think, be precisely the same if the proposal were to alter the bye-laws under the provisions of the deed of settlement. I move your Lordships that the appeal be allowed and the action dismissed with costs both here and below.

**LORD ROBERTSON**—

The appellants are an assurance company carrying on the business of assurance in its various departments. Among other branches of their business they issue life policies, the holders of which participate in the profits of the business. The respondent holds one of these policies. He is not a member of the company, and holds no relation to it other than that of a policy-holder. At the time when the respondent's policy was issued—namely, in 1886—the whole of the profits made in this branch, which is called the Mutual and Participating Branch, were divided among the policy-holders in that branch. In 1903 a change was made by altering one bye-law under a power given by another bye-law, and now there is first taken out of the profits provision for a reserve fund, and what is distributed among the policy-holders is the balance, instead of as formerly the whole of those profits. That this change was made in the interests of the company as an institution, and was a matter of sound finance, is not in dispute. That it was competent to the company in terms of its institution, and regularly done, is also not in dispute; and it is therefore unnecessary to go through the various provisions in the deed of settlement and bye-laws.

The case of the respondent is that, standing as he does outside the company, his contractual rights as a policyholder have been violated by the change. The order which he has sought and obtained is a declaration that the appellants ought to continue to distribute the entire profits coming from the Mutual and Participating Branch. Now the whole question in the case is, Did the appellant company contract with the respondent to the effect of depriving themselves of the right which they had under their constitution of making this change? It seems to me not merely that they did not, but that, as part of the contract, the respondent bound himself to take only such profits as should be declared according to the rules of the company as they existed at each declaration of profits.

The policy itself, to which one naturally first looks for the contract, gives no countenance to the respondent's claim, and, on the contrary, limits his rights to the amount assured and “all such other sums, if any, as the said company by their directors may have ordered to be added to such amount by way of bonus or otherwise, according to their practice for the time being.” When we turn to the proposal we find that the respondent signed a declaration that “I agree to conform to and abide by the deed of settlement, and bye-laws, rules, and regulations of the company in all respects.” The only express reference to profits contained in the proposal is in the eleventh question, “If in the Mutual Department are any profits which may be declared to be appropriated by way of addition to the policy, or reduction from the future premiums, or making the policy payable during lifetime?” The answer was, “By way of addition.” The third question is, “Sum to be assured and for what term?” and the answer is, “£400 payable under table A.” Now, table A is all figures except the following words at the top “Annual premiums to assure a sum of money at death, with profits in addition;” and at the bottom, “The entire profits divided triennially.” I have now stated everything bearing on the subject that is to be found in the policy, the proposal, and the only document referred to in these instruments, namely, table A. These seem to me to constitute the contract, and they negative the respondent's case and establish that of the appellants. But the Court of Appeal and the learned Judge whose judgment they affirmed have felt themselves entitled to decide the case not on those documents but on the prospectus which was shown to the respondent before he made his proposal.

The theory of Kekewich, J., was that there was a “collateral contract,” while the learned Lords Justices justify the introduction of the prospectus on the somewhat singular ground that inasmuch as table A, which is referred to in the proposal, is to be found in the prospectus, therefore you are entitled to read the rest of the prospectus relating to mutual policies as incorporated in the contract. I am unable to agree in this. We are not here in an action for damages, or for rescission of the contract, and I do not feel entitled when the respondent in his proposal refers to table A to hold him as incorporating all the rest, or part of the rest, of the print in which that table is to be found. The passages in the prospectus on which the Court of Appeal proceed contain a description of the system as *de facto* existing at the time. But it seems to me that the respondent, so far from binding the appellant company to perpetuate that system, has placed himself in the hands of the company to the extent of binding himself to “abide by”—those are the words of the proposal—their rules. There is nothing repugnant or unreasonable in his thus following the fortunes of the company, and this is what he has done. For these reasons I think that the judgments appealed against ought to be reversed.

**LORD LINDLEY**—

This appeal turns entirely on the contracts entered into between the insurance company and its participating policy-holders represented by Mr Baily. The contracts are contained in the policies issued to them. It is contended that the applications for these policies were based on the faith of prospectuses containing statements and holding out inducements which preclude the company from making alterations in the mode of applying their profits without the consent of the policy-holders. If these gentlemen were seeking to rescind or rectify their contracts on the ground of fraud or mistake, or were suing for damages occasioned by fraudulent misrepresentations, it would be legitimate to refer to the statements in the prospectuses on the faith of which they became policyholders. But the complaining policyholders are not doing anything of this sort, and the prospectuses not being referred to in the policies cannot in my opinion be legitimately referred to in order to construe the contracts into which the policy-holders have been induced to enter. These contracts are to be found in the policies themselves. By each policy the company agree to pay to the executors of the assured a fixed sum out of the funds of the company, “and all such other sums, if any, as this company by their directors may have ordered to be added to such amount by way of bonus or otherwise, according to their practice for the time being: Provided always that this policy is made subject to the conditions and regulations hereon indorsed.” That is the contract between the parties, but the indorsed conditions and regulations are part of it, and the fifth is important.

The company was formed as long ago as 1854, andthe object of the fifth regulation is to limit the liability of the members of the company. But the regulation throws light on the position of the policy-holders and on what they can claim under their policies. The fifth indorsed condition or regulation in effect provides that the funds of the company, “after satisfying prior claims and charges according to the provisions of the deed of settlement and bye-laws of the company for the time being, shall alone be liable for the payment of the moneys payable under the policy, and that no shareholder, member, director, or other officer of the company shall be liable to any demand in respect of the policy beyond or otherwise than out of the payment in the manner and at the times provided for by the deed of settlement and the then bye-laws of the company of the amount thus remaining unpaid of the shares held by him.”

The reference to the deed of settlement and bye-laws for the time being is all important, for the bye-laws determine how the profits of the company are to be disposed of, and those bye-laws are subject to alteration from time to time by an extraordinary meeting of the shareholders of the company (see clauses 9, 24, 56 of the deed of settlement). The policy-holders are not shareholders, and have no voice in making or altering bye-laws; but the sum payable under any policy, in addition to the fixed sum mentioned in it, is made by the policy itself to depend upon what the directors may have ordered to be added to such sum, and that depends upon their practice for the time being. The practice of the directors in its turn depends on how the profits are to be ascertained and divided in accordance with the bye-laws, which may be altered from time to time as above pointed out.

I am quite unable to adopt the view taken by the Courts below as to the inability of the company to alter their bye-laws as they have done, and, *inter alia*, to make a sinking fund without the consent of the policy-holders. I can find no contract to that effect. A collateral contract so wholly opposed to the contracts contained in the policies is not, in my opinion, established by the evidence in the case. Of course the powers of altering bye-laws, like other powers, must be exercised *hona fide*, and having regard to the purposes for which they are created and to the rights of persons affected by them. A bye-law to the effect that no creditor or policy-holder should be paid what was due to him would in my opinion be clearly void as an illegal excess of power. But in this case it is conceded that the alteration contemplated and sought to be restrained is fair, honest, and businesslike, and will, in the opinion of the directors and shareholders of the company, be beneficial as well to the policy-holders as to the shareholders. The sole question is whether such an alteration infringes the rights of the policy-holders. In my opinion it clearly does not. I am of opinion that the appeal should be allowed, and that the action should be dismissed, and that the respondents should pay the costs of the action and of the appeals both here and below.

Judgment appealed from reversed.