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Court of Appeal upholds ruling that PPF compensation cap amounts to unlawful age discrimination (Secretary of State for Work and Pensions and Board of the PPF v Hughes)

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Pensions analysis: The Court of Appeal has unanimously upheld the High Court's first instance decision that the statutory cap on the compensation payable by the Pension Protection Fund (PPF) to pension scheme members who have not achieved normal pension age at the date of their employer's insolvency amounted to unlawful age discrimination by treating them less favourably than those who had waited until their retirement date and were not subject to the cap. However, the court overturned the decision of the lower court that the PPF's approach to calculating compensation for retirees and survivors did not comply with the 2018 ruling by the European Court of Justice (ECJ) in Hampshire v Board of the PPF (C-17/17) that Article 8 of the EU Insolvency Directive requires Member States to guarantee to each individual employee compensation corresponding to at least 50% of the value of his or her accrued pension entitlement in the event of the employer's insolvency.
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Secretary of State for Work and Pensions and the Board of the Pension Protection Fund v Hughes [2021] EWCA Civ 1093

What are the practical implications of this case?

The decision will afford some relief to the PPF in that its post-Hampshire scheme has been upheld as lawful without the need to introduce adjustments which it regarded as administratively cumbersome and expensive. Those affected by the Hampshire 50% ruling comprise both (a) members subject to the compensation cap and (b) members where the bulk of pensionable service was pre-April 1997 and so did not qualify for annual increases under PPF compensation and/or the member lives longer, and inflation proves markedly higher, than actuarially assumed. However, the PPF's success is more limited than appears because the disapplication of the compensation cap means that former capped members will now be entitled to 90% of their PPF entitlement instead of the Hampshire 50% serving as the floor.

The ruling on survivors is significant in that, contrary to the first instance ruling, survivors cannot maintain a free-standing claim to a Hampshire 50% minimum by reference to the scheme benefits they could have claimed. The compensation scheme under the Pensions Act 2004 provides the survivor of any member who dies after the onset of employer insolvency (the date of assessment for PPF purposes) with PPF compensation at half the rate of the periodic compensation payable to the member at the date of death. Under the PPF's interim scheme to provide the Hampshire uplift, survivors of affected members will nevertheless benefit, but only indirectly and to the extent that the member's benefit is greater, as a result of the Hampshire uplift, than it otherwise would have been. Nevertheless, survivors of members subject to the compensation cap will benefit significantly from the disapplication because the half rate periodic compensation to which they become entitled will now be calculated by reference to the uncapped periodic compensation payable to the member at the date of death.

The disapplication of the compensation cap represents a significant victory for the tiny proportion of pension scheme members affected by the compensation cap (also benefiting their survivors as just noted).

At first instance, the judge held that claims against the PPF for cap arrears were subject to a six-year limitation period running from the date each instalment fell due. There are two outstanding limitation issues not ruled upon. One concerns the treatment of any shortfall not paid by the trustees of schemes in assessment and transferred to the PPF as a lump sum. It is considered likely that this is subject to a six-year limitation period from the date of transfer. The other concerns claims for

compensation cap arrears against trustees of schemes in assessment. A claim for cap arrears will, as a claim for arrears of pension entailing recovery of trust property from trustees, not be subject to a defence of limitation under section 21(1)(b) of the Limitation Act 1980 (as held by Morgan J in *Lloyds Banking Group Pensions Trustees v Lloyds Bank* [2018] EWHC 2839 and *Punter Southall Governance Services v Hazlett* [2021] EWHC 1652). Whether trustees will seek, and if so be held entitled, to rely on section 138 of the Pensions Act 2004 (which requires trustees to reduce benefits to the level payable by the PPF had it assumed responsibility) remains to be seen. Were that analysis correct, the unpaid arrears would not, it is thought, cease to be a liability, but would, at the end of assessment, either fall to be added back to the benefit payable to the member on scheme winding-up or form part of the shortfall on a transfer to the PPF.

In the case of occupational pension schemes winding-up outside the PPF, priority is accorded to PPF benefits, as defined. Such benefits will have to be valued and liabilities discharged, taking account both of the Hampshire 50% floor and of the disapplication of the compensation cap.

What was the background?

This was a 'rolled-up' appeal (including permission) by the Department for Work and Pensions (DWP) and the PPF against the decision of Mr Justice Lewis in June 2020 ruling on an application for judicial review of the decision of the PPF to introduce a scheme to apply uplifts to PPF members' benefits following the decision of the ECJ in Hampshire in September 2018 that employee members of occupational pension schemes were entitled to compensation, on the insolvency of the employer, representing not less than 50% of the value of his scheme benefits.

The case also entailed a challenge, both under EU law and ECHR/Human Rights Act 1998, to the statutory compensation cap affecting those (and only those) members who were under the scheme's normal retirement age when the scheme went into assessment. Put simply, by contrast to those over normal pension age, such members receive 90% of a capped benefit, instead of 100% of an uncapped benefit.

Mr Justice Lewis ruled, first, against the DWP that the PPF compensation cap was in breach of Article 8 of the Insolvency Directive (which the ECJ had held in Hampshire has direct effect) on grounds of unjustifiable age discrimination and that it must be disapplied with effect from its enactment in 2005.

The judge accepted the PPF's contention that the interim scheme the PPF had introduced to give effect to the 'Hampshire 50%' could lawfully adopt a one-off actuarial valuation based on the scheme assessment date for calculating the uplift, and rejected the argument that a year-by-year assessment was required to ensure the sum received was no less than 50% than that payable under the scheme in any year. He held the PPF scheme nevertheless to be in breach of Article 8, in that it (i) failed to ensure delivery of 50% of the total amount receivable under the scheme throughout the member's lifetime, specifically in the case of those who lived longer than assumed in the actuarial valuation (the 'Lifetime Payments Test'), and (ii) failed to provide a member's survivors with compensation equivalent to 50% of the scheme benefits to which they would have been entitled.

What did the court decide?

The Court of Appeal dismissed the DWP's appeal, holding on the central issue that it was within the judge's discretion to rule that the compensation cap was not necessary or appropriate to achieve the legislative aims relied upon, and that he had not been wrong in exercising his discretion.

However, after reviewing Article 8 and ECJ caselaw, the court allowed the PPF's appeal, reversing the judge's decision, holding that an uplift to 50% based on the one-off valuation mechanism sufficed to comply with Article 8; that Article 8 did not in addition mandate the delivery of 50% of the precise quantum of the scheme benefit over time; and that as survivors' interests were purely derivative, they had no freestanding right under Article 8 to claim a Hampshire 50% uplift.

Compensation cap: DWP's appeal

The DWP argued first that the judge erred in allowing the challenge out of time. The Court of Appeal held that it was a classic case management decision, properly made, in particular because the issue could have been raised in private law proceedings.

Second, the DWP contended that the decision did not engage EU law and so could not be challenged under the Charter or EU law. The argument was that Article 8, as interpreted by the ECJ in

Hampshire and Bauer, laid down a floor of protection below which Member States may not drop, but left to national courts any protection which sits above that floor, which thus included the modus operandi of the cap. The Court of Appeal rejected this contention, citing with approval the judge's summary that Article 8 was not limited to providing 50% of the value of benefits, and protecting against poverty, but that those were ways in which the obligation to take the necessary measures to protect pension rights is achieved; if a member state adopts other measures to protect pensions, it would still be implementing the obligation in EU law to take the necessary measures, as for example, where different levels of protection were provided for on grounds of nationality, or place of residence or sex or age.

The Court of Appeal concluded that Article 8 covered more than pension rights, and that the legislation and Member States operating in that area were implementing EU law. Caselaw did not compel a different conclusion. In conclusion (at [158]), the court judged that in Hampshire the ECJ was simply making clear that within the Directive and Article 8 'there is a minimum set of rights that could not be placed in jeopardy by national law. The court was not deciding that the 50% threshold amounted to full and exhaustive satisfaction of Article 8.'

Permission to appeal was therefore refused on both grounds.

The DWP's third argument was substantive: that the judge erred in holding that the cap constituted unjustifiable age discrimination (a) by applying the wrong test, (b) by failing to allow a wide margin of discretion, (c) by not focussing on the current PPF scheme, and (d) by distinguishing irrationally between the cap and the 90% limit. Rejecting this argument, the court took as its starting point that, as with a proportionality challenge, the appeal did not warrant a fresh assessment, but was restricted to deciding whether the judge's reasoning was justified and withstood scrutiny. The judge had been correct to resolve any tension between the aim of providing the protection afforded by Article 8 and achieving the legitimate aims sought to be achieved by the compensation cap in favour of the requirements of Article 8.

It was not irrational to distinguish the compensation cap from the 90% cap as the latter cap was appropriate and necessary to achieve the legislative aims, whereas the compensation cap produced, for a small number, very significant further reductions in protection not obviously or materially furthering the legislative aims. The judge was not wrong to hold that a cogent justification was needed for the very serious financial losses that the tiny proportion of employees affected would sustain. They had earned those benefits and the employer's insolvency did not break the chain of causation requiring protection of their interests because Article 8 as interpreted supplied the link.

The DWP argued that it was not the compensation cap as originally enacted but only the current PPF scheme, as amended first in 2017, when a long service cap was introduced, and subsequently to give effect to the ECJ's decision in Hampshire, that needed to be justified. The Court of Appeal rejected this, holding that the judge had been correct in ruling that the cap needed to be justified from the date of enactment onwards. Not only was this approach logically correct, but also the cap had had past effects, as well as present and continuing effects to which mitigations are relevant. A defence of limitation which the judge had ruled applied to claims against the PPF for cap arrears accruing more than 6 years before the claim was issued had the result that significant past losses would not be recovered. Furthermore the injustice to long-serving employees addressed in 2017 only entailed prospective changes, and consequently a number of long-serving employees affected by the cap may recover nothing at all in respect of that injustice.

The DWP accepted that the judge had stated the correct test that the compensation cap had to be a necessary and appropriate means of achieving the legislative aims, but argued that he misapplied the test. The Court of Appeal rejected this argument. While the judge had in some instances used the word 'appropriate', rather than 'appropriate and necessary', he had not misdirected himself. If something was not an appropriate means of achieving a legitimate aim, it did not matter whether or not it was necessary. The word 'appropriate' was used in reference to the appropriateness of the measure, not its necessity.

As to margin of discretion, the judge had expressly recognised and accepted that the state had a wide margin of discretion for all the reasons given by the DWP and accepted; but the policy considerations produced before enactment and relied on by the DWP justified a significantly different policy from that which the DWP tried to justify before the judge, since the cap, as enacted, had been modified in two very significant ways after its enactment. There was no evidence that officials had consciously adverted to the justification for the modified policy position, and the initial policy as enacted had (a) been acknowledged to be unjustified for longer-serving employees and (b) been held unlawful by the ECJ.

PPF's interim scheme: PPF's appeal

The two issues on appeal concerned (a) whether Article 8 required a Lifetime Payments Test or just payment of 50% of the actuarial value of the benefits and (b) whether it required the survivor also to be paid 50% of the benefits they would have received.

Lifetime Payments Test

The Court of Appeal took note of the fact that Article 8 was general, open-textured, broad and gave considerable latitude as to implementation; and that Article 8 referred to the employee or ex-employee's interest in respect of rights to pension benefits, rather than to the benefits themselves: this was consistent with the protection of interests which remained prospective at the date the PPF took on the benefits.

With that in mind, the court held that the judge had misunderstood the 'indications' from the ECJ caselaw. None of the cases led to the conclusion that the obligation was to provide at least 50% of 'the actual value over time of the benefits' as opposed to their 'actuarially predicted value'. The Lifetime Payments Test would require the PPF to check at unspecified times whether the valuation was delivering 50% of the value, and to provide a top up, at least at the end of the pension period. The language in Hampshire and caselaw was consistent with a single prospective valuation of pension rights. The ECJ had used the language of value and valuation, not amount; of 'accrued entitlement', not the benefits themselves; and of 'envisaged growth', not growth and actual circumstances over the pension period. The fact that demographic and economic assumptions used in determining and comparing two future income streams would prove inaccurate did not render a prospective comparison invalid. A system of retrospective valuation would also preclude lump sum compensation, but no ECJ decision indicated that lump sum compensation did not comply with Article 8.

The court noted the judge's reliance on references in Hampshire to 'protection which lasts for the entire pension period' and 'envisaged growth in the pension entitlement throughout that period' but considered that these did not amount to an indication that a one-off determination of value must be subject to an ex post facto comparison, and the terms 'value', 'accrued entitlement' and 'envisaged growth' indicated the contrary. Likewise, the word 'outcome' used by the ECJ in Hogan and relied on by the Claimants related to whether the guarantee could be 50% or lower, not the issues before the judge or on appeal. The court noted finally that the PPF's one-off calculation was not immune from challenge and expressed no view as to how finely tuned the actuarial assumptions used must be to reality, or how broad or narrow might be any margin of judgment or discretion.

Survivors

This issue was relevant to the survivors of members who die after the scheme enters assessment (by contrast, survivors of members who had died beforehand, and are already in receipt of pension, receive PPF compensation based on 100% of their basic scheme entitlement). The court noted the importance of this issue both to individual survivors and to the PPF, which estimated that the judge's decision on survivors would cost about £1bn to implement, though it was unclear if that took account of the ruling on the compensation cap. The PPF argued that its scheme took proper account of survivors' benefits, because the one-off valuation took account of their derivative interests and any shortfall in their benefits would be addressed by the Hampshire uplift to the member's benefit.

The Court of Appeal distinguished between the procedural question as to who could enforce rights to survivors' benefits from what was the content of those rights.

On the first question, the court held that while the member was living, his derivative beneficiaries are not identifiable and had no directly effective rights; conversely, applying Ten Oever and Coloroll, survivors do have directly effective rights once the member dies. The argument that survivors had no such rights was rejected. Article 8 continues to protect the rights of members.

On the second question, the right of the prospective survivor of a member living at the date of the employer's insolvency was purely contingent and inchoate and part of the member's entitlement. Had a freestanding right for the prospective survivor been intended, Article 8 would have been differently expressed. The contributions paid into the scheme for benefits including survivors' rights were reflected in the survivor benefits which were part and parcel of the employee's accrued rights, valued on the assessment date, with the PPF paying the survivor, if any, half the compensation the member was receiving at his death. The right was qualitatively different from the right conferred on the survivor upon the member's death, after the insolvency, which was a directly effective right—to receive at least 50% of what the member was receiving at the date of death. There was no right to return to the

drawing board and calculate the survivor's compensation on the basis of the rules of the original pension scheme.

Case details

- Court: Court of Appeal (Civil Division)
- Judges: Lady Justice Asplin, Lord Justice Green, Lady Justice Elisabeth Laing
- Date of judgment: 19 July 2021

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