

COMMENTS FROM COUNSEL: A LEAK IN THE STATUTORY LIFEBOAT? COMPENSATION FOR LOSS OF PENSION BENEFITS ON EMPLOYER INSOLVENCY

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In this article, Thomas Seymour of Wilberforce Chambers considers the implications of the Court of Appeal's judgment in *Hampshire v Board of PPF and DWP [2016] EWCA Civ 786*, and the effect that the reference to the ECJ might have on the protection of pension benefits.

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A key feature of New Labour's pension legislation of 2004 is the Pension Protection Fund (PPF). Introduced against the background of Article 8 of the Insolvency Directive (*Directive 2008/94/EC*), it was framed to provide compensation for loss of pension benefits on

employer insolvency - 100% benefits for pensioners and 90% benefits for those under normal pension age - with a cap fixed at a level to keep the cost under control and to prevent senior executives and higher earners from manipulating pension schemes to their advantage.

For the past 12 years the PPF lifeboat, funded by the employer levies, has successfully navigated choppy waters, including major employer insolvencies. It was hitherto thought that Article 8 gave member states considerable latitude as to the required system of protection; but in *Hampshire v PPF and DWP [2016] EWCA Civ 786* the Court of Appeal by a majority favoured the view that Article 8, as interpreted by ECJ caselaw, requires at least 50% protection of benefits of all occupational pension scheme members – a result which, as the Court acknowledged, is incompatible with the compensation cap and UK legislation as it stands. If this is correct, the PPF, if not holed below the waterline, has sprung a significant leak. The two key issues as to the meaning of Article 8 and whether it has direct effect in UK law have been referred to the ECJ which is expected to rule on them during 2017/18.

Article 8 of the Insolvency Directive requires member states to ensure that on employer insolvency "necessary measures are taken" to protect current and former employees' interests in respect of accrued rights under occupational pension schemes.

ECJ: ROBINS AND HOGAN CASES

In *Robins and others v Secretary of State for Work and Pensions (Case C-278/05)* the ECJ held that, although Article 8 did not require benefits to be funded in full, and left considerable latitude to member states, the UK's Financial Assistance Scheme (FAS), the precursor to the PPF, under which the applicants (whose non-pensioner benefits ranked behind pensions on winding-up) received only 20% and 49% of their benefits, was non-compliant with Article 8. In *Hogan v Minister for Social and Family Affairs, Ireland (Case C-398/11)* in which the claimant members of the Waterford pension scheme faced losing well over half the value of their pension benefits on the employer's insolvency, the ECJ held that the Irish Government had failed to put in place a scheme compliant with Article 8, as interpreted in *Robins*. Both cases involved claims for *Francovich* damages against the member state, not claims that Article 8 was directly effective. In *Robins* the ECJ held that there was no *Francovich* breach and pointed out that Article 8 did not specify any minimum level of protection; whereas in *Hogan* the ECJ held that when judgment in *Robins* was delivered (25 January 2007) member states were informed that Article 8 required an employee to receive at least half his benefits, and that Ireland's subsequent failure to comply was a sufficiently serious breach for *Francovich* damages purposes.

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HAMPSHIRE V BOARD OF PPF AND DWP

Hampshire v PPF and DWP concerns the Turner & Newell Scheme of which Mr Hampshire was a member, which entered PPF assessment following the qualifying insolvency event in 2006. The statutory valuation of “protected liabilities”, based on PPF compensation, required the trustees to continue to administer the Scheme on the basis of PPF compensation. Mr Hampshire had an early retirement pension following redundancy aged 51 (estimated at £76,000 per year by 2006), which was drastically cut to £19,800 by the PPF compensation cap, because, aged 62, he had not attained normal pension age (65) at the date of insolvency to qualify for 100% benefits. He could not readily claim *Francovich* damages since the insolvency triggering his claim occurred before 25 January 2007. So he challenged the PPF valuation on the basis that Article 8 required at least half of his pension benefits to be protected. The High Court, in upholding the PPF Ombudsman’s rejection of Mr Hampshire’s complaint, interpreted Article 8 and the ECJ decisions as requiring system-compliance rather than minimum protection for every individual. In both cases there was no adequate legislative scheme and very considerable numbers of employees suffered substantial and uncompensated losses of pension entitlement. The PPF by contrast was a carefully designed scheme, taking account of the need for balanced economic and social development (as the Directive required), introduced with a moral hazard rationale, including preventing higher earners from manipulating schemes. Further, the ECJ cases were claims for damages which did not suggest that Article 8 was directly effective.

On Mr Hampshire’s appeal, the Court of Appeal, despite forceful arguments from the PPF and the DWP (who intervened), took a different view. The majority considered that *Robins* did establish “a minimum level of protection that is of universal (and therefore individual) application” (by inference 50 or 50.1%) and that *Hogan* confirmed this (at paragraph 37 of the judgment); but because the statutory scheme under PA 2004 was so different and the cap only affects a small percentage of the membership, the point was not *acte clair*: so it directed a reference to the ECJ of the primary issue as to the meaning of Article 8 as interpreted in those cases. Applying *Marleasing (Case C-106/89)* principles, the Court of Appeal held (unsurprisingly) that if Article 8 did bear this meaning, it could not be “read down” into PA 2004 as this would remove a fundamental feature of the legislation (the compensation cap). So Mr Hampshire’s own claim could only prevail if Article 8 had direct effect in UK law. Although Article 8 does not specify any minimum

protection, Mr Hampshire argued that its meaning had become precise by 25 January 2007, when judgment in *Robins* was delivered, so that it has direct effect at least from then. Consequently the issue of whether Article 8 has direct effect was also referred to the ECJ.

REFERENCE TO THE ECJ

In the UK, the group affected will be those under normal pension age at the date of employer insolvency with early retirement pensions or deferred benefits which exceed the compensation cap. (Individuals with over 20 years’ service now have a higher cap introduced by the Pensions Act 2014.) It will thus be the higher earning former employees, with benefits exceeding the cap, who stand to benefit from the decision. Such an outcome is surely not what the ECJ necessarily had in mind in *Robins* and *Hogan*.

Given that the ECJ in *Hogan* interpreted *Robins* as a decision that every scheme member must receive at least half his accrued pension benefits, the starting assumption must be that the ECJ will more likely than not reaffirm this interpretation. Yet there remains a powerful counter-argument. *Robins* was previously understood and interpreted, not as a decision requiring minimum protection of every pension scheme member’s benefits, but that FAS, as a system of legislation, did not comply with Article 8. The system-based approach seems consistent with both (a) the lack of specificity in Article 8 and (b) the need, acknowledged in *Robins*, to accord member states latitude as to the measure of protection. There is nothing in Article 8 to imply that protection of 50% or any other proportion of benefits was either necessary or sufficient. Why should 49.9% be non-compliant and 50% be compliant? The account required to be taken of “the need for balanced economic and social development” is not best served by an interpretation requiring the highest earning employees to receive the same proportionate measure of protection as lower paid employees. In *Robins* and *Hogan* the ECJ was not considering a comprehensive national compensation scheme, carefully designed to favour average and lower paid employees with moral hazard and economic and social considerations in mind.

Mr Hampshire’s further argument that Article 8 has direct effect involves the proposition that the ruling in *Robins* on 25 January 2007 authoritatively determined the meaning and effect of Article 8 and so required it to have direct effect and be applied by national courts to pre-existing disputes. But this seems much more doubtful; and it is to be noted that in *Hogan* the ECJ’s consideration only related to non-compliance and

resultant exposure of member states to damages claims.

At all events, the ECJ's decision will surely be of considerable interest not just in the UK but other member states, if the upshot is that member states have a duty to ensure at least 50% protection of benefits for every scheme member on employer insolvency. In the UK, this would - subject to Brexit - in practice necessitate amendment of primary legislation to make the PPF compliant, and an increase in the levy on employers. Even assuming

that Article 8 does not have direct effect, the UK Government would in the meantime be exposed to claims by any affected members for *Francovich* damages to the extent that their pension benefits were reduced to below 50% in consequence of an employer insolvency since 25 January 2007. Such claims will however be subject to a 6 year limitation period which, it is suggested, should run from the date of insolvency.

The views expressed are the author's own and not those of Practical Law.

FURTHER READING

- [Legal update, Hampshire v PPF: Court of Appeal orders reference to ECJ on meaning and direct effect of Article 8 of the Insolvency Directive and Hampshire v Board of the Pension Protection Fund \[2016\] EWCA Civ 786 \(28 July 2016\).](#)
- [Practice note, Pension Protection Fund: overview.](#)
- [Practice note, Seeking a reference to the ECJ.](#)
- [Practice note, EU law and its interpretation in the UK.](#)