Wilberforce Pensions

The Edward Nugee Memorial Lectures

June 2016

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Foreword

There are numerous reasons why pensions law is fascinating. Among them are the fundamental intersections with other areas of law, the necessary interfaces with other professional disciplines, the deep policy issues that unavoidably arise, and its inexorable development including through statutory change.

The four Edward Nugee Memorial lectures given in 2016 illustrate these facets of pensions work. For example, members' rights to information are not only related to a "complex web of statutory obligations" but also involve the application of basic principles of trust law; it is well known that the application of the moral hazard regime throws up intense questions of policy, but it also gives rise to questions in unjust enrichment and statutory accounting; one is assisted in understanding recent developments in the PPF entry rules by going back to the history of company and insolvency law, but the outstanding uncertainty of the ways in which the presence of the PPF and the s.75 framework is to be respected by trustees remains; and the insights of an employer covenant specialist are invaluable for consideration of how to think about DB Schemes on the decline curve.

The lecturers in this year's series have kindly prepared the enclosed notes to accompany their talks, and we hope you find them helpful, interesting and/or provocative.

Jonathan Hilliard QC

James Walmsley

The Speakers

Robert Ham QC

Robert Ham has been ranked as a leading silk in the areas for Pensions, Trusts and Traditional Chancery in Chambers UK. He is described as “incredibly charming, extremely receptive, relaxed and easy to work with”. He combines this amiability with a skill for providing “clear, concise advice” that brings him instruction after instruction.” Chambers & Partners, 2016 describe him as one of the great names of the Chancery Bar who is a noted expert on pensions and trusts cases. His pensions practice is informed by expertise in professional negligence as it relates to the field. “He is very flexible, keen to help and he has a huge knowledge of the subject.”

Paul Newman QC

Paul has regularly advised some of the largest and highest value UK pension schemes and companies on various pensions issues, often of a highly technical nature. He regularly acts for The Pensions Regulator and has been heavily involved in advising on, and appearing in cases relating to, various provisions of the Pensions Act 2004. He also has extensive experience of advising and litigating on various public sector and industry-wide pension schemes.

He is consistently ranked in the legal directories such as The Legal 500 and Chambers & Partners as a leading pensions silk who is “the counsel to go to if you want a clear opinion”. Solicitors praise him for his “superb advice that is delivered in a way that enables clients to move swiftly to a decision” and he is described as “a very impressive advocate, who is extremely good on his feet and very persuasive.”

Jonathan Evans QC

Jonathan has appeared in many of the most significant pensions cases in recent years. He has experience across the whole range of pensions law, including regulatory matters and issues relating to the Pensions Protection Fund. He has acted for a range of clients, from government departments and trustees or employers of major occupational pension schemes to private individuals. He has been instructed both for and against the Pensions Protection Fund and the Pensions Regulator and also by the Pensions Ombudsman and the PPF Ombudsman.

Jonathan Hilliard QC

Jonathan took silk in 2016. He deals with litigation and complex technical advisory work, such as on corporate reorganisations, insolvency and moral hazard issues. He is described in the current Chambers and Partners as "*hugely intelligent*" and "a*n exceptionally talented practitioner who shows great tactical awareness, and is technically very competent".* Recent examples of his reported cases include *Pollock v Reed,* the interlocutory decisions in the *British Airways* litigation, *MNRPF, Box Clever, Lehman, Nortel, Pi v The Pensions Regulator, Becker & Fellowes v The Pensions Regulator, Storm Funding, FSS* and *BT*. He has experience across the range of areas that pensions work crosses over with, being ranked in the directories for pensions, trusts, offshore, traditional chancery and High Net Worth work (Chambers and Partners) and pensions, civil fraud, commercial litigation and private client (Legal 500). Prior to taking silk, he was described in the directories as "*the star pensions junior*" and "*a pensions star*", and they also commented that "*he is excellent at making a complicated case*

seem simple for a judge". He was previously listed as one of the 10 stars of the junior commercial and chancery bar in Legal Week, and as one of the 10 future stars of the Bar in The Times, which commented that "*he has it all- no wonder he's in demand*".

Edward Sawyer

Edward Sawyer was called to the Bar in 2001. He has a commercial and chancery practice, with a specialism in pensions. He has extensive experience of pensions litigation and advisory work, having appeared in a number of high-profile recent cases such as *IBM* (both the rectification and good faith cases), *Nortel, Merchant Navy Ratings* and *Box Clever*. He regularly deals with issues as to scheme funding, section 75 debts, equalisation, rectification, trustee and employer duties, construction, insolvency, regulatory powers, PPF entry and professional liability, amongst other matters. Edward is recommended as a pensions junior in Chambers & Partners and The Legal 500.

Andrew Mold

Andrew has extensive experience in pensions law covering all sizes of matters including proceedings before the Pensions Ombudsman, The Pensions Regulator, the High Court, Court of Appeal and Supreme Court. He regularly acts for trustees, members, sponsoring companies, professional advisors and the regulatory bodies. He has also been instructed in many of the recent leading pension cases especially those considering the use of The Pensions Regulator's powers. Chambers & Partners, 2016 describe him as "an intellectual powerhouse" who is "bright and energetic with an impressive recall and he is fully on top of his subject." A versatile junior who maintains a strong presence in both the traditional and commercial chancery areas.

Thomas Robinson

Tom's practice covers a broad spectrum of pensions litigation, with specialisms in the regulatory sphere and at the intersection between pensions and insolvency. He has been instructed in the main moral hazard cases (Nortel, Lehman Brothers, Bonas, Carrington Wire, MG Rover and Desmond) and advised administrators, employers and others on regulatory matters. He has also acted as counsel to the Determinations Panel of the Pensions Regulator, including in cases concerning skilled persons reports under s.71 of the Pensions Act 2004, the removal of scheme trustees and in the 'Box Clever' case. He has been recommended as a leading junior in pensions and insolvency by The Legal 500 and Chambers UK for several years. Legal 500 2016 describes him as "*One of the best pensions regulatory lawyers in the field*."

James McCreath

James has a growing reputation as an up and coming junior who undertakes a range of pensions litigation and advisory work, where he is instructed on his own as sole counsel and as junior counsel as part of a larger team. He has experience acting for employers, trustees, and members, and in cases across a range of areas in pensions law, including regulatory matters. He has been recommended in Chambers & Partners 2016 for Pensions. The directories recognise his communication skills, his ability to get on top of the details of a case, and his attention to client service. He was "highly recommended" in Legal Week's 2016 'Stars at the Bar'.

Members' Rights to Information

Paul Newman QC and Edward Sawyer

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Members' Rights to Information[1]

Paul Newman QC and Edward Sawyer

Introduction

Just as a common refrain from the lawyer is that the job would be a lot easier without clients, one of the more challenging aspects of being a trustee is having to deal with members. But members are of course as important to trustees as clients are to lawyers, and pension scheme trustees have a responsibility towards protecting the interests of members which is at the heart of their fiduciary duties.

One of the more challenging obligations on trustees and administrators is the provision to members of information about the pension scheme and the members' rights under the scheme. If knowledge is power, then the statutory and common law rights of members to information about the scheme and its workings are amongst members' most powerful weapons, and the trustees' obligations to keep members informed, and to accede to requests by members for information, can be problematic.

There are, broadly speaking, 4 sources of rights members may exercise to seek disclosure of pension scheme documents from the trustees:

(i) various statutory rights to pensions information, most notably under the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ("Disclosure of Information Regulations");

(ii) the equitable jurisdiction of the court to order disclosure of trust documents to beneficiaries;

(iii) rights to access under the Data Protection Act 1998; and

(iv) disclosure of documents in the course of civil litigation under Part 31 of the Civil Procedure Rules.

Most familiar to pensions lawyers are the statutory rights of pension scheme members to information under the Disclosure of Information Regulations, but as we have said these are only part of the information regime which trustees must be aware of.

[1] This paper reflects the law as at 7 June 2016, the date of our Edward Nugee Memorial Lecture on this topic.

In this paper we will consider the rights pension scheme members have to information beyond the Civil Procedure Rules, and we will consider some of the issues arising out of those rights, most notably the extent to which the trustees must disclose legal advice, and the interaction between the members and the trustees in respect of the trustees' decision-making powers.

We will first look at the two principal sources of document disclosure outside of the disclosure of information regulations and rights in litigation: under general equitable principles and under legislation, including the Data Protection Act.

We will then go on to consider the particular issue of how those sources of disclosure interact with the right of trustees to assert legal professional privilege over documents.

Finally, we will consider the trustees' decision-making powers: whether there is a duty on trustees to give and disclose the reasons for their decisions; and whether and to what extent the trustees should consult the members before making decisions.

Members' rights to information – General equitable principles

We will begin by looking at the equitable jurisdiction of the court to order disclosure of trust documents to beneficiaries.

Pre-*Schmidt*

Prior to 2003, the equitable right of trust beneficiaries to disclosure of information and documents relating to the trust was a matter of relatively rigid rules.

(i) The general rule was that a beneficiary of income or capital had the right at all reasonable times to inspect and be furnished with copies of trust documents, as being incidental to the beneficiary's beneficial ownership of the trust property.[2]

(ii) This was subject to an exception, definitively considered in *Re Londonderry's Settlement* [1965] Ch 918, that the trustees were not bound to disclose or allow inspection of documents disclosing the reasons for exercising a power or discretion in a particular way. This reflected

[2] *Re Cowin* (1886) 33 ChD 179.

the principle, which we will come back to later, that trustees are not obliged to disclose the reasons for taking a particular decision.

(iii) Case law established a series of other exceptions relating to particular categories of documents, such as correspondence between trustees or trustees and beneficiaries, or agendas of trustee meetings.

The idea of the right of disclosure as incidental to the beneficial interest of the beneficiary was hard to justify in the face of those exceptions, which were established for reasons of policy rather than principle. Moreover, the beneficial nature of that right sat uneasily with the fact that objects of discretionary trusts had a right of disclosure, even though they did not have any proprietary rights over trust property in the strict sense.[3]

Schmidt v Rosewood

Be that as it may, the property-based concept underlying the right of disclosure was swept away by the decision of the Privy Council in *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26; [2003] 2 AC 709, and replaced with a broader principle of judicial discretion. As Lord Walker of Gestingthorpe, giving the judgment of the Board, concluded (at [66]):

> *a beneficiary's right to seek disclosure of trust documents, although sometimes not inappropriately described as a proprietary right, is best approached as one aspect of the court's inherent jurisdiction to supervise, and where appropriate intervene in, the administration of trusts.*

Although the Board's decision involved an Isle of Man settlement and Manx Law, it was based on English principles and English case law, and has subsequently been endorsed as the correct approach by Briggs J in *Breakspear v Ackland* [2008] EWHC 220 (Ch); [2009] Ch 32 at [52].

So, the general legal principles after *Schmidt* can be summarised as follows.

[3] Indeed, the authorities never fully investigated the extent to which this theoretical basis justified a right of disclosure for beneficiaries who had no proprietary rights in any particular trust property, such as active and deferred members of pension schemes, who have no proprietary rights to scheme assets: *Granada Group Ltd v The Law Debenture Pension Trust Corporation plc* [2015] EWHC 1499 (Ch); [2015] Bus LR 1119 at [53] per Andrews J.

(i) A beneficiary has a right to seek disclosure of trust documents.

(ii) That right is best approached as an aspect of the court's inherent jurisdiction to supervise, and where appropriate intervene in, the administration of trusts.

(iii) A proprietary right is neither sufficient nor necessary to entitle a beneficiary to disclosure of trust documents, because there may be circumstances (especially of confidentiality) in which such an interest is not a sufficient basis for requiring disclosure of trust documents.

(iv) A proprietary right is not necessary because a discretionary beneficiary, including an object of a fiduciary power, may be entitled to protection from the court under its supervisory jurisdiction. But the circumstances in which he may seek protection, and the nature of the protection which he might expect to obtain, will depend on the court's discretion.

(v) *Re Londonderry's Settlement, supra,* and more recent cases have begun to work out in some detail the way in which the court should exercise its discretion in cases where disclosure is sought.

(vi) In exercising that discretion, the court will take account of:

(a) the competing interests of different beneficiaries, the trustees themselves and third parties;

(b) the fact that those competing interests are particularly potent where there are issues or personal or commercial confidentiality involved;

(c) the likelihood of the applicant benefiting materially from the trust; for example, whether a discretionary object, or a beneficiary with a remote or wholly defeasible interest should receive any disclosure at all;[4]

[4] Despite the discretionary nature of the disclosure jurisdiction, it is still necessary for a person to establish as a minimum a prima facie case that he is a beneficiary before there can be any question of the court requiring a trustee to disclose documents *Birdseye v Roythorne & Co* [2015] EWHC 1003 (Ch); [2015] WTLR 961 at [24] per Newey J.

(d) whether competing interests could be protected by limiting or redacting the material released;

(e) whether competing interests could be protected by the giving of undertakings to the court or arrangements for inspection by professionals so as to limit the use to which the material would be put.

This discretionary jurisdiction represents an improvement on the old rigid system, at least in terms of logic and principle, as it avoids the creation of technicalities to justify departures from that system, and allows the court to balance the need for transparency in the trustees' dealings with the need to protect trusts from attempts by beneficiaries to exploit disclosure rights contrary to the interests of the trust as a whole. What it also does, of course, is to make it more difficult to advise in advance on precisely what documents or information will be disclosable and in what circumstances.

Applicability to pension scheme documents

How do these principles apply to pension scheme members and beneficiaries?

Applicability in principle

The first question is whether they apply to those members and beneficiaries at all.

One of the maxims of equity is that "equity follows the law": in the context of legislation, this means that, where a rule of statute law is direct and governs the case or particular point, a court of equity is bound by it and cannot exercise its powers to depart from it.[5]

So, the equitable jurisdiction of the court may be abrogated where Parliament has enacted legislation which is intended to operate as an exclusive code covering that jurisdiction.

An analogy may be drawn with *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518, where the House of Lords held that the duty of trust and confidence implicit in the employer-employee relationship did

[5] Story on Equity (3rd ed., 1920) p. 34; Hanbury & Martin, Modern Equity (19th ed., 2012) para 1-026; see also Turner, Equity and Administration (2016) at p.227 (J.D. Heydon).

not give the employee wider rights in a dismissal situation, because unfair dismissal legislation provided the employee with a more limited remedy for the conduct complained of.

As we have said, pension scheme members have been granted statutory rights to see certain pension documents, under the Disclosure of Information Regulations, either as a matter of right for new or prospective scheme members or on request for existing members. Can it be argued that the limited rights of access to pension documents contained in the Disclosure of Information Regulations constitute a complete code for the provision of trust documents to beneficiaries in a pensions context, thereby ousting the equitable jurisdiction of the court to provide a wider disclosure in that context?

There are no English reported cases of pension scheme members seeking documents under this equitable right,[6] so it remains possible to argue that the equitable jurisdiction is excluded by the Disclosure of Information Regulations.

However, in our view, any such argument is likely to fail, as there is nothing in those regulations to create an exclusive jurisdiction, or otherwise to suggest an intention to oust the equitable jurisdiction of the court. Whereas in *Johnson v Unisys,* the creation of wider common law rights would have undermined the limited jurisdiction of the legislation in precisely the circumstances covered by the legislation, there is nothing in the Disclosure of Information Regulations to suggest that they would similarly be undermined by a wider equitable jurisdiction to order disclosure of pension documents.

This situation is probably closer to the case argued by the employer in the *IBM* remedies hearing,[7] in which it contended that, where a pensions consultation process breached the implied duty of trust and confidence, in circumstances where it would also have breached The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006, that breach did not give rise to a right to financial compensation because those Consultation Regulations only provided for regulatory remedies, and did not provide for individual remedies.

That argument was rejected, on the basis that the statutory scheme for consultation was not intended to be an exhaustive code and did not displace the employees' common law rights, and the fact that

[6] *Schmidt v Rosewood* has been applied in the High Court of Ireland to a claim by pension scheme members for documents relating to the scheme: *Re Irish Express Cargo and Associated Company Retirement Benefit Scheme* [2005] IEHC 118; [2005] 1 IR 519.
[7] *IBM United Kingdom Holdings Ltd v Dalgleish* [2015] EWHC 389 (Ch); [2015] PLR 99.

the statutory scheme did not give the employees any individual remedies at all meant that it was not inconsistent with that scheme for employees to have individual remedies at common law.[8]

Similarly here, failure to comply with the Disclosure of Information Regulations only gives rise to civil penalties which can be imposed by the regulator,[9] and does not give the members any individual remedies against defaulting trustees. There is therefore nothing inconsistent with the common law granting those members rights and remedies which are beyond the scope of the statutory disclosure scheme.

Another case more in point is *The Pensions Regulator v Dalriada Trustees Ltd* [2013] EWHC 4364 (Ch), in which an application by the regulator to remove trustees of a pension scheme under the court's inherent supervisory jurisdiction was defended on the ground that the regulator's statutory powers constituted a comprehensive code for removing pension scheme trustees. Nugee J rejected this argument, holding (at [34]) that:

> *Very clear words would be required to oust the jurisdiction of the court to supervise trusts and if necessary intervene in them. The fact that Parliament conferred alternative powers on the Regulator does not to my mind begin to suggest that Parliament impliedly wished to oust or curtail the existing jurisdiction of the court.*

Similarly here, the Disclosure of Information Regulations contain no clear ouster of the court's inherent supervisory jurisdiction, and should be regarded as an alternative, rather than an exclusive, scheme for the disclosure of pension scheme documentation to members and beneficiaries.

Applicability to death beneficiaries

The other pensions-specific aspect we want to consider concerns the applicability of the equitable disclosure jurisdiction to death beneficiaries, where that disclosure is sought during the lifetime of the member.

Death benefits under pension schemes may take the form of the payment of a lump sum on the death of the member to one or more of a class of objects of a discretionary power vested in the trustees; or they may take the form of an automatic right to benefits on the death of a member for a spouse or

[8] per Warren J at [685]-[688].
[9] Reg.5

child or dependent. These benefits are contingent, and are also defeasible during the lifetime of the member, as they could be destroyed on the transfer of a member's benefits (whether under the governing provisions of the scheme or pursuant to Ch.4 of Part 4 of the Pension Schemes Act 1993) to another retirement benefits arrangement which does not offer death benefits. The contingent and defeasible nature of these benefits is often advanced as a reason why a requirement in a pension scheme for member consent to benefit changes applies to members only, and not to death beneficiaries during the member's lifetime.[10] However there are no English cases where this issue has been the subject of any reasoned decision.

Death beneficiaries are a class of beneficiary whose prima facie rights to disclosure under the equitable jurisdiction have been weakened by the change in the basis for equitable disclosure from an incident of the beneficiary's proprietary right to the exercise of court's supervisory jurisdiction.

(i) Under the pre-*Schmidt* principles, rights of inspection were accorded to objects of discretionary trusts and other contingent beneficiaries, such as beneficiaries of estates in the course of administration,[11] and under those principles, once those rights were accorded, they were as strong as the rights of any other beneficiary of a trust.

(ii) However, under the *Schmidt* principles, in exercising its supervisory jurisdiction, the court may consider that the circumstances of the application – such as the need to maintain confidentiality – outweigh the beneficiary's interest in seeing trust documents.

(iii) In exercising its discretion, the court will also take into account the likelihood of the applicant benefiting materially from the trust; so, the more remote the beneficiary's interest, the weaker the claim the beneficiary may have to disclosure of the documents concerned.

(iv) And the burden probably lies with the beneficiary to prove that his or her prospects of benefitting under the scheme are sufficient to justify an order in his or her favour.[12]

(v) In a pensions context this may justify refusing disclosure of trust documents to the spouse or child of a member who stand to benefit on the death of the member, where that disclosure is sought during the lifetime of the member.

[10] see, eg, Pollard, The Law of Pension Trusts (1st ed., 2013), para 8.147.
[11] *A-G of Ontario v Stavro* (1994) 114 DLR (4th) 750).
[12] Lewin, *supra*, at para 23-076.

So, for example, a claim by a spouse for disclosure of medical reports obtained by the employer in connection with an unsuccessful ill-health early retirement request by a member, where the member has not sought those documents, may be refused on the basis that the spouse's interest remains contingent and indeed defeasible during the member's lifetime, so that that interest does not justify disclosure of what would otherwise be documents which are sensitive and confidential as between the employer and the member.

Scope of court's review

Finally on this aspect, we want to touch on the important issue of the role of the court in supervising the trustees' decision whether or not to disclose trust documents.

Usually, where a power or discretion is vested in the trustees, the court will generally only interfere where the trustees' decision is outside the range of decisions a reasonable body of trustees could make.[13] However, the fact that the disclosure jurisdiction was held in *Schmidt* to be an aspect of the court's inherent jurisdiction to supervise and intervene in the administration of trusts, suggests that the court has a wider discretion than its usual limited role in reviewing trustee decisions. The editors of Lewin on Trusts are of this view.[14]

However, the difficulty with this wider jurisdiction is that it sits uneasily with the fact that any request by a beneficiary for trust documents will generally be made to the trustees initially, so that the trustees will be required to consider that request and exercise their discretion; and, as we will see, in accordance with general principle, trustees are not required to give reasons for their decisions. How, in those circumstances, can the court assess the reasons for the trustees' refusal to disclose documents, on a subsequent challenge by the beneficiary?

It appears that this point influenced Briggs J in *Breakspear v Ackland, supra* to hold that the court's jurisdiction is limited to the usual principles of the review of trustee discretions.
Briggs J identified (at [69]-[71]) 4 different ways in which the disclosure issue may be presented to the court:

[13] *Harris v Lord Shuttleworth* [1994] PLR 47.
[14] (19th ed.) at 23-020.

(i) the trustees may seek to surrender their discretion to the court, in which case (if it permits the surrender, which it is not obliged to do) the court is exercising its own discretion afresh, rather than reviewing any negative exercise of discretion by the trustees;

(ii) the trustees may, without surrendering their discretion, invite the court in effect to bless their refusal to disclose;

(iii) the case may be brought by the disappointed beneficiary by way of a challenge to the trustees' negative exercise of their discretion to disclose;

(iv) the beneficiary may seek simply to invoke an original discretion in the court, as part of its jurisdiction in the administration of trusts.

Briggs J said that the second and third of those types of application involve a review of the trustees' negative exercise of their discretion to disclose:

(i) if the trustees themselves apply, then it is in practice inevitable that they will have to disclose their reasons;

(ii) but if the disappointed beneficiary applies, then the trustees could decline to give reasons, and defend the challenge on the basis that, if it be the case, the disappointed beneficiary has disclosed no grounds for impugning either the fairness or the honesty of their decision, their reasoning being off-limits for that purpose.

Finally, if the disappointed beneficiary seeks to invoke the court's administrative jurisdiction, Briggs J said that it would be incumbent upon him to demonstrate, by reference to whatever facts may be available to him, that an occasion has arisen which called for the interference of the court. A mere refusal to disclose the documents, unaccompanied by reasons or evidence of mala fides or unfairness, would not ordinarily justify such intervention.

The requirement for the beneficiary to put a positive case for the disclosure of the documents, and the ability of the trustees to hide behind a refusal to give any reasons for refusing disclosure, appears to support a relatively limited jurisdiction of the court for interfering in the decision of the trustees not to disclose trust documents. However, this does seem to be inconsistent with the original jurisdiction of the court to intervene in the administration of the trust, which should not be

determined on the basis of a mere burden of proof, but should involve a more investigative process in accordance with the court's general supervisory jurisdiction. It is highly unlikely that the court would approach other aspects of its inherent supervisory jurisdiction on the basis of burden of proof.[15]

Members' statutory rights to information – requirements applicable to trustees in Regulations and the Data Protection Act 1998

The general equitable principles described above are overlaid by a complex web of statutory obligations on pension trustees to provide information to members. [16] This paper will first take a brief look at the pensions-specific obligations, which are mostly to be found in various Regulations applicable to occupational and personal pension schemes. We will then look in more detail at the regime under the Data Protection Act 1998 (the "DPA 1998") which, although not a pensions-specific piece of legislation, imposes significant obligations on pension trustees in relation to member data.

Before turning to the Regulations and the DPA 1998, it is worth making the obvious point that additional disclosure obligations may be placed on the trustees by the terms of the scheme's trust deed and rules. The scope and effect of any such obligations will depend on the construction of the scheme's provisions in the ordinary way.[17]

Trustees' disclosure obligations in Regulations

[15] So, for example, the court may remove a trustee under its inherent jurisdiction if the court is satisfied that that is necessary to enable the trusts to be properly executed, even if specific charges of misconduct levelled by the beneficiaries were not made out: *Letterstedt v Broers* (1884) 9 App Cas 371, 386 per Lord Blackburn.

[16] This paper does not deal with a pension scheme employer's obligations to provide information to members. In general, the obligations on employers to provide information are much less extensive. By way of example, there is the basic obligation on an employer to provide an employee with a written statement of particulars of employment, including particulars of any terms relating to "pensions and pension schemes" (s.1(4)(d)(iii) Employment Rights Act 1996). Other examples include the contracting-out, auto-enrolment and consultation legislation which impose a variety of notification and information duties on employers in relation to pensions. And (potentially) the employer's duty of good faith or other contractual duties might indirectly require employers to keep members informed or at least not mislead them or disappoint reasonable expectations in relation to their pension scheme (see e.g. *Scally v Southern Health* [1992] 1 AC 294, cf. *University of Nottingham v Eyett* [1999] OPLR 55, *Hagen v ICI* [2002] PLR 1, *IBM v Dalgleish* [2014] EWHC 980 (Ch) etc). Such failures by the employer could potentially also amount to maladministration in the eyes of the Pensions Ombudsman (but see the *University of Nottingham* case just cited). For a recent application by the Pensions Ombudsman of the *Scally* duty to inform, see *Bennett (PO-7182)*, 25 April 2016.

[17] By way of example, many scheme amendment powers require notification of members. Whether or not such notification is essential to the validity of the amendment will depend on the interpretation of the power: see for example *Betafence v Veys* [2006] EWHC 999 (Ch) (failure to notify did not invalidate amendment) cf. *Vaitkus v Dresser-Rand* [2014] EWHC 170 (Ch) (obiter: failure of trustee to issue notification to members would have invalidated attempted amendment).

The principal statutory sources of members' rights to information about their pension schemes are s.113 Pension Schemes Act 1993 and s.41 Pensions Act 1995. The detailed requirements under these provisions are now contained in the Disclosure of Information Regulations.

The Disclosure of Information Regulations provide an extensive combined code for disclosure of information to members and other beneficiaries of both occupational and personal pension schemes. But it is not an exhaustive code and, as we will see, additional disclosure obligations arise under other pensions-specific legislation.

It is beyond the scope of this paper to give an account of the detailed provisions of the Disclosure of Information Regulations. In summary, the Regulations impose disclosure obligations on the trustees or managers of an occupational pension scheme, and on the managers of a personal pension scheme, in respect of actives, deferred, pensioners and pension credit members as well as prospective members, dependants and partners. The disclosure obligations cover (*inter alia*) basic information about the terms of the scheme, accounts and funding information, benefit statements, information about options arising under the new DC flexibilities, information about benefits in payment and information about winding up. The Appendix to this paper provides a list of the main topics addressed by the Disclosure of Information Regulations.

Other pensions legislation contains additional disclosure obligations for trustees, examples of which are also contained in the Appendix to this paper. These include disclosure obligations in the fields of pensions tax, protection of early leavers, transfer values, contracting-out, pension sharing on divorce, stakeholder pensions and winding up. Disclosure for the purpose of consultation on changes to pension schemes is discussed later in this paper.

Another source of pensions-specific disclosure obligations is the Financial Services and Markets Act regime: see e.g. Part 20A FSMA 2000 (pensions guidance). For personal pension schemes, the pension provider and intermediaries will be required to comply with the relevant Financial Conduct Authority rules, found in the FCA's Conduct of Business Sourcebook.[18] In addition, personal pension providers should follow the FCA's policy statement PS15/4 (issued on 27 February 2015) on communications with members about retirement options and the guidance guarantee.

[18] COBS 14 (providing product information to clients) contains disclosure and information requirements. Other disclosure rules are contained in e.g. COBS 4 on communications with clients, COBS 6 on provision of information about the firm and its charges, COBS 13 on the preparation of product information, COBS 16 on reporting to clients, COBS 19 on pension transfers and conversions/opt-outs, and so on.

The Pensions Regulator has published several pieces of guidance for trustees and advisers of both DB and DC schemes in relation to disclosure to members.[19] In addition, the recently revised Code of Practice for Incentive Exercises identifies further information that should be provided to members in connection with an incentive exercise, and the Pensions Regulator has stated that it supports the code and will have regard to it in the conduct of any regulatory proceedings in relation to such an exercise.[20]

Disclosure obligations for pension trustees under the DPA 1998

Overview of the Act

The pensions-specific legislation identified above ensures that important "nuts and bolts" information is supplied to members so that they are properly informed about their benefits, options and tax position in the ordinary course of events. What the above legislation does not generally do, however, is entitle members to sensitive information about the internal workings of the scheme or the trustees' thought-processes in situations where a dispute has arisen. For example, there is no obligation under the Disclosure of Information Regulations to provide members with copies of minutes recording the trustees' decision-making on issues affecting individual members, such as decisions on ill-health early retirement or discretionary decisions on individual death benefits. Individual beneficiaries might be able to obtain such information under the general equitable principles discussed earlier in this paper, but they might be deterred by the legal complexities and costs involved. However, the DPA 1998 potentially provides a cheap and simple way for individual beneficiaries to require the trustees to disclose information of this nature, free of the complexities arising under the general equitable rules (though, as we will see, recent case-law has muddied the waters).

We start with a general overview of the operation of the DPA 1998.

The DPA 1998 implements the requirements of EU Directive 95/46/EC. The Act protects "personal data", which are defined as, broadly speaking, computer-processed information relating to a living individual who is identifiable from the data, including any expression of opinion about the individual and any indications of intention in respect of him. The Act also catches some paper-based filing systems. The DPA 1998 applies to the "processing" of personal data, which is widely defined to cover almost any conceivable holding or use of such data. The Act primarily places obligations on the "data

[19] Entitled "Providing information to members", "Communicating with members" and "Communications to members about tax relief on their contributions".
[20] The Pensions Regulator's guidance on "Incentive exercises", July 2012.

controller" who is, in summary, a person who determines the purposes for which and the manner in which personal data are processed. The individual who is the subject of the data is the "data subject".

The central obligation imposed by the DPA 1998 is in s.4(4), which provides that it is the duty of the data controller to comply with the "data protection principles" in relation to the personal data he controls. The eight data protection principles are in Schedule 1 of the Act.

For example, Schedule 1 requires that personal data be processed lawfully and fairly, and it provides that data is only processed fairly if, *inter alia*, the data subject is, so far as practicable, informed of the purpose for which the data are intended to be processed. Similarly, personal data can only be processed if at least one of a range of qualifying conditions is met. The most relevant of these is that the data subject has given consent or, if his "sensitive personal data" are being processed, he has given "explicit consent".

Enforcement of obligations under the DPA 1998 is in the hands of the Information Commissioner and individuals have a statutory entitlement to compensation for breaches of the Act under s.13. Data subjects also have a right of access to the personal data held about them, the so-called "right of subject access" under s.7. This right is discussed below.

General relevance of the DPA 1998 to pension trustees

Pension trustees will often (through their administrators) hold member data in computer form, so such information will fall within the purview of the DPA 1998. Information about members and their dependants (name, age, salary, employment details, family details, nominations for death benefits etc.) will be "personal data", and the trustees will often hold "sensitive personal data" too (in particular regarding health conditions: see the definition in s.2). As noted above, expressions of opinion and intention about individuals fall within the definition of "personal data", so computer records of trustee decision-making about individual members are likely to be caught by the Act.

Since the trustees determine the purposes for which this data is processed, they will be "data controllers" for the purposes of the Act and must comply with the data protection principles. This will involve, amongst other things, obtaining consent to process personal data (or explicit consent for sensitive personal data) and informing members of the purposes for which personal data will be processed. Pension trustees could provide the necessary notifications to members via scheme literature and obtain the necessary consents by, e.g., asking members to sign consents when filling in

membership forms or applications. The Information Commissioner has emphasised that consent must be "freely given", meaning that the individual has "real choice", and the Commissioner takes the view that for consent to be "explicit" (for processing sensitive personal data) the individual must have been told clearly what personal data are involved and what use will be made of them.[21] This will be especially pertinent for ill-health retirement applications.

Where pension trustees use the services of scheme administrators and professional advisers, such persons are likely to be "data processors" (as defined in s.1) who process personal data on behalf of the trustees. The trustees remain responsible under the DPA 1998 as the data controllers and should therefore see to it that their data processors have proper procedures in place to ensure compliance with the data protection principles and other obligations under the Act.

An example of this vicarious responsibility in the pensions context can be found in *Scottish Borders Council v Information Commissioner*, First-Tier Tribunal, 21 August 2013. The old pension records of a local authority were dumped in a Tesco's bin by the local authority's external data processing company. As the data controller, the local authority was held to have committed a serious breach of the data protection principles (and the Commissioner imposed a £250,000 penalty, although on appeal it escaped liability because the contravention was not likely to cause substantial damage or distress).

There is a risk that the trustees' administrators or professional advisers could be treated as a joint data controller along with the trustees if they control the data for their own purposes too. The Information Commissioner's view is that professionals (including lawyers) who receive personal data from a client will often become data controllers in their own right.[22] The Institute and Faculty of Actuaries appears to take the view that a scheme actuary (who has a personal appointment) could become a data controller unless the data provided to him is anonymised so that individuals cannot be identified, and it has issued guidance on the subject.[23]

A potential danger for pension trustees arises if they permit a sharing of member data with the scheme's employer. The Information Commissioner takes the view that employers should not use information gained from trustees or administrators of pension schemes for general employment purposes; the Commissioner also considers that the fact an employer funds a scheme does not give it a right to receive information about individual scheme members beyond that necessary for the

[21] Information Commissioner's "Employment Practices Code", November 2011, p81.
[22] Information Commissioner, "Data controllers and data processors: what the difference is", version 1.0, 2014, paragraph 27.
[23] Institute and Faculty of Actuaries, "Data controller responsibilities", 1 August 2014, at e.g. paragraph 4.4.

operation of the scheme.[24] Trustees/administrators should therefore ensure that personal data shared with employers is only used for proper purposes relating to the scheme of which members have been informed. This is particularly important for in-house pensions administration teams of large employers who are nominally working for the scheme trustees but who also have another "hat" as part of the employer's human resources department, where there might be a temptation to use pension scheme data for general employment purposes.

Another potential danger for pension trustees arises from transfers of personal data outside the EEA. This is likely to be relevant to schemes whose employers are part of a multi-national group, particularly where there is a funding guarantee from an overseas parent company, or where the trustee uses multi-national firms of advisers who store data outside the EEA. Data protection principle 8 in Schedule 1 of the DPA 1998 prohibits the transfer of personal data outside the EEA unless it is to a country that ensures an adequate level of protection for the rights and freedoms of data subjects. There are exceptions to this principle in Schedule 4 of the DPA 1998, most relevantly where the individual consents to the transfer of his data, but, unless an exception applies, data transfers outside the EEA must comply with principle 8. For transfers to the USA, the European Commission decided in 2000 that adequate data protection was provided by US undertakings who self-certify adherence to seven "safe harbour" principles. However, in *Schrems v Data Protection Commissioner* [2016] QB 527, the CJEU ruled that the Commission's decision was invalid and that the USA does not provide an adequate level of protection. Work is now under way on a new "safe harbour" arrangement known as the EU-US Privacy Shield. In the meantime the Information Commissioner has issued interim guidance on data transfers to the USA, which is noticeably vague about what data controllers should actually do now.[25]

For pension schemes involved in litigation or disputes, data protection problems can arise (for instance, where use of member data might be relevant, e.g. for preparing expert reports, or where disclosable documents make reference to individual members). These problems may be alleviated by s.35 DPA 1998 which contains exceptions that (broadly speaking) permit disclosure of personal data as required by law, or where disclosure is necessary for the purpose of legal proceedings or establishing legal rights or obtaining legal advice.

The "right of subject access" under s.7 DPA 1998

[24] Information Commissioner's "Employment Practices Code", November 2011, p38-39.

[25] Information Commissioner, "Data transfers to the US and Safe Harbour – interim guidance", 10 February 2016. The guidance suggests that data controllers should "take stock" but "don't rush to change".

As mentioned above, data subjects have a "right of subject access". By s.7, an individual is entitled to be informed by the data controller whether the latter is processing any personal data of which the individual is the data subject, and if so to be given a description of the personal data, the purposes for which they are being processed and the recipients to whom they may be disclosed; the individual is also entitled to have the information communicated to him in intelligible form (s.7(1)). To exercise this right, the individual need only make a request in writing and pay the prescribed fee of £10 (s.7(2) and reg.3 of SI 2000/191). The data controller must comply with the request "promptly" and in any event within 40 days (s.7(8) and (10)), in default of which the court may order compliance (s.7(9)). There are exceptions for certain types of information in Part IV and Schedule 7 of the Act.

This right originates in art.12 of EU Directive 95/46/EC, which requires EU member states to guarantee every data subject the right to obtain from the data controller, without excessive delay or expense, confirmation as to whether data relating to the subject is being processed and information as to the purpose of the processing, as well as a right to have the data communicated to him in intelligible form.[26] It is to be noted that it is a right to information, not a right to require copies of documents.[27] In *Durant v Financial Services Authority* [2004] FSR 28, the Court of Appeal explained that:

(i) The primary objective of the Directive was to protect individuals' fundamental rights to privacy and the accuracy of their personal data held by others. The intention of the Directive, as transposed into the DPA 1998, was to enable an individual to obtain his personal data, that is, information about himself; and the purpose of the legislation was "to enable him to check whether the data controller's processing of it unlawfully infringes his privacy and, if so, to take such steps as the Act provides … to protect it."

(ii) The Act is not an automatic key to any information about matters in which the individual might be named or involved, nor does it assist him to obtain discovery of documents in litigation or in complaints against third parties.

(iii) The Act is focused on readily accessible information, and in most cases only information that names or directly refers to the individual would qualify as "personal data" – mere mention of

[26] In addition, see now art.8 of the Charter of Fundamental Rights of the European Union: "(1) Everyone has the right to the protection of personal data concerning him or her. (2) Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified. …"

[27] See e.g. *Re Southern Pacific Personal Loans* [2014] Ch 426 at [43].

> the individual in a document would not necessarily amount to "personal data". This was a question of relevance and proximity to the individual: the information would have to be "biographical in a significant sense" (i.e. going beyond the individual's involvement in an event that has no personal connotations) and should be focused on the individual (rather than on some other person or some transaction in which he may have figured). In short, it must be information that affects his privacy in a private or business/professional capacity.

The restrictive definition of "personal data" in *Durant v FSA* has subsequently proved somewhat controversial, and the Information Commissioner has issued guidance which sets forth a wider concept of "personal data".[28] The guidance was approved by the Court of Appeal in *Edem v Information Commissioner* [2014] EWCA Civ 92. The guidance states that it is not always necessary to consider "biographical significance" and that data may be personal data simply because it is "obviously about" an individual.

However, whichever of these interpretations of "personal data" is correct, it seems very likely that the sort of individual member data processed by a pension trustee will fall within it.

Therefore the question arises whether a pension scheme member or dependant who is aggrieved by a pension trustee's decision (for example refusing an early retirement pension or as to the allocation of a death benefit) could make a subject access request under s.7 DPA 1998 to see information relating to the decision. In particular, could he make a s.7 request with a view to launching an Ombudsman complaint or even litigation?

This question brings into focus another feature of *Durant v FSA* that has subsequently caused controversy, namely the court's view that the right of access under s.7 cannot be used to obtain discovery of documents in litigation or in complaints against third parties (the purpose of s.7 being, according to *Durant*, to check that the personal data is being processed lawfully and accurately). In *Durant*, the applicant had made an access request under s.7 in support of his efforts to re-open previous unsuccessful litigation against a third party. The court, dismissing the request, described it as "a misguided attempt to use the machinery of the [DPA 1998] as a proxy for third party discovery with a view to litigation or further investigation" [31].
On this narrow view of the purpose of s.7, the court could exercise its discretion under s.7(9) not to order compliance with a subject access request where it has been made for an improper purpose.

[28] Information Commissioner, "Determining what is personal data", version 1.1, 2012.

However, the narrow *Durant* view of the purpose of s.7 has not been applied in a number of subsequent cases. In *Dunn v Durham County Council* [2013] 1 WLR 2305, at [16], the Court of Appeal observed that an individual involved in a dispute was entitled – before, during or without regard to legal proceedings – to make a subject access request under s.7, and that such a request would be attractive to prospective claimants in litigation because it was significantly less expensive than pre-action disclosure under CPR 31.16 and might satisfy the prospective claimant's needs. In *Re Southern Pacific Personal Loans* [2014] Ch 426 at [46], David Richards J said that *Durant* was not authority for the proposition that a data controller could refuse a s.7 subject access request on the grounds of its purpose. Likewise, in *Lin v Commissioner of Police for the Metropolis* [2015] EWHC 2484 (QB), at [111]-[114], Green J considered *Durant* and held that a s.7 request could be made for the purpose of defending proceedings (in that case, criminal proceedings). And in *Guriev v Community Safety Development* [2016] EWHC 643 (QB), Warby J clearly preferred the view that a s.7 access request is "purpose blind" and that there can be no objection to its being made for the purposes of litigation (although he did not have to decide the point on the facts of the case): see [67] and [70]-[72].

However, the *Durant* view of s.7's purpose is not moribund. In *Kololo v Commissioner of Police of the Metropolis* [2015] 1 WLR 3702, QB, Dingemans J followed *Durant*, but held that, even though the data subject had the principal purpose of obtaining the data for use in proceedings, this did not defeat his request because he also had the proper purpose of checking the accuracy of the data: see [30], [35]-[36].

An even stricter approach was taken in the recent decision of HHJ Behrens sitting as a Deputy Judge of the Chancery Division in *Dawson-Damer v Taylor Wessing* [2016] 1 WLR 28. This case is of interest to lawyers advising in relation to trust-based pension schemes, as it involves the application of s.7 DPA 1998 in the context of a trust. The beneficiary of a discretionary Bahamian settlement and her children made a subject access request under s.7 addressed to the UK solicitors of the trustee, seeking access to personal data contained in the trust documents and papers held by the solicitors. HHJ Behrens found that the request was made for the purpose of obtaining information for hostile trust proceedings in the Bahamas in which the beneficiary sought to challenge various appointments made by the trustee. It appears that the beneficiary only had limited rights of access to trust documents under Bahamian law. Applying *Durant v FSA*, the Judge held that it was not the purpose of s.7 to enable an individual to obtain discovery of documents that might assist her in litigation or complaints against third parties, and so he would not have exercised the court's discretion under s.7(9) to compel compliance with the request: [38], [62.2], [71]. Unfortunately, none of the above cases expressing the contrary view appear to have been cited to him. HHJ Behrens also considered that s.7 is qualified by

s.8(2) so that the data controller need not provide data at disproportionate effort (which is at odds with David Richards J's view on this point in *Southern Pacific* at [48], another case apparently not drawn to his attention). HHJ Behrens' primary reason for rejecting the request was privilege, considered later in this paper.

The current state of the law on s.7 is therefore in some disarray. There are two Court of Appeal authorities (*Durant* and *Dunn*) which point in different directions on the question whether s.7 can be used in aid of actual or anticipated litigation. Regrettably, it appears that *Durant* was not cited to the Court of Appeal in *Dunn*, which casts doubt on the authority of the latter. Meanwhile, different first-instance Judges are taking inconsistent views of the purposes for which a s.7 request may be made or enforced.

An appeal in *Dawson-Damer* is due to be heard by the Court of Appeal in July 2016, and it is to be hoped the court will clarify the law. In our view, there is considerable force in the argument that there is no implied restriction in s.7 on the purpose for which an access request may be made. No such restriction appears in the Act, which seems to envisage a simple and quick procedure whereby a data subject can make a request without stating his purpose and without the data controller having an opportunity to interrogate him on his purpose.[29] If there is no implied restriction in s.7 itself, then it would appear there is no warrant for the court to introduce such a restriction by the back door by rigidly exercising its discretion under s.7(9) to refuse to order compliance in every case where the data subject wishes (or might wish) to use the data for the purpose of a dispute. Indeed such a rigid ban on enforcing compliance would appear to be contrary to *Durant* itself where the Court of Appeal said the court had an untrammelled discretion to exercise under s.7(9).

Data protection: future developments

Directive 95/46/EC will be replaced by the new General Data Protection Regulation (Regulation (EU) 2016/679) ("the GDPR"). The GDPR came into force on 24 May 2016 and will apply in all EU member states from 25 May 2018. Assuming the UK remains in the EU, the GDPR will overhaul the existing data protection rules. This paper does not attempt to summarise the new rules, but it is worth noting that the GDPR includes:

[29] This view is consistent with the Information Commissioner's Code of Practice on subject access requests, which states that the purpose for which a request is made does not affect its validity (p21, p47).

(i) enhanced rights for individuals to obtain access to their personal data and information about how it is shared (see in particular reg.15 of the GDPR);

(ii) enhanced requirements for obtaining an individual's consent to data processing;

(iii) direct obligations on data processors;

(iv) tougher enforcement measures, including fines of up to 4% of the transgressor's annual worldwide turnover or EUR 20 million (whichever is greater) (see reg.83).

Protection for trustee legal advice

The next matter we wish to consider is the extent to which trustees can prevent disclosure of legal advice obtained by them in the context of applications under the equitable jurisdiction or the DPA 1998. This involves a consideration of the interaction of these jurisdictions with claims of legal professional privilege over legal communications.

Legal professional privilege

There are two types of legal professional privilege:

(i) legal advice privilege, which covers confidential communications between a lawyer and his client, coming into existence for the purpose of giving or getting legal advice;

(ii) litigation privilege, which applies where litigation was in reasonable prospect or pending, and covers confidential communications between the client and his lawyer or agent, or between one of them and a third party, for the sole or dominant purpose of either giving or getting advice with regard to the litigation or collecting evidence for use in the litigation.

It is important to note that privilege operates *in personam* rather than *in rem*: in other words, it need not operate against the whole world. It is usually best viewed as a right which one or more holders can assert against everyone in the world, except perhaps specific individuals.
So, the fact that privilege over trust documents could be asserted in an application against a trustee by a stranger to the trust, does not mean that the trustee could assert that privilege against a claim for disclosure of the documents by a beneficiary of the trust.

Equitable jurisdiction and legal professional privilege

The interaction between the equitable disclosure jurisdiction and privilege was one of the issues discussed in *Re Londonderry's Settlement, supra*.

(i) Although, as stated earlier, this case no longer provides the theoretical basis for the equitable disclosure jurisdiction, it is still relevant to the question of how the court should exercise its disclosure discretion.

(ii) One of the issues discussed in that case was the disclosure of legal advice and communications between the trustees and their lawyers.

(iii) The Court of Appeal in *Re Londonderry* referred with approval (at p.932) to the decision in *Talbot v Marshfield* (1865) 2 Dr & Sm 549: in that case, the advice in question had been paid for out of the trust fund, and was held to be disclosable, as it represented the property of the beneficiaries. It therefore follows from that principle that the trustees could not claim legal professional privilege, as the privilege was held by the trustees for the benefit of the beneficiaries as the ultimate owners of the fund as well as for their own benefit, at least where their interests were aligned.

(iv) By contrast, the Court of Appeal in *Re Londonderry* also confirmed that, where the trustees obtain and pay for legal advice in respect of a claim against them for breach of trust or other relief in contentious trust proceedings, they can claim legal professional privilege as a defence to a claim by a beneficiary for disclosure of that advice.

(v) This applies to advice and communications both before and after the commencement of proceedings where a breach of trust has already been intimated,[30] but not to communications before commencement of more general proceedings in relation to the trust property.[31]

However, these principles still need to be considered in the context of the overall discretion which the court now has in the exercise of its supervisory jurisdiction. Prior to *Schmidt*, Salmon LJ in *Re Londonderry's Settlement* said (at p.938) that a trust document not covered by privilege was required

[30] Lewin, *supra*, at 23-052.
[31] *Re Mason* (1883) 22 Ch D 609.

to be disclosed. However, we consider that, following the more general jurisdiction identified in *Schmidt*, the fact that privilege cannot be asserted against a beneficiary does not mean that disclosure will be automatically directed, if confidentiality considerations outweigh the advantages of disclosure to the beneficiary.

But in our view, the converse situation does not apply: where privilege can be asserted by the trustees against the beneficiary, the court does not have any discretion nevertheless to order disclosure, even in the wider post-*Schmidt* jurisdiction. In our view, documents in that category cannot be regarded as "trust documents" which are subject to the court's equitable jurisdiction: having been obtained for the benefit of the trustees, the documents are entitled to be regarded as the trustees' own personal documents.[32]

This represents a clear distinction between legal professional privilege and the equitable disclosure of trust documents. As Briggs J said in *Breakspear v Ackland, supra,* at [59], when discussing the relevance of confidentiality in the equitable jurisdiction:

> *confidence may be overridden by the exercise of the court's discretion, whereas privilege may not*.

The Pensions Ombudsman has applied the general *Schmidt* jurisdiction in ordering disclosure of legal advice obtained by trustees of a pension scheme to a member relating to the calculation of the member's early retirement pension, rejecting the trustees' argument that the advice attracted privilege as against the member.[33] And the Determinations Panel of the Pensions Regulator has also applied this jurisdiction in refusing to accept a claim for legal professional privilege over counsel's advice as to how to pursue possible claims to remedy a funding shortfall in the scheme.[34]

In discussing whether a claim for legal professional privilege could be maintained, as we said earlier, one of the indicia identified in the cases was whether the trustees had paid for legal advice out of their own resources, and not the trust's resources.

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[32] This meets an objection to the *Schmidt* approach identified by Judd J in *Krok v Szaintop Homes Pty Ltd & Ors (No.1)* [2011] VSC 16 at [13], that the trustees' right to withhold a document on the ground of legal privilege becomes susceptible to the exercise of discretion, which is contrary to the mandatory nature of legal privilege.
[33] *Cameron v The Trustees of the Digital Equipment Company Pension Plan* (2005).
[34] *Data General Employee Benefit Plan* (TM 1915) (2008).

In our view, the question of where the payment came from is not the relevant question to determine whether privilege applies, although the answer to that question may help to identify the answer to the relevant question. In our view, the relevant question is whether the trustees' and beneficiary's interests are aligned: if they are not, and there exists a dispute between the trustees and the beneficiary, the trustees should be able to maintain privilege over legal advice relating to the dispute, even if they were able to obtain funding for that advice from the trust assets.

Thus, in *Rollo Ventry Wakefield Gray v BNY Trust Company of Australia Limited* [2009] NSWSC 789,[35] a beneficiary failed to obtain disclosure of legal advice relating to litigation between him and the trustees where the trustees had obtained an order after the conclusion of litigation that entitled them to recoup their costs of legal advice from the trust estate. The court held that the documents, which were privileged at the time they were created, did not lose that privilege as a result of that order. The court confirmed that the legal advice was not at any time to be regarded as a trust document.[36]

So, for example, in a pensions context, the fact that the employer paid for the trustees' legal advice, because of a covenant in the scheme rules requiring the employer to meet the trustees' expenses, would not prevent the trustees from claiming privilege in respect of that advice against an employer, where the trustees' interests are not aligned with those of the employer.

Finally on this subject, we wanted to mention *Garvin Trustees Ltd v The Pensions Regulator* [2015] PLR 1. Although this involved the disclosure process of the Upper Tribunal, and not the equitable jurisdiction of the court, it is a recent example of privilege being asserted in a pensions context.

The issue raised in the case was whether documents previously held by the scheme's corporate employer, but which passed into the possession of a shareholder on the liquidation and subsequent dissolution of the employer, were subject to legal professional privilege. This is likely to be an important practical consideration in some pensions cases, where the employer's conduct may be in issue long after it has ceased to exist.

[35] See also *Blades v Isaac* [2016] EWHC 601 (Ch); [2016] WTLR 589 at [51] (Master Matthews).
[36] The procedure in *Re Beddoe* applications, by which beneficiaries who are potential defendants to the claim for which *Re Beddoe* relief is sought are not entitled to be present when the legal advice received by the trustees on the claim is being discussed in court (see *Re Moritz* [1960] Ch 251), may be seen as an example of this principle, as the basis for it is the conflict of interests of the trustees and those beneficiaries: see Passmore on Privilege (3rd ed., 2013) at para 6-020 n.21.

(i) The documents in issue concerned the provision of legal advice to the employer relating to a transaction which was the subject of a contribution notice application by the regulator, supported by the scheme trustee. The trustee sought disclosure of the documents, which had been retained by the shareholder with the permission of the employer's liquidators. That application was opposed by the targets, in whose interests it was to resist disclosure.

(ii) It was argued by the trustee that no right of privilege could be claimed because the right was vested in the employer alone, and as the employer had been dissolved there was no entity which could assert the right.

(iii) The Judge accepted this argument, holding that:

(a) the employer could not assert any right to privilege as it no longer existed, and the time period for restoring the employer to the register had expired [33]-[34];[37]

(b) although theoretically the right of privilege became vested in the Crown as *bona vacantia,* the Crown had no interest in maintaining privilege and had declined to do so: the shareholder was under no obligation to maintain the privilege simply because it vested in the Crown [40]-[43];

(c) the documents were therefore held to be disclosable.

(iv) The Judge confirmed that privilege can only be asserted by the person who is entitled to the right, and a third party is not entitled to do so even if he has possession of the documents concerned [24].[38]

[37] citing *Wight v Eckhardt* [2003] UKPC 37; [2004] 1 AC 147 at [27] per Lord Hoffmann.
[38] citing *Three Rivers DC v Bank of England (No.6)* [2004] UKHL 48; [2005] 1 AC 610 at [26] per Lord Scott of Foscote, and *Schneider v Lee* [1954] 2 QB 195.

Privilege and the Data Protection Act 1998

As already mentioned, the right of subject access in s.7 DPA 1998 is subject to various exceptions in Part IV and Schedule 7. One of these relates to privilege. Schedule 7 paragraph 10 provides:

> *Personal data are exempt from the subject information provisions [which include s.7] if the data consist of information in respect of which a claim to legal professional privilege or, in Scotland, to confidentiality of communications could be maintained in legal proceedings.*

This exception was considered by HHJ Behrens in the private trusts case already considered above, *Dawson-Damer v Taylor Wessing* [2016] 1 WLR 28, Ch D. As will be recalled, in that case a discretionary beneficiary and her children made a subject access request under s.7 against the Bahamian trustee's UK solicitors. The solicitors and their predecessor firm had provided legal advice to the trustee for about 30 years. One of the grounds on which the request was refused by the respondent was privilege pursuant to Schedule 7 paragraph 10 of the DPA 1998.

The data in question related to the period prior to the dispute between trustee and beneficiary emerging. The applicants argued that this was therefore a situation where a trustee could not claim privilege against a beneficiary, because they had the same joint interest (see the principles discussed above).

The respondent placed reliance on the *Londonderry* principle that a trustee is not obliged to disclose documents (including legal advice) which would reveal the reasons for the exercise of dispositive powers.[39] The respondent appears to have argued that the equitable principles which permit trustees to withhold documents from beneficiaries fall within the concept of "legal professional privilege" within Schedule 7 paragraph 10 DPA 1998.

At [62]-[63], HHJ Behrens:

(i) rejected the applicants' argument that "legal professional privilege" was a separate concept from the equitable principles, stating that he had "great difficulty" with the proposition that the principles of disclosure in relation to trustees and beneficiaries could be separated from legal professional privilege;

[39] The *Londonderry* principle is discussed further below.

(ii) he therefore concluded that the exception in Schedule 7 paragraph 10 applied to all documents of which the trustee could resist compulsory disclosure.

Thus the Judge appears to have considered that a trustee's ability under the *Londonderry* principle to withhold information from a beneficiary regarding the reasons for the exercise of a dispositive discretion was no different from legal professional privilege, and so the relevant data were exempt from the subject access request regime in s.7 DPA 1998. If this is correct, it significantly undermines the effectiveness of s.7 for a beneficiary who is trying to obtain information about a trustee's decisions about him.

With respect, we consider HHJ Behrens' conclusion on this point to be wrong, because a trustee's ability to withhold information under the *Londonderry* principle is fundamentally different from legal professional privilege. As discussed elsewhere in this paper, the former is a feature of the court's supervisory jurisdiction over trusts, exercised in the interests of the beneficiaries as a whole, pursuant to which the court will generally uphold the confidentiality of trustee decision-making and not order disclosure. The *Londonderry* principle is ultimately discretionary, and the court may override confidentiality and order disclosure where appropriate: see *Breakspear v Ackland* [2009] Ch 32 at [52]-[56], [73], [101] (a case where the *Londonderry* principle was indeed overridden in the exercise of the court's discretion). In contrast, legal professional privilege is an absolute substantive right which cannot be overridden in the court's discretion, whose origins lie in different policy considerations which are far removed from the law of trusts.[40] It seems highly improbable that Parliament could have intended the reference to "legal professional privilege" in Schedule 7 paragraph 10 DPA 1998 to include equitable rules permitting a trustee to withhold documents and information from a beneficiary.

Thus, (even assuming that the *Londonderry* non-disclosure principle applies to pension trusts, which may be open to doubt as discussed elsewhere in this paper) we do not think that a pension trustee can safely rely on the equitable principles which permit non-disclosure of reasons to a beneficiary as justifying a refusal to comply with a subject access request under s.7.

It is however possible that HHJ Behrens' actual decision in *Dawson-Damer* could be justified on an alternative ground, namely that even if the *trustee* was not entitled to rely on privilege against his beneficiary, the actual respondent to the request was the trustee's *solicitor*, and the solicitor was in

[40] See e.g. *R v Derby Magistrates' Court, ex p B* [1996] AC 487.

no position to release privileged documents to the beneficiary (so that as between solicitor and beneficiary they remained privileged, and thus subject to the Schedule 7 paragraph 10 exception).[41] It will be interesting to see how the Court of Appeal deals with this point in the forthcoming *Dawson-Damer* appeal.

Trustee decision-making

Many requests by scheme members for information and documents from trustees involve an investigation of the reasons behind the exercise by trustees of the powers and discretions vested in them by the governing provisions of the scheme. The purpose of these requests can vary from the member wanting to understand better the reasoning behind the decision, to the member seeking evidence to support a claim or complaint against the trustees.

We will begin by considering whether and to what extent pension scheme trustees are under a duty to give reasons for their decisions, and to disclose those reasons to members; and we will then consider whether trustees should consult with members prior to those decisions being taken.

The giving and disclosure of reasons[42]

As a matter of general trust law, when making decisions in the exercise of their powers and discretions, trustees are under no duty to give or disclose reasons for those decisions. This was definitively established in *Re Londonderry's Settlements, supra*,[43] in which the Court of Appeal identified 5 grounds for this proposition:

(i) nobody could be called on to accept a trusteeship involving the exercise of a discretion unless, in the absence of bad faith, he were not liable to have his motives or reasons called in question either by the beneficiaries or by the court;

(ii) the trustees' role is confidential and they could not properly exercise it if at any moment there was likely to be an investigation to see whether they had done so in the best possible manner;

[41] See Lewin on Trusts (19th ed.) at 23-048 and the Jersey case of *Cunningham v Cunningham* [2010] JRC 074 (trustee's solicitor not entitled to waive privilege at the instance of a beneficiary).
[42] See, generally, Pollard, The Law of Pension Trusts (1st ed., 2013), paras 18.99-18.141.
[43] See also *In re Beloved Wilkes Charity* (1851) 3 Mac & G 440.

(iii) the exercise could not be challenged if bona fide and with no improper motive, so that the trustees' reasons for acting as they did were immaterial;

(iv) disclosure would not be for the good of the beneficiaries as a whole, being likely to embitter family feeling and relationships with the trustees;

(v) an obligation of disclosure might make the lives of trustees intolerable, with the consequence that persons would be reluctant to act as trustees.

Re Londonderry involved a family trust with lay trustees, and those bases have a weaker application to pension schemes, whose trustee bodies are required to know and understand their duties and powers,[44] and indeed often now include specialist professional trustees. Moreover, the position of beneficiaries under a private family trust is very different from the position of members of a pension scheme, the former being objects of the settlor's bounty, and the latter's benefits being regarded as deferred remuneration for their employment.

Notwithstanding this, there is English authority to the effect that the general trust law principle applies to pension schemes, and that pension trustees are subject to the same rule relieving those trustees from the disclosure of their reasons for a decision. In *Wilson v Law Debenture Trust Corpn* [1995] 2 All ER 337,[45] Rattee J applied the *Londonderry* principle to hold that pension scheme trustees were not bound to give reasons for their exercise of a bulk transfer power in a particular way. The Judge rejected the contrary argument based on the different status of pension scheme members over private trust beneficiaries, relying on the "clear and unequivocal" statement of Megarry V-C in *Cowan v Scargill* [1985] Ch 270 that in general the principles applicable to private trusts as a matter of trust law applied equally to pension schemes.

Subsequent events have, in our view, cast sufficient doubt on the rationale for the decision in *Wilson v Law Debenture* so as to justify a reconsideration of its application.

(i) The statement in *Cowan v Scargill* that private trust principles apply equally to pension schemes has been thrown into considerable doubt following the decision of Asplin J in *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch);

[44] ss.247-248 Pensions Act 2004.
[45] see also *Crowe v Stevedoring Employees Retirement Fund Pty* [2003] PLR 343 (Sup Ct Victoria).

[2015] PLR 239, where the Judge did not apply the private law trust principle identified in *Cowan v Scargill* (that trustees are required to act in the best interests of beneficiaries) in its literal sense, so as to exclude the interests of the employers.

(ii) Despite the requirement for the Pensions Ombudsman to determine matters involving a person's legal rights in substance in the same way as a court would do,[46] the Ombudsman is of the view that pension scheme trustees should provide beneficiaries with reasons for their decisions, and that to fail to do so constitutes maladministration: *Allen v TKM Group Pension Trust Ltd* [2002] PLR 333.[47]

(iii) The existence of the Pensions Ombudsman is another reason for adopting a different approach to the decisions of pension scheme trustees. In private trust cases, a beneficiary wishing to challenge the trustees' decision must commence High Court proceedings and overcome the threshold of setting up an arguable case, and the court will not allow the beneficiary to seek disclosure by way of a "fishing expedition". The beneficiary must therefore put a forensic burden on the trustees which can only be overcome by the disclosure of reasons, which can be a high hurdle to surmount. A pension scheme member, by contrast, is under no such burden: he can initiate a complaint to the Pensions Ombudsman, who does not have jurisdiction to strike out a complaint unless it is scandalous, frivolous or vexatious;[48] and the Ombudsman's jurisdiction is largely inquisitorial rather than adversarial,[49] so that the trustees cannot hide behind the burden of proof. This is consistent with the role of the Ombudsman, which is to provide a simple swift and cheap means of initiating complaints.[50] In practice, therefore, pension scheme trustees will be more easily compelled to disclose their reasons in order to defend an Ombudsman complaint than if they were facing a High Court claim.

(iv) Even so, a difference in treatment can be also discerned from a more recent High Court case involving pension scheme trustees. In *Saffil Pension Scheme Trustees v Curzon* [2005] EWHC 293 (Ch); [2005] PLR 267, the trustees of a pension scheme rejected the application of a

[46] *Arjo Wiggins Limited v Ralph* [2009] EWHC 3198 (Ch); [2010] PLR 11.
[47] See also the determinations in *Mrs P v Centrica Staff Pension Trustees Ltd* (2007); *Hedley* (2008); *Stone* (2007); and *Raza* (2008). Note also the determination in *National Bus* [1997] PLR 1, where the Ombudsman (at [105]) distinguished *Wilson v Law Debenture, supra,* on the basis that it only applied where there could be any number of perfectly acceptable reasons for a trustee's decision, and that it did not apply where only extraordinary reasons for exercising the discretion could have justified the way the trustee acted.
[48] Reg.16(1)(b) of the Personal and Occupational Pension Schemes (Pensions Ombudsman) (Procedure) Rules 1995 (SI 1995/1035).
[49] *Hillsdown Holdings v Pensions Ombudsman* [1997] 1 All ER 862 at 894 per Knox J.
[50] *Seifert v Pensions Ombudsman* [1997] 4 All ER 947 at 952 per Staughton LJ.

member for an ill-health early retirement pension without giving any reasons. The Pensions Ombudsman upheld the member's complaint and that decision was upheld on appeal. The basis of the decision was that the trustees had mistakenly thought they had a discretion when in fact they were obliged to grant the pension on the satisfaction of certain conditions, but the Judge (Park J) also criticised the failure of the trustees to give reasons, stating (at [41]) as follows:

> *I have said on several occasions already that the Trustees never gave to Mr Curzon any explanation of the reasons for their decision. That seems to me to have been most unsatisfactory. In Fox LJ's term in Kerr v British Leyland (supra) Mr Curzon was not a volunteer. That is, he was not a beneficiary under the scheme by virtue of the bounty of a settlor or testator. He was a beneficiary because it was part of his contract of employment that he should be a beneficiary. A reasoned case had been put to the Trustees on his behalf, well supported by the letter from Mr May, the neurological surgeon whom he had recently consulted. He could reasonably have expected something more than the simple 'Sorry, no', which was all that he got from the Trustees.*

(v) In *Re HHH Trust* [2011] JRC 235, a Jersey court applied the *Schmidt* jurisdiction to a claim by a member of a Jersey-based employee benefit trust for disclosure of documents from the trustee to assist the member in seeking advice on his tax affairs. In so doing, the Jersey Court seemed to assume (at [30]) that the jurisdiction extended to employee benefit trusts and indeed to pension schemes, although the approach to disclosure may be different in arrangements which may have thousands of members, requiring greater clarity in the documentation sought.

(vi) The fact that reg.13 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 require pension trustees to keep minutes of any decisions made at a trustees' meeting also tends to suggest that the general trust law position may be different for pension trustees.

(vii) Even in a private trust context, where trustees have given reasons for the exercise of their discretion, the blanket prohibition on their disclosure following *Re Londonderry* has been relaxed following *Schmidt*, and the court now has the discretion to override the confidentiality and order the disclosure of the trustees' reasons and/or any relevant documentation relating

to those decisions. And it is notable that, in *Breakspear*, Briggs J expressly limited his consideration of the *Londonderry* principle to the specific context of "family discretionary trusts" (such as those before him): it is therefore possible to argue that that principle should not apply to "business trusts" such as pension scheme trusts.

In our view, all these matters give support to the view of a number of commentators that pension scheme trustees ought to be under a duty to give reasons to members with regard to the exercise of their decision-making powers, even if there is no corresponding duty on the part of trustees of private family trusts.[51]

In the light of this, we are of the view that decisions taken by pension scheme trustees ought to be properly reasoned, and those reasons properly minuted, and that trustees should not be wary of disclosing those reasons when called upon to explain their decisions, even where those decisions may be challenged by the member or members concerned. In the long run, the trustees will be sufficiently protected from the latitude given to trustees by the court in the exercise of their discretions, which will not be overturned by the court unless the trustees have taken irrelevant or failed to take relevant considerations into account, or unless the decision is one which no reasonable body of trustees could take.[52] And, as the *Saffil* case shows, a failure to give reasons for decisions or a refusal to disclose those reasons will expose the trustees to the disapproval of the court or the Pensions Ombudsman, who will be less inclined to accept the trustees' substantive arguments in support of their decisions.[53]

Consultation with members on decisions to be taken by trustees[54]

Lewin on Trusts states: "Statute apart, trustees are under no duty to consult the beneficiaries before exercising their powers".[55]

How accurate is this statement in the context of pension trusts? The starting point is that trust law does indeed impose no general obligation on trustees to consult beneficiaries about proposed decisions: see e.g. *X v A* [2000] 1 All ER 490 at 496, Ch D. The trustees act as principals and are not the

[51] Lord Browne-Wilkinson, "Equity and its relevance to superannuation today" (1992), cited in *Crowe v Stevedoring Employees Retirement Fund, supra*, at [34]; Sir Robert Walker, "Some Trust Principles in the Pensions Context" [1996] PLR 107; Hayton [2005] Conv 229 at 236-237; Smith (2015) Tru LI 161 at 170.
[52] *Harris v Lord Shuttleworth* [1994] PLR 47.
[53] See also *Scott v National Trust* [1998] 2 All ER 705 at 719, where Robert Walker J said that if a decision taken by trustees is directly attacked, they may be compelled either legally (through discovery or subpoena) or practically (to avoid adverse inferences) to disclose the substance of their reasons.
[54] This paper does not deal with the trustees' obligations to consult the employer (for example on investment and funding matters) or an employer's obligations to consult members.
[55] (19th ed.) at 29-099.

agents or delegates of the beneficiaries, and they must make their own decisions. But this is only the starting point, not the end point.

The trust instrument might impose consultation obligations on trustees. It is unlikely that the rules of a pension scheme will require the trustees to consult members (although it is not uncommon for the rules to require consultation with someone else, such as the employer or scheme actuary).

Even if there is no express consultation obligation under the trust instrument, it is sometimes suggested that there are implied obligations akin to a consultation requirement. In *Scott v National Trust* [1998] 2 All ER 705 at 718, Ch D, Robert Walker J suggested that if pension trustees were to change a long-standing policy of making discretionary payments to a needy beneficiary, the beneficiary might have a "legitimate expectation" of the benefit continuing and so should be warned of the change in policy and have an opportunity to seek to persuade the trustees otherwise. It would seem that Robert Walker J regarded this consultation-like obligation as arising as part of a trustee's duty to make decisions rationally: that is, no rational decision-maker would make such a decision without having heard what the beneficiary has to say. The same point could be viewed through the *Futter v Futter* lens of relevant considerations: it might be that a trustee's duty to take account of relevant considerations would compel him to hear what the beneficiary has to say.[56] This could arise in, for example, cases where it is relevant to an exercise of discretion for the trustee to understand the financial means of a beneficiary or his dependants, or in cases where the trustee has to form a judgement on the facts relating to a beneficiary such as his state of health.[57]

More generally, there often appears to be an instinctive reaction on the part of Judges that consultation of beneficiaries is a good thing, even if it is not a strict legal requirement. For example, in *X v A*, cited above (a private trusts case), although Arden J held that consultation was not legally required, she went on to say that the trustee should consider any comments that the beneficiaries did in fact make, and she added that the trustee's proposal to give beneficiaries advance notification of investment decisions was appropriate. To take an example from the pensions context, in *Re Owens Corning Fibreglass (UK)* [2002] PLR 323, Ch D, a pension trustee wished to proceed with a compromise agreement in respect of a scheme funding claim, and Neuberger J said that in most cases it would be desirable to let beneficiaries and their representatives know what was going on, although in the end he approved the compromise agreement without consultation having taken place. Similarly, in the context of representative proceedings under the CPR involving pension schemes, several recent cases

[56] *Pitt v Holt, Futter v Futter* [2013] 2 AC 108, SC.

[57] For an example of the latter, see *Kerr v British Leyland* (1986) [2001] WTLR 1071, CA.

have emphasised the desirability of consultation or have even suggested it is mandatory if a representation order is to be obtained.[58]

However, this is not the invariable reaction of Judges. For instance, it is apparent from the judgment in *Merchant Navy Ratings Pension Fund v Stena Line* [2015] EWHC 448 (Ch) that the trustee did not consult members on the proposed amendments that were the subject of the trustee's "blessing" application, and this was not a bar to the court approving the amendments. And, leaving aside the question of procedural requirements in litigation, the instinctive reaction of some Judges in favour of consultation might now have weakened in the light of the statutory consultation requirements for pension schemes (discussed below), on the basis that if legislation provides for consultation for some pension changes but not others, it is not appropriate to introduce a Judge-made requirement for consultation for those other changes.

Even if there is otherwise no obligation to consult, statute may require a trustee to consult beneficiaries on a proposed decision. For example, for trusts of land, s.11 Trusts of Land and Appointment of Trustees Act 1996 imposes consultation obligations. In the pensions context, s.259(2) Pensions Act 2004 provides that regulations may require the trustees or managers of an occupational pension scheme not to make prescribed decisions unless satisfied that prescribed consultation has been undertaken by the employer.

The prescribed requirements for s.259 are found in the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 ("the Consultation Regulations"). The Consultation Regulations apply to "listed changes" that affect certain types of occupational and personal pension schemes. Although the Consultation Regulations do not require the trustees of an occupational pension scheme to carry out a consultation themselves, the Regulations nevertheless apply directly to the trustees (reg.3(1)) and they provide that no trustee "may decide to make a listed change" that affects the scheme until any required statutory consultation has been carried out by the employer (reg.6(1); see also reg.7(1)). Thus it appears to be incumbent on trustees to check that the employer has consulted before the trustees "decide" to proceed with the change. A failure by the trustees to comply with reg.6(1) is a breach of the Consultation Regulations

[58] This paper does not deal with pension litigation and whether consultation is a procedural requirement. This is an interesting topic which deserves a paper of its own. Suffice it to say that it is open to question whether recent decisions and guidance are consistent or actually reflect the law on whether trustees are under a duty to consult on the requirements for the making of a representation order: compare, for example, *PNPF Trust Co v Taylor* [2009] EWHC 1693 (Ch), *Industrial Acoustics v Crowhurst* [2012] EWHC 1614 (Ch), *Archer v Travis Perkins* [2014] EWHC 1362 (Ch), *Pollock v Reed* [2015] EWHC 3685 (Ch), *Girls' Day School Trust v GDST Pension Trustees* [2016] EWHC 1254 (Ch), Chancery Guide 2016 paragraph 29.97ff, CPR 19.7 and CPR PD 64B paragraph 7.7(4).

which triggers possible sanctions under regs.18-18A. However, the failure does not of itself affect the validity of the trustees' decision (s.259(3) Pensions Act 2004), and it seems strongly arguable that a monetary penalty cannot be imposed on the trustees under reg.18A, since that regulation only refers to breaches of reg.7(3), which applies solely to the employer.

The Consultation Regulations do not define the term "decide", so it is not entirely clear at what point a pension trustee will be taken to have "decided" to make a listed change. The Consultation Regulations envisage that the consultation should be in respect of a "proposal" to make a listed change (regs.7(1) and 11(1)) and that the "decision" to make the change should only be made at the end of the consultation (reg.16). Therefore it appears that "decide" means taking the *final* decision to proceed, and, if that is right, there is no prohibition on trustees making a provisional decision pending consultation by the employer, so long as it can still fairly be described as falling within the realm of a "proposal".[59]

Care should be taken as to whether a proposed course of action involves the *trustees* (as opposed to the employer) deciding to make a listed change. Obviously, if the trustees are being invited to make a listed change by exercising a power of amendment vested in them, the Consultation Regulations will bite (assuming they are otherwise applicable to the scheme). It seems very likely that the same will be true if an exercise of the amendment power by the employer is subject to the trustees' consent, as the change cannot be made but for the trustees' agreement. More subtle issues can arise, for example where a listed change will occur only if the trustees do nothing. This could arise where, say, an employer serves a notice terminating the scheme which will result in a cessation of accrual (a listed change), but the trustees have power under the rules to suspend the effect of the notice. If the trustees decide not to suspend the notice (and so permit the cessation of accrual to take effect), have they decided to make a listed change? The answer is debatable, although our view on balance is that they have not, since they have not decided "to make" a listed change but have forborne to prevent one.

To sum up, pension trustees are generally not required to consult with members in advance of making a decision, but consultation obligations can arise under the Consultation Regulations (or under any other applicable statutory consultation requirements), under the scheme's rules, potentially under the court's procedural rules in litigation, and (in particular circumstances) as a consequence of the ordinary requirements of rational trustee decision-making.

[59] See by analogy *Cunliffe v Goodman* [1950] 2 KB 237, CA (a landlord and tenant case) on the distinction between "decision" and provisionality. The Pensions Regulator's guidance on consultation refers to "final decisions" being made at the end of the consultation (February 2015 guidance, p3), which might be read as suggesting there is no bar on making provisional decisions at an earlier stage.

It follows that in the general case where there is no consultation obligation, pension trustees are entitled to make decisions under conditions of confidentiality without telling members what is going on. This is illustrated by the recently-published decision in *Pollock v Reed* [2015] EWHC 3685 (Ch) where the employer invited the trustees to consider a restructuring of the pension scheme in circumstances of financial distress. It was said that for the restructuring to have any realistic prospect of succeeding, it was essential for confidentiality to be maintained, given that the decision involved commercially sensitive information about the employer's financial health: see Asplin J's judgment at [8]. The representative beneficiary was not permitted to discuss the matter with his fellow members: see [8]. Despite these confidentiality restrictions, Asplin J was satisfied that the trustees had made a proper decision and the court would have "blessed" the trustees' decision [138], although the proposal could not proceed for other reasons.

However, *Pollock v Reed* involved an extreme set of facts where the need for confidentiality was so great that the court was prepared to hold the hearing in private and to place its judgment under embargo for several months. It should not be regarded as a licence for trustees to keep members in the dark in the normal run of cases. It should also be borne in mind that a need for confidentiality does not trump the requirements of the Consultation Regulations. If a listed change is proposed but there is a pressing need to keep matters confidential from members, then the safe way forward would be to apply to the Pensions Regulator to waive or relax the statutory consultation requirements (reg.19 of the Consultation Regulations), although such an application could be time-consuming and requires a decision of the Determinations Panel. And once the change has actually been made, it may well be disclosable to members under the Disclosure of Information Regulations, pursuant to reg.8 or pursuant to reg.11 and Schedule 3 paragraph 3 of those Regulations.

APPENDIX

The Disclosure of Information Regulations

The disclosure obligations in the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 cover (*inter alia*):

(i) *Basic information about the scheme:* There is an obligation to provide basic information such as eligibility, contributions, AVCs, transfers, benefits, accrued rights, the scheme's tax status, dispute resolution and so on. There must also be disclosure of material changes to the information. See regs.6-10 and Schedule 2 of the Regulations. The basic information must now cover the new pension flexibilities (see further below) and "lifestyling" (i.e. an investment strategy that progressively reduces risk as a member approaches retirement).

(ii) *Information to be given on request:* There are obligations to provide members with requested information about the constitution of the scheme, an annual report, copies of the audited accounts and auditor's statement, statements/reports/plans and actuarial certificates under the Scheme Funding regime in Part 3 Pensions Act 2004, and information about whether the member is entitled to acquire transfer credits. See regs.11-14 and Schedule 3 of the Regulations.

(iii) *Funding and benefit statements:* Members must be given a summary funding statement and annual benefit statements. See regs.15-17 and Schedules 4-6 of the Regulations.

(iv) *New pension flexibilities:* There are now obligations to provide information to members relevant to the flexible DC options introduced on 6 April 2015. The thinking behind the flexibility reforms was that members should be freer to make their own decisions, for which purpose there are new disclosure obligations in an effort to ensure members can make properly-informed decisions with the benefit of appropriate advice. These obligations include "signposting" the Pension Wise advice service, providing "retirement risk warnings" and disclosing information about flexible benefits four months before a member's retirement date (the so-called "retirement wake-up pack") and at other times. See regs.18-21 and Schedules

2, 7 and 10 of the Regulations.[60] The Pensions Regulator has issued guidance to trustees and administrators about these new obligations.[61]

(v) *Information about benefits in payment:* When a member's benefits come into payment, and upon his death, information must be provided about *inter alia* the amount payable and rights to death benefits. See regs.20-21 and Schedule 7 of the Regulations.

(vi) *Winding up:* Information must be provided about any decision to wind up the scheme and about the effect of winding up on benefits. There are also ongoing disclosure obligations during the winding up itself. See regs.23-25 and Schedule 8 of the Regulations.

Other pensions legislation imposing disclosure obligations on trustees

Examples of other pensions legislation requiring trustees to disclose information to members are:

(i) *Tax:* The pensions tax regime imposes various disclosure and notification obligations on the "scheme administrator", which will often be the trustees. For example, the scheme administrator is required to provide to the member or his personal representatives statements about the expenditure of his lifetime allowance, annual pensions savings statements for annual allowance purposes, details of any unauthorised payments made, notice of intention to make payments in respect of the member's tax liability, statements about flexible access to DC benefits, and so on. See the Registered Pension Schemes (Provision of Information) Regulations 2006 made under the Finance Act 2004, as amended by the Taxation of Pensions Act 2014.

(ii) *Early leavers:* The trustees or managers must provide the leaver with information as to the rights and options available to a member whose pensionable service terminates before normal pension age: see reg.27A of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991. The Preservation Regulations contain various other notification obligations with regard to early leavers, such as the duty to provide information about a proposed transfer

[60] On a related topic, the Pension Schemes Act 2015 imposes obligations on the scheme's trustees or managers to disclose information about the requirement to take independent advice before converting "safeguarded benefits" (benefits other than money purchase and cash balance benefits) to flexible benefits: see ss.48-50 of the 2015 Act and reg.6 of the Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015.

[61] "Communicating with members about pension flexibilities", April 2015.

of their accrued rights without consent under reg.12(4B). The trustees or managers are also under a duty to provide an early leaver with a statement of his right to a cash transfer sum or contribution refund pursuant to s.101AC Pension Schemes Act 1993.

(iii) *Transfer values:* The transfer value regime contains additional disclosure obligations for the trustees or managers of the scheme. Under s.93A Pension Schemes Act 1993, they must provide a member who requests it a statement of entitlement in respect of the cash equivalent of his transferrable rights. Further provisions regarding the statement of entitlement are found in the Occupational Pension Schemes (Transfer Values) Regulations 1996 at reg.6 and following. Reg.11 and Schedule 1 contain further obligations on trustees to disclose information about transfer values and their calculation. The Pensions Regulator has issued guidance on transfer values, including guidance on what information should be provided to members.[62]

(iv) *Contracting-out:* The contracting-out regime (now abolished for future service) contains obligations to notify members of various matters relevant to their contracted-out rights (although these obligations often fall on the employer rather than the trustees). See for example reg.3 of the Occupational Pension Schemes (Contracting-out) Regulations 1996 and regs.5(c) and 10(b) of the Contracting-out (Transfer and Transfer Payment) Regulations 1996. Schedule 2 paragraph 12 of the Disclosure of Information Regulations also contains obligations to inform members about the contracted-out status of their employment (revoked from 6 April 2017).

(v) *Divorce:* The pension sharing regime contains its own disclosure obligations. Under s.23 Welfare Reform and Pensions Act 1999, the person responsible for a pension arrangement may be required to supply pension information in connection with divorce. The person responsible will be the trustees or managers of the scheme: see s.46(2) of the 1999 Act. The detailed requirements are set out in the Pensions on Divorce etc (Provision of Information) Regulations 2000.

(vi) *Stakeholder pensions:* For stakeholder pension schemes, one of the conditions to be satisfied is that the trustees or managers provide members with annual statements about the value of

[62] Regulatory guidance, "Transfer Values", September 2008, at paragraphs 66-69.

their rights under the scheme and related details. See regs.18-18F and Schedule 3 of the Stakeholder Pension Schemes Regulations 2000.

(vii) *DC governance:* The Occupational Pension Schemes (Scheme Administration) Regulations 1996 now require the trustees or managers of a DC occupational pension scheme to prepare an annual governance statement setting out *inter alia* the level of charges and transaction costs applicable. See regs.23 and 26 of the Scheme Administration Regulations. The statement must be provided to members under Schedule 3 paragraph 34 of the Disclosure of Information Regulations.

(viii) *Winding up:* Where a scheme is in winding up, further disclosure obligations are placed on the trustees or managers by the Occupational Pension Schemes (Winding Up) Regulations 1996 (as amended by the 2005 version of those Regulations), such as the duty to give members a notice explaining how the scheme's liabilities are proposed to be discharged (and, where applicable, the member's consent must be obtained) (reg.6) and the duty to inform members of various decisions concerning winding up (reg.11).

What is reasonable: some complexities of the moral hazard regime

Contribution Notices – the relevance of gains made by the Target to the amount of the CN

Jonathan Evans QC

The central question to be addressed is whether the amount of any benefit received by the Target, either directly from the scheme employer or as a result of its actions in relation to the scheme employer, is relevant to the amount that tPR can require the Target to pay to the trustees under a Contribution Notice ("CN"), and if so, why and how.

The starting point, as with so many other unresolved and interesting questions of pensions law, is a judgment of Warren J. In this case, his decision in the Upper Tribunal in the *Bonas* case[63]. In that case, among other matters and in addition to deciding the point in issue in the case itself, Warren J considered in general terms the purpose of the CN regime.

It is important to bear in mind, as we shall see, that in *Bonas* Warren J was considering the nature of the CN regime as it was originally enacted, i.e. when it contained only one "limb" or "gateway", namely the "main purpose" test – that is, before the addition of the second, alternative "gateway" of "material detriment", introduced by amendment in 2008. His comments about the CN regime therefore must be read in the context of the main purpose test alone.

In analysing and discussing the scope and purpose of the CN regime, Warren J drew a contrast with the FSD regime. As regards CNs, he said that the purpose of that regime was to enable the trustees to recover from the Target the amount of the s.75 debt that has become irrecoverable as a result of the Target's acts:

> "[Section 38] *provides for the imposition of a liability on a person who has, by his acts or failures, caused a detriment to a scheme by preventing the trustees from recovering that which they would otherwise have been able to recover in respect of the section 75 debt. The scheme can be compensated for that detriment. But it is not, as I see it, the purpose of section 38 to go further than that, so as to impose a penalty on the target for his behaviour. Recovery of further amounts is the domain of the FSD regime under section 43 imposing a positive obligation on an associate of an employer in certain defined circumstances to provide financial support for the scheme*" (at paragraph 100)
>
> "*More generally, section 38(5)(a)(i) applies where the relevant act or failure to act has as one of its main purposes to prevent recovery of the whole or part of the section 75 debt. The purpose of this provision (in contrast with the different regime of FSDs) must, I suggest, be to enable the*

[63] *Michel Van De Wiele v the Pensions Regulator* [2011] 023 PBLR.

Trustees to recover from the persons concerned the amount which the act or failure to act has resulted in becoming, or possibly becoming, irrecoverable. It is no part of section 38 to make him liable for a large sum (£20 million in the present case, according to the Regulator) when, but for his acts, the section 75 debt would not have been recoverable, in whole or in part, quite apart from those acts. The section is concerned with recoverability and the extent to which the relevant act or failure to act prejudices that recoverability." (paragraph 193)

As appears from these two passages, this purpose of the CN regime was said to be different to the purpose of the FSD regime, which (implicitly) is <u>not</u> confined to compensation for the amount by which the Target's actions have damaged the scheme (i.e, in the context of the *Bonas* case, the amount by which recovery of the s.75 debt was reduced). Under that alternative regime, the judge said, tPR could "go further" than a purely compensatory approach.

Warren J's statement about the purpose of s.38 makes clear that in his view, the CN regime is <u>essentially compensatory</u>: the trustees are to be compensated for the amount by which their s.75 debt recovery has been reduced by the acts of the Target – and nothing more.

If that is right, whether the Target has benefitted from its actions in relation to the employer or the scheme, and the amount of any such benefits, should be totally irrelevant to the amount of the CN: the only question is by how much those acts have reduced the recoverable s.75 debt; any benefit received by the Target is irrelevant.

But is that right? A brief consideration of the two regimes is called for, in order to see whether the judge's views about their contrasting purposes holds good.

<u>The FSD regime – s.43 PA 04</u>

Two initial questions arise:

- what is the purpose of an FSD?
- what is the relevance of gains made by the Target to the amount of an FSD?

In the light of the answers to those questions, two further questions then follow:

- was Warren J right to identify a contrast between the FSD regime and the CN regime? If so,
- what is the significance of the contrast for the relevance of gains made by the Target?

As for the first question, the purpose of an FSD is simply to increase the funding level of the scheme (which can also be expressed as the security of scheme benefits). It is a tool to improve the funding position in circumstances where the scheme is under-resourced or has an inadequate covenant (in the

case of a service company employer). This tool can be used (by tPR) where there is an imbalance between the funding position of the scheme and the ability of those connected with the scheme to support it – in essence there is someone who could, and in tPR's view should, provide better support to the scheme. The financial support is either the assumption of liability for employer's funding obligations or the making of a contribution towards the employer's liabilities. Hence and FSD is less about any particular conduct on the part of the Target than it is about identifying an ability to improve scheme funding.

As for the second question, the benefits received by Target are expressly made relevant to the decision whether to require the Target to provide support – see s.43(7). An FSD can only be issued where tPR thinks this is reasonable, and the extent to which the Target has benefitted from its relationship with the scheme is expressly stated to be relevant to this question whether Target should be required to provide support to the scheme. Further, and importantly, tPR also has to be satisfied that the particular direction that it makes (i.e. the amount/nature of support it requires the Target to provide) is reasonable, having regard to (among other things) the benefit received by the Target (s.43(5)(b): "*only if … the Regulator is of the opinion that it is reasonable to impose the requirements of the direction on that person*"). Hence, in the case of an FSD, the extent of any benefit received by the Target clearly is relevant to the amount of the liability imposed on the Target: it is not sufficient that the Target is a financially strong connected or associated person; in order to issue an FSD against that Target, the extent of benefit received from employer or the scheme by that Target has to be such that (combined with other factors) it is reasonable to require the Target to provide support to the scheme in a given amount.

The relevance of gains by the Target under the legislation as enacted

As for the third question, in the writer's view Warren J was right to identify an essential contrast between the purpose of the CN and FSD regimes. A s.38 CN is essentially about responding to acts of the Target that have damaged the scheme. An FSD is essentially about forcing the Target to provide additional support to an insecure scheme.

As for the fourth question, given this essential difference in purpose, the answer to the question about the relevance of gains made by the Target is much less clear.

As mentioned above, Warren J's comments in *Bonas* were with reference to s.38 as originally enacted, not as it stands after the amendments made in 2008 (this was because of the dates of the acts of the Target relied on as grounds for the CN – which took place in 2006). Thus, he considered only the "main purpose" test for a CN, not the additional "material detriment" test that has since been added. And there was at that time a clear contrast in the legislation between the prescribed "reasonableness factors" in the case of a CN under s.38 and those that applied in the case of an FSD under s.43: as

explained above, s.43 expressly required tPR to consider the benefits received by the Target when deciding whether to issue an FSD, but there was no such requirement to consider benefits under s.38: that requirement was only added in 2008 (by the new s.38(7)(ea)).

As the legislation originally stood, the question of what benefit the Target had received therefore might well be thought to be irrelevant to the issue of a CN: it was not a prescribed factor to be taken into account in the way that it was for an FSD. Further, the question of benefit might be thought to be equally irrelevant to the amount of the CN if one was to be issued, not just the reasonableness of issuing the CN at all.

It is important to note that the "reasonableness limitation" on the power to issue a CN applies not only to the identity of the Target (whether it is reasonable to impose a CN on this person at all) but also to the amount of the CN:

- S.38(3) says that the CN can be issued only if tPR considers that it is reasonable "*to impose liability on the person to pay the sum specified in the notice*";
- That the amount of the CN had to be reasonable was clearly stated by Warren J in *Bonas*: "*I should also mention section 39(1) which provides that the sum specified in a contribution notice may be either the whole or a specified part of the shortfall sum in relation to the scheme. This provision does not, of course, override the need for the specified sum to be reasonable. The cumulative effect of section 38 and section 39 is that the sum specified must (a) be the whole or part of the shortfall sum and (b) be reasonable.*" (paragraph 10);
- The position is the same in relation to FSDs under s.43, as already mentioned – it has to be reasonable to impose the particular support direction on the Target, i.e the amount has to be reasonable too.

On this basis, it might be thought relatively easy to defend the proposition that the amount of gains made by the Target is simply irrelevant to whether to issue a CN or the amount of any CN that is issued:

- Gains by the Target are not themselves relevant to the statutory purpose, which is about making good loss suffered by the Scheme (recoverability of the s.75 debt);
- Gains by the Target are expressly stated to be relevant to FSDs but not so stated to be relevant to CNs – the contrast in the legislation suggests that gains are intended to be irrelevant to CNs.

But before reaching that conclusion, it is necessary to consider the changes made to the CN legislation in 2008.

The changes to the CN legislation in 2008:

For present purposes, just two of the changes are of interest: the addition of the material detriment test and the inclusion of benefit to the Target in the prescribed "reasonableness factors" in s.38(7).

The question is whether these changes make any difference to the relevance / irrelevance of gains by the Target.

Taking first the introduction of the material detriment test, this plainly widens the scope for issuing a CN: it is no longer necessary to show that the Target acted with the main purpose (and effect) of reducing the amount of the s.75 debt that could be recovered; it is now sufficient that the Target's acts caused material detriment to the likelihood of accrued benefits being paid (s.38A).

But this does not change the fundamental purpose of a CN, namely requiring the Target to make good damage caused to the scheme. It is no longer necessary to show that recovery of the s.75 debt itself has been prejudiced, but it is still necessary to show detriment or harm to the scheme – an adverse effect on the ability to pay accrued benefits. It follows that, after this change to the legislation, the CN regime is still essentially compensatory.

It also follows from this that the central question is also unchanged: the relevant question is how much the Target has harmed the scheme, not how much it has profited.

This first change, the new material detriment test, therefore does not itself alter the position regarding the relevance of gains made by the Target to the issue or amount of the CN.

This raises the interesting question: if that is right, why was s.38(7) amended to include the benefits received by the Target as a factor relevant to the issue of a CN, and not just whether to issue a CN, but if so in what amount? Or does the inclusion of that factor in the list of factors to be taken into account in relation to reasonableness mean that CN regime is (contrary to the conclusion reached above) not in fact essentially compensatory at all?

The relevance of benefits following the change to the CN legislation:

A cynic might perhaps conclude that the benefit received by the Target was introduced as an additional reasonableness factor because this makes it easier to justify a CN in a large amount - if the Target can be shown to have benefitted from its relationship with the employer, it arguably makes it more reasonable to require it to pay a substantial sum to the scheme.

But this is not an adequate answer, because that logic would make it correspondingly harder to justify a CN from someone who had caused real damage to the Scheme (and had the means to make good that loss) but did not do so not for his own benefit – the lack of benefit would then become a negative factor in the reasonableness balance. And that does not seem right. If a Target has caused harm to the scheme, it should be exposed to the risk of a CN even if it did not itself benefit as a result.

It must not be forgotten that, even after the consideration of the amount of benefit the Target may have received, there is an overall cap on any single Target's liability under both the CN and the FSD regimes. This cap is the full amount of the s.75 debt: no matter how great the benefit to the Target, its individual moral hazard liability cannot exceed the full s.75 debt.

The existence of that cap would seem to offer further support for the view that the focus (of both FSD and CN regime) is on supporting the scheme / making good loss to the scheme not depriving the Target of its gains.

But again the question arises: if that is right, why is the matter of gains or benefits made by the Target relevant to CNs at all (as it undoubtedly is, following the 2008 amendments)? More particularly, does the deliberate and specific inclusion of gains in the CN reasonableness factors mean that CN's are <u>not</u> purely compensatory after all, and either Warren J was wrong about that in *Bonas* or the position has subsequently changed as a result of the 2008 amendments?

<u>Conclusion:</u>

The writer's view is that the inclusion of gains in the reasonableness factors for CNs, whatever the reason, is <u>not</u> sufficient to alter the essentially compensatory nature of a CN.

It should be noted that tPR apparently takes a different view. The s.89 report issued following *Bonas* stated that tPR does not think that the amount of a CN is restricted to compensation for the harm caused by the Target to the scheme. That view does not appear to have been updated or contradicted by tPR. The regulator's view, it seems, is that while the CN regime is not punitive or penal, it is broader than a purely compensatory regime. For example, it could be understood as intended, or extending to, depriving the Target of its gains (note that common law damages for breach of contract, which are essentially compensatory, can exceptionally be gains-based). tPR would argue that CNs are concerned with reasonableness more generally: the relevant question is simply, in the light of all relevant circumstances, what sum is it reasonable to require the Target to pay? In answering that question, tPR has to have regard to the prescribed reasonableness factors, and significantly none of these factors concerns the amount of loss caused to the Scheme: the focus is on broader considerations. Further, tPR would argue that it is important to see the CN regime as part of a moral hazard framework and in that context it has to operate as a deterrent against certain types of conduct; and that deterrent effect loses its teeth (or at least has them filed down) if the worst that can happen to the Target is being imposed with liability to make good the damage it has caused.

Hence there is a policy argument in favour of a broader view, taking CNs as going beyond a purely compensatory mechanism.

The writer's view is that, despite these policy arguments, the focus of CN regime, as derived from the legislation, remains on the detriment to the scheme and it is therefore the quantum of the detriment

that should drive the amount of the CN. The "gateway" is a detriment to the scheme (either damage to the recovery of the s.75 debt or "material detriment" more generally). The amount of the CN should therefore be such amount as is required to make good that detriment, insofar as this is reasonable. The amount of the liability should correspond to the cause of the liability. And the s.75 debt cap ("shortfall sum") still applies so any single Target's CN cannot exceed that amount in any event.

It must be acknowledged that tPR's approach gains support from the inclusion of gains in the reasonableness factors – this strengthens the idea that quantum is to be assessed by consideration of factors other than just the amount of loss caused to the scheme (as does the new consideration of impact on other creditors in the new s.38(7)(eb)).

But the focus nevertheless remains on the detriment to the scheme and the essential purpose remains compensatory. The fact that it might be desirable to have a broader, more extensive, scope to a CN (on policy grounds) does not mean that this is what the legislation has in fact achieved. On the approach advocated here, it is admittedly initially not obvious what role benefits plays beyond making it easier (more reasonable) to issue a CN if Target has in fact benefitted (i.e. the "cynical" view identified above).

One possibility is that, in a material detriment case, the amount of benefit received by Target might, in some circumstances, stand as a proxy for the extent or value of the detriment caused to the scheme, or, if not as a proxy, it might at least be a relevant factor in assessing the amount of the detriment to the scheme. For example, consider a case where there has been a reduction in employer covenant strength as a result of a transfer of something of value (eg assets or business or IP rights) from the employer to the Target, but the employer is still solvent and there is no immediate prospect of scheme wind-up. This would not be a "main purpose" case, but could be a material detriment case: the employer is rendered materially less likely to be able fully to fund accrued liabilities as a result of the transfer of value. But the extent of that detriment to the scheme (the reduced likelihood of the solvent and trading employer being able to fund scheme benefits) could be very hard to value. Perhaps the benefit received by the Target (i.e. the value of assets transferred away) could be used to inform the valuation of the detriment to the scheme and hence the amount of the CN.

Another possibility is that in a multiple Target case, the reasonableness of how much to require each individual Target to pay will be informed by the extent to which each has benefitted – thus giving the concept of benefit some meaning and content but without straying away from the essentially compensatory nature of the CN regime.

Moral Hazard Claims: Contribution *between* Parties

Andrew Mold

I. Introduction

An interesting and fairly discrete topic that has arisen in at least a couple of moral hazard cases to date is the issue of potential contribution claims between parties who are (or may be) targets of the Regulator's moral hazard powers. This paper will consider how these claims might arise and whether or not they are likely to succeed.

The issue of whether a contribution claim is available will become relevant in the common situation in which more than one party has participated in the conduct, or brought about a state of affairs, that gives rise to a s.38 CN, FSD or s.47 CN. Determining which party (out of those in the firing line) should ultimately bear the lion's shares of any liability will often be commercially significant because the parties who previously acted together in a way that has given rise to liability for a CN or FSD may, by the time of any hearing before the Determinations Panel, be: (a) subject to different ownership; or (b) insolvent. Therefore, where the ultimate liability falls will be important.

There are two relevant aspects to how the ultimate liability between multiple parties may be determined:

(i) First, there are the specific powers under the CN and FSD parts of the Pensions Act 2004 which enable the Determinations Panel ('DP') to decide upon multiple targets' respective liability – and those powers include specifically whether to make targets 'jointly and severally' liable under a CN.

(ii) Second, there is the question of whether a target who has received a CN (or FSD) can subsequently bring a contribution claim against: (a) another target: or (b) potentially a third party (who was not an actual target of the Regulator).

The aim of this paper is to focus on the second of those aspects. However, initially we shall briefly consider the first aspect.

II. The Pensions Act 2004 Powers

Focusing first upon CNs, when faced with multiple targets, the DP will be required in the body of a CN to:

'identify any other persons to whom contribution notices have been or are issued as a result of the act or failure to act in question and the sums specified in each of those notices' **(s.40(2)(c))**

Provision is then made expressly for the DP to make targets liable on a 'joint and several' basis:

'Where the contribution notice so specifies, the person to whom the notice is issued ("P") is to be treated as jointly and severally liable for the debt with any persons specified in the notice who are persons to whom corresponding contribution notices are issued' (s.40(8))

A 'corresponding' CN may only be issued as a result of the same act or failure to act that has justified the issue of the CN to which it corresponds (s.40(9)(a)).
Accordingly, when faced with multiple targets who have engaged in conduct together that justifies the issue of a CN, the DP can decide:

(i) whether to make 'non-corresponding' CNs against the targets – which presumably should reflect the DP's perception of each target's respective responsibility for the conduct justifying the issue of a CN.

If this approach is taken by the DP, then the DP has effectively decided which parties should ultimately bear what amount of liability.

(ii) alternatively, the DP may determine that multiple targets should be made 'jointly and severally' liable for a single quantum figure under 'corresponding' CNs – without determining the targets' respective responsibility inter se.

It follows that where the targets have differing commercial interests (rather than, for example, all being part of one solvent group with common ownership), there will be an incentive for one target to argue why its responsibility for the conduct giving rise to the CN is less than another target's and therefore why it should only be subject to a lower 'non-corresponding' CN.

In contrast, the Regulator and the Trustees will usually favour a CN made on a 'joint and several' basis rather than non-corresponding CNs that apportion the respective liability of the targets. This is because where a CN is issued on a 'joint and several' basis, the whole of the CN debt may be recovered from any one of the multiple targets against whom a CN has been issued.

This will be particularly advantageous where there is doubt over some of the targets' solvency. This approach reflects a wider compensation principle that aims to ensure that the victim of multiple wrongdoers should be fully compensated, by placing the risk of one wrongdoer's insolvency onto the shoulders of the other wrongdoers rather than on to the victim. However, this approach also means that the parties against whom enforcement action is taken will often be chosen on the basis of their ability to pay rather than on account of their respective blameworthiness. It is for this reason that where 'joint and several' liability exists, the party against whom the liability has been enforced is normally able to bring a claim for contribution or indemnity against another party who was subject to the same liability.

The ultimate importance of the approach taken by the DP will be affected by whether a target can in fact subsequently bring a contribution claim. This is because if a target cannot subsequently bring a contribution claim, then how the DP determines the targets' respective responsibility when issuing a CN will be the end of the matter – thereby also determining how the ultimate liability falls. For this reason, consideration about whether or not a subsequent contribution claim is likely to be available may need to be given at the DP stage when arguing over whether it is reasonable to issue a CN and, if so, in what amount and on what basis.

Set out above are provisions dealing with s.38 CNs. Similar provisions apply in relation to CNs (under s. 47) following non-compliance with an FSD. Further, an FSD may also itself lead to an arrangement approved by the Regulator that involves 'joint and several' liability. For ease, we shall focus on the position of CNs rather than FSDs in the remainder of the paper.

III. A Possible Contribution Claim?

So, assuming that the DP has determined to issue a CN to a target, can that target seek a contribution from another party by bringing a contribution claim?

As indicated above, in addition to being relevant to the options open to a target following the issue of a CN, this issue will also potentially be relevant to the prior question of how the DP should exercise its powers in the first place. A real life example in which this point arose was the *Carrington Wire* case determined by the DP in early 2015.

(i) In *Carrington Wire*, the Regulator originally sought CNs against three targets: two companies within the Severstal group (a large Russian-owned mining and steel supply group) and an individual called Mr Williams.

(ii) Severstal had purchased Carrington Wire (a UK supplier of wire and wire products) and provided a parental guarantee for Carrington Wire's pension scheme liabilities. Crucially, however, that guarantee would terminate on the sale of Carrington Wire out of the Severstal group.

(iii) Unfortunately, Severstal failed to make a success of Carrington Wire and after a few years sought an exit.

(iv) Severstal then entered into an arrangement with Mr Williams whereby Carrington Wire was sold to an SPV (with no material assets) owned by Mr Williams – thereby terminating Severstal's guarantee of the scheme's liabilities and leaving behind a weak employer for the scheme.

(v) Shortly before the case was due to be heard by the DP, the Severstal targets settled with the Regulator making a payment of some £8.5m into the scheme.

(vi) However, the case continued against Mr Williams against whom a CN of £382,136 was sought (this being a sum that Mr Williams had personally received under the sale transaction).

(vii) In the Warning Notice, the CN that had been sought against Mr Williams (for £382,136) had been sought on a 'joint and several' basis with the Severstal targets. The total sum originally sought against the Severstal targets in the Warning Notice was £17.721 million (with £382,136 of that amount on a 'joint and several' basis with Mr Williams).

(viii) Before the DP, one of the arguments put forward by Mr Williams was that:

a. Had a CN been issued against him on a 'joint and several' basis with the Severstal targets, he would have been able to claim a 2/3 contribution from them.

b. However, were a CN now to be issued against him in the full amount of £382,136, he would not be able to claim any contribution from them.

c. **Thus, he argued, the Regulator having settled with the Severstal targets, it would only be reasonable for the DP to issue a CN in the amount of 1/3 of £382,136 (i.e. £127,379) against him on a sole basis.**

(ix) Therefore, Mr Williams' argument depended upon two issues:

a. **whether Mr Williams could in fact have brought a contribution claim against the Severstal targets had a CN been issued to all three targets on a 'joint and several' basis; and**

b. **whether Mr Williams might now still be able to bring a contribution claim against the Severstal targets notwithstanding their settlement with the Regulator and the fact that no CN would be granted on a 'joint and several' basis.**

(x) The relevance of these issues was that if either:

a. **Mr Williams could never have made a successful contribution claim against the Severstal targets; or**

b. **alternatively, he could still do so,**

then he could not be said to be prejudiced by the issue of a CN against him on a sole basis.

(xi) On the facts of Carrignton Wire, the DP did not consider that it needed to resolve these interesting legal issues because, even assuming the position most favourable to Mr Williams – namely, that he would previously have had a good claim for a contribution against the Severstal targets which he now no longer had – the DP considered that it was nonetheless reasonable to issue a CN against Mr Williams for £382,136 on a sole liability basis.

Although the DP did not ultimately have to decide these points in *Carrington Wire*, it is interesting to consider their merit as they may well be raised in future cases.

(A) <u>Contribution claim against another target?</u>

A claim for contribution in relation to a debt (which is the liability to which a CN gives rise: s.40(3)) falls outside of the Civil Liability (Contribution Act) 1978. This now seems to be the accepted position

although there has been some previous authority suggesting the contrary: see *Hampton v Minns* [2002] 1 WLR 1; *Revenue and Customs Commissioners v Yousef* [2008] EWHC 423 (Ch) at [20] to [26]. Instead, claims for contribution by those who pay more than their share of a common liability for the same debt lie in equity and at common law: see, for example, *Dering v Earl of Winchelsea* (1787) 1 Cox 318. The basis for such a claim is unjust enrichment: the defendant (to the contribution claim) has been unjustly enriched by the claimant paying the defendant's debt under legal compulsion.

According to *Goff & Jones*, *The Law of Unjust Enrichment*, (8th Ed) at 20-01, there are four conditions for making out a contribution claim:

(i) the claimant and the defendant must both be liable to the third party;

(ii) the third party must be forbidden from accumulating full recoveries from both of them;

(iii) the third party may choose to recover in full from either of them; and

(iv) some or all of the burden of paying should ultimately be borne by the defendant.

On the face of it, these conditions would appear to be capable of satisfaction in the case of corresponding CNs issued against multiple targets on a 'joint and several' basis.

Importantly, however, a right to contribution may be excluded by contract or by statute (expressly or impliedly). Therefore, the question arises whether the Pensions Act 2004 impliedly excludes a right of contribution in the case of a CN (there is no express exclusion to that effect).

As set out above, s.40(8) expressly enables the DP to determine that persons be 'jointly and severally' liable in respect of a sum under a CN. However, a statutory provision in these terms in not conclusive that a contribution claim may be made between those parties who are made 'jointly and severally' liable. This can be seen from the *Yousef* decision:

(i) In *Yousef*, HHJ Purle QC had to consider the position of a company director who was liable under ss.216-217 of the Insolvency Act 1986 which deals with liability in relation to 'phoenix' companies.

(ii) Under s.217, any person involved in the management of the 'phoenix' company is personally liable for its debts. The provision then goes on to provide that any person responsible under the section is 'jointly and severally' liable with the 'phoenix' company and any other person who is liable.

(iii) Mr Yousef, who was a director of a 'phoenix' company was being pursued by HMRC for revenue debts of the 'phoenix' company. He claimed entitlement to seek a contribution from other directors who would also be caught by the provisions of ss.216-217 but who had not been sued by HMRC.

(iv) However, HHJ Purle QC considered that in the context of these particular provisions under the Insolvency Act, the words 'jointly and severally' did not give rise to the right of contribution. He considered that the provisions were concerned solely with protecting creditors and widening the range of people from whom recovery could be sought (at [33]).

(v) The Judge's reasoning was primarily based upon what he considered to be the 'strange' (at [32]) consequences that might follow if claims for contribution were allowed for liabilities created under these statutory provisions. For example, the Judge considered that it would be very odd if a 'phoenix' company that had actually satisfied its debts could then seek a contribution from its own directors or former directors (particularly, as the 'phoenix' company might have changed ownership).

(vi) Accordingly, the Judge concluded that it was Parliament's implied intention to exclude any right of contribution in respect of the statutory liability.

Therefore, as *Yousef* indicates, just because a statute provides for liability to be on a 'joint and several' basis does not mean that a contribution claim will necessarily be available. However, in the case of a CN under s.38 (or a CN under s.47), it is not at all obvious that equivalent 'strange' consequences (to those that existed in *Yousef*) would follow if a right of contribution were available.

In a case in which corresponding CNs are issued against targets on a 'joint and several' basis – rather than dividing up the CNs for different amounts against each target on a sole basis – the DP will not have addressed the respective responsibility amongst the Targets. Therefore, the normal position that one debtor should be able to seek a contribution from a co-debtor should follow. Otherwise, the

target who is the easiest to enforce against will be left to pick up the full extent of liability under the CN without recourse to any other target who might be equally or more blameworthy.[64]

(B) Contribution claim against a third party

At first sight, the answer to the question whether a target who has received a CN might seek a contribution against a third party who has not been a recipient of a corresponding CN might appear straightforward and as follows:

(i) In order for a right to contribution to be available, the debtors must be under a common liability.

(ii) Under s.38, there is no liability for the CN debt before the CN is issued.

(iii) Therefore, if a CN is only issued to one target (and no corresponding CN is issued to the third party against whom a contribution claim is brought), then the target and the third party will not be under a common liability.

(iv) Thus, a condition for bringing a successful contribution claim will not have been satisfied and the claim will fail.

This looks fairly clear and simple (and is probably right). However, as with most things, there is a possible counter-argument.

Under this counter-argument, it might be said that it does not matter that a CN has not actually been issued to the third party: it is only necessary to show that the third party would have been liable had a CN been sought against it. This reflects the approach that applies in ordinary contribution claims: it does not matter that a party against whom a contribution is sought has not actually been sued by the original claimant, so long as that party was liable for the same damage (and therefore a claim against the third party would have been successful).

Further, the counter-argument might be said to draw some support from the Supreme Court decision in the *Nortel & Lehman* case [2014] AC 209.

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[64] Assuming a right of contribution is not excluded, the default rule between joint debtors is one of equal apportionment. However, there are exceptions to this rule (for example, if one party has received a larger benefit, then he may be ordered to shoulder a greater share of the debt). Detailed discussion of how the liability should be apportioned is beyond the scope of this paper.

(i) In that case, the Supreme Court considered whether a liability for a FSD or CN was a provable debt. The relevant time for judging this was the date of the target company's entry into administration.

(ii) However, in both the *Nortel & Lehman* cases, no FSD had been issued at that date and a Warning Notice had not even been served.

(iii) In finding that a FSD/CN issued after the date of entry into administration was a provable debt, the Supreme Court relied upon the test set out in r.13(12)(1)(b) of the Insolvency Rules, namely that it was a liability which arose '*by reason of* [an] *obligation incurred before*' the insolvency event.

(iv) The Supreme Court ultimately found that this test was satisfied on the basis that the facts justifying the issue of a FSD existed at the date of the insolvency event thus making the target vulnerable to the liability being incurred.

(v) As Lord Neuberger stated (at [85]), at the date of the insolvency event:

> **'*the Target companies were not in the sunlight, free of the FSD regime, but were well inside the penumbra of the regime, even though they were not in the full shadow of the receipt of a FSD, let alone in the darkness of the receipt of a CN*.'**

(vi) The above passage, although very attractively expressed, does not appear particularly easy to apply or to provide a bright-line test. However, it might be relied upon to say that, for contribution claim purposes, it is sufficient that a party is inside the 'penumbra of the regime', even though no FSD or CN has actually been issued against it.

However, whilst there may be a counter-argument along the lines set out above, the possibility of a contribution claim against a third party who has not received a CN would also give rise to some difficulties or oddities. For example, if and to the extent that the quantum of a CN is not simply referable to loss caused to the employer or the scheme but is instead set by reference to the wider concept of reasonableness (taking into account the particular circumstances of the target), it is difficult to say that a payment by a target has 'extinguished' the claim against a third party in the same way that this might be said in relation to a normal debt or damages claim. Instead, it would have to be said that the target's satisfaction of its own CN has somehow served to reduce the potential liability of the

third party – because, having recovered from the target it would not be reasonable for the Regulator to seek a CN from the third party (either at all, or only in a lower amount).

As referred to earlier, the issue of whether a contribution claim might exist is perhaps more likely to arise at the DP stage of a case in the context of arguments about the reasonableness of issuing a FSD or CN against a particular target (as was the case in *Carrington Wire*) rather than forming the subject of separate later contribution proceedings. A similar issue arose in the on-going *Box Clever* case in which the targets complained about the Regulator's decision not to pursue the other joint venture party (Carmelite) – arguing that this failure was relevant to whether it was reasonable to issue a FSD against the targets that had been pursued. Those targets claimed that they had been prejudiced by the Regulator's decision not to pursue Carmelite because the Regulator was seeking to hold the targets solely liable for the scheme's deficit rather than their being able to share any liability with Carmelite. The *Box Clever* case is ongoing but the targets' argument received little sympathy from the Upper Tribunal on an interlocutory application for disclosure relating to the Regulator's reasons for not pursuing Carmelite.

Therefore, to date, no decision in the context of the Regulator's moral hazard powers has actually been given as to whether and in what circumstances a contribution claim may be brought by a target. It follows that there is scope for argument on the point and we may expect to see this issue raised again in future cases.

The statutory definition of "service company": some problems

James McCreath

Introduction

1. Of the two statutory gateways under s.43(2) for the imposition of a Financial Support Direction, the most obviously problematic is the 'insufficiently resourced' test. Even by the standards of pensions legislation generally, the relevant provisions of The Pension Regulator (Financial Support Directions etc.) Regulations 2005 are very far from a model of clarity.

2. Set against that, the first gateway (to which, as a matter of statutory language, the 'insufficiently resourced' test operates as an alternative) can seem very straightforward. It simply requires that the employer is a 'service company', and everyone knows what a service company is: it's a company that exists not to conduct economic activity in its own right, but to provide services to the companies in the group that do the real business. The case for regulatory intervention in such companies is clear. It is other companies in the group who derive economic benefit from the activities of the service company, and accordingly they should pay the true cost of those activities, including the costs of providing the pensions promised to employees.

3. However, true to form the legislation takes a concept that may appear simple, and gives it a definition which is anything but. This paper will consider a few of the difficulties posed by that definition

The statutory provision

4. The definition of "service company" is contained in s.44(2), and is in the following terms:

> *"An employer ("E") is a "service company" at the relevant time if–*
>
> *(a) E is a company as defined in section 1(1) of the Companies Act 2006,*
>
> *(b) E is a member of a group of companies, and*
>
> *(c) E's turnover, as shown in the latest available individual accounts for E prepared in accordance with Part 15 of that Act, is solely or principally derived from amounts*

charged for the provision of the services of employees of E to other members of that group."

5. There are three elements to this definition.

6. First, E must be a company. Establishing whether this is satisfied ought to be straightforward!

7. Second, E must be a member of a group of companies. Again, this should be straightforward.

8. Third, E must meet various conditions in respect of its turnover. This is where the definition becomes problematic. To establish whether this is satisfied, it is necessary to identify three things:

    (1) E's latest available individual accounts prepared in accordance with the Companies Act 2006.

    (2) The turnover shown in those accounts.

    (3) Whether that turnover is solely or principally derived from amounts charged for the provision of the services of employees of E to other members of the group.

9. Each of these poses its own difficulties.

Turnover

10. I will turn to the difficulty of identifying the correct accounts below. But once those accounts are identified, establishing the turnover of the service company will be straightforward, surely? Somewhere on the P&L sheet there will be a figure for turnover, or gross sales. That, one might think, is the end of the story.

11. This answer, while straightforward and definitive, is not necessarily satisfactory. The point of establishing a service company's turnover is to work out how much of that is attributable to services provided to other group companies. But it is in the nature of service companies that they are subservient. Often they will not insist on actual payments of cash from the other group members, preferring to set up intercompany balances. The amount of those balances, or indeed

of any actual payments made, will not necessarily reflect the true value of the services as arms-length economic actors might agree it.

12. Thus the definition could lead to somewhat of a perverse result. The more subservient the service company – the greater the discrepancy between the real worth of its services and the payments it receives from group companies for them – the less likely it is to fall within the definition. But it is surely in precisely those circumstances that the rationale for regulatory intervention is clearest.

13. It is not difficult to imagine mechanisms in principle to avoid this problem. Parliament could have provided for some mechanism that allowed the alleged service company's turnover to be deemed or imputed by reference to the true value of the services being provided (such value assessed as the price an arms-length economic actor would have been willing to pay for them).

14. While that would in principle be a good solution, in practice, devising and applying an appropriate mechanism to allow turnover to be deemed or imputed would likely be fiendishly complex and expensive. So it is perhaps unsurprising that Parliament has apparently provided for a 'black and white' concept of turnover.

"Solely or principally"

15. The next difficulty arises out of the requirement that turnover must be *"solely or principally"* derived from amounts charged for the provision of services of employees of E to other members of that group. What "solely" means is straightforward. But what "principally" means is not.

16. It seems to me there are two things "principally" could mean (the second of which is hardly a great source of elucidation):

    (1) more than half; or

    (2) something else.

17. As to what that 'something else' might be, as a matter of ordinary language, it seems to me it must require the relevant turnover to constitute numerically between 50 and 100% of E's total turnover. It also seems to me that that 'something else' could potentially embrace a qualitative assessment of the importance of that turnover to the operations of the service company as a

whole. For example, if a service company derives 60% of its turnover from providing services to its parent, but the remaining 40% is derived from a base of repeat and financially secure customers, it seems to me that it could be harder to say that its turnover is *"principally"* derived from providing services to the parent than if the numbers were the same, but the remaining 40% was derived from a few ad hoc and irregular customers.

18. Which of these meanings is then to be preferred? So far as judicial authority is concerned, there is not, so far as I can see, any judicially accepted definition of "principally". Dictionary definitions simply repeat the problem by including both potential meanings.

19. We are therefore left to apply first principles to the language actually used in the statute. It is undoubtedly tempting to suggest that the first potential meaning is the correct one, as it has the great advantage of permitting a simple and straightforward answer to the question.

20. But it seems to me that it is difficult to resist the suggestion that it is the second meaning that is the correct one. When these statutory provisions intend a test to consist of a simple mathematical comparison, however crude or capricious that might be, they say so in terms. The insufficiently resourced test is the paradigm example of that. Under s.44(3), the value of the resources of the employer must be less than a specified percentage, the prescribed percentage, of the section 75 debt. Fall 0.1% short of that percentage, and you fail the test. Exceed it by 0.1%, and you pass the test.

21. Thus the fact that in the immediately preceding sub-section Parliament has eschewed imposing a precise mathematical threshold seems to me to indicate that no such threshold was intended. Instead, the use of the word "principally" indicates that a more nuanced, and possibly qualitative, test was intended.

Accounts

22. The final potential problem I want to explore relates to the identification of the correct accounts from which the turnover figure is to be derived. On the face of the statute, that seems a simple exercise: the relevant accounts are *"latest available individual accounts for E prepared in accordance with Part 15"* of the Companies Act.

23. However, the Companies Act and regulations made under it impose various requirements on the preparation of accounts (see generally ss.393 ff of the Companies Act 2006). But suppose that the service company, if only through incompetence, has failed to comply with these requirements in what purport to be its most recent Companies Act accounts. The statutory language appears clear: it requires that the accounts be prepared *"in accordance"* with that Act, not *"in purported accordance"* or *"attempted accordance"*. Thus it is at the very least arguable that such accounts do not fall within the language of s.44(2).

24. An argument along those lines could potentially benefit either the Regulator or the Target, depending on what the questionable accounts, and the latest accounts prepared in undoubted accordance with the Companies Act, show. Coming from a Target, it is potentially a very unattractive argument; it is very possible indeed that the personnel involved in producing and approving the non-compliant accounts will themselves have been employees or officers of the Target company.

25. But moving from a recognition of that unattractiveness to a legal analysis as to why it is wrong is not straightforward. There are a number of arguments as to why the service company itself should not be allowed to pray in aid the non-compliance of its own accounts, whether arising under some form of estoppel or the law's reluctance to allow a party to rely on its own wrong. However, it does not follow that the Target would be similarly bound.

Conclusion

26. The net effect of these difficulties is that showing a company to be a "service company" could be significantly harder than might appear to be the case on a first reading of the legislation. Companies which might appear in need of extra funding for their pensions schemes might very well not satisfy the test.

27. However, in my view, that is not obviously a problem. It seems to me that the purpose of the "service company" test is to address the problems created by "pure" service companies – that is, companies with no real economic activity beyond the provision of group services. It is not intended to cast a wider net which might capture other companies in need of extra pensions funding.

28. My reason for taking that view lies in the kind of "moral hazard" which the service company test addresses. The presence of two separate gateways in s.43(2), it seems to me, is explicable by the fact that they address two different types of moral hazard.

29. Taking the insufficiently resourced test first, the moral hazard that that addresses is the risk that wealth and pensions obligations are unevenly distributed amongst group companies, whether by design or chance.

30. The service company test it seems to me addresses a rather different moral hazard. It is not about whether the service company has less wealth than other companies in the group. There is no requirement for it to be insufficiently resourced, and it could even be better resourced than its parent against whom an FSD was sought (although that would no doubt be relevant to reasonableness). The moral hazard is not present disparity in wealth, but arises out of the mismatch between legally binding pensions obligations and economic reality which exists when a service company exists only to provide services to the group, and is therefore wholly dependent on the group to continue supporting the scheme. Absent regulatory intervention, that mismatch leaves it open to the parent company to effectively escape the group's pension liabilities simply by terminating its relationship with the service company.

31. This is consistent with the way in which the test was introduced in Parliament. Explaining the service charge test in Standing Committee, the Pensions Minister, Malcolm Wicks, said the following (27 April 2004, columns 780 – 781):

> *"[Service companies] frequently have no material assets and their sole revenue comes from amounts charged to other group companies for the service of the employees, pursuant to inter-company agreements. If the parent company wishes to dump its pension liabilities, it can simply terminate its agreement with the company and wind both it and the scheme up. The service company will have no assets with which to pay any section 75 debt due."*

32. It follows that if the company in question not only provides services to other members of its group, but has its own independent economic activity on the basis of which it could survive even without the support of its group, the hazard underlying the service company test does not exist. Thus a restricted interpretation of the statutory expression 'service company' in that context may be said to be justified. That of course is not the end of the story so far as regulatory action is concerned, but such action must instead proceed under the insufficiently resourced test.

33. That however leads to one further oddity of the language of s.44(2)(c). The turnover exceeding the relevant threshold (whatever that may be) must be *"derived from"* amounts charged to companies within the same group. So far, I have been assuming that that means the same as *"consists of"*, or, in other words, that the section requires a numerical analysis of the amounts actually charged to companies within the same group.

34. But that assumption is not necessarily a safe one. A service company may be economically dependent on its group even though in crude numbers it does not receive all or the principal amount of its turnover from the group. For example, it may sell services to third party customers of a group company. Or it may only be economically viable for it to provide services to third parties because it is already providing services to the group.

35. In such cases, it seems to me at least arguable that the consequent turnover, while received from third parties, is *"derived from"* amounts charged for services to group companies. There are obvious difficulties with that argument – making sense of the reference to "amounts charged" for example – but it is arguably consistent with the underlying statutory purpose.

PPF Entry and employers' financial distress

Thomas Robinson

1. These written notes look at the gateway for PPF Entry that is set out in s.127 of the Pensions Act 2004 ("PA 04"), namely the need for a qualifying insolvency event.

2. When I first started preparing my talk I thought I would be arguing that the gateway is unfit for purpose, as it brings with it all sorts of complications and baggage from the world of insolvency that would be better dispensed with altogether. However I am now more inclined to think that the gateway of an insolvency event performs a valuable role in some cases, but that in others it has a distorting effect. We have probably all seen cases where the need to show an insolvency event in the next 12 months leads to consideration of creating a cash crisis. My main message in this paper is to stress the difference between insolvency and insolvency events, and to suggest that the more the legislation focuses on the latter, the more difficulty it gets us into.

Why is this relevant to us as pensions lawyers?

3. Section 127 of PA 04 provides probably the main route for PPF entry. It deals with situations of employer insolvency. It states that "*this section applies where a qualifying insolvency event has occurred in relation to the employer in relation to an eligible scheme*".

4. This triggers the commencement of the PPF assessment period, and s.127(2) imposes an obligation on the PPF to assume responsibility for the scheme if the result of that assessment is to show the value of its assets was less than its protected liabilities (and a scheme failure notice has been issued and no withdrawal event has occurred).

5. The qualifying insolvency events are defined in s.121(3) of PA 04 as follows, where (a) and (b) are steps towards implementing a CVA, (c) is the appointment of an administrative receiver, (d) is the commencement of administration, (e) and (f) are the commencement of CVL, either starting as CVL or starting as MVL but where it turns out not all debts can be paid, so the company is insolvent, and (g) is winding up by the court:

> *(3) An insolvency event occurs in relation to a company where–*
> *(a) the nominee in relation to a proposal for a voluntary arrangement under Part 1 of the Insolvency Act 1986 submits a report to the court under section 2 of that Act (procedure where*

nominee is not the liquidator or administrator) which states that in his opinion meetings of the company and its creditors should be summoned to consider the proposal;

(b) the directors of the company file (or in Scotland lodge) with the court documents and statements in accordance with paragraph 7(1) of Schedule A1 to that Act (moratorium where directors propose voluntary arrangement);

(c) an administrative receiver within the meaning of section 251 of that Act is appointed in relation to the company;

(d) the company enters administration within the meaning of paragraph 1(2)(b) of Schedule B1 to that Act;

(e) a resolution is passed for a voluntary winding up of the company without a declaration of solvency under section 89 of that Act;

(f) a meeting of creditors is held in relation to the company under section 95 of that Act (creditors' meeting which has the effect of converting a members' voluntary winding up into a creditors' voluntary winding up);

(g) an order for the winding up of the company is made by the court under Part 4 or 5 of that Act.

6. These events also form triggers for the s.75 debt.

7. The thinking seems clear: it was employer insolvencies such as Allied Steel & Wire that gave such an impetus to the creation of the PPF and it is therefore those events that should trigger the commencement of a PPF assessment period. Equally, employers who are not insolvent should not be able to get the PPF to assume responsibility for their pension schemes and relieve themselves of their pension obligations. Hence s.121 does not include the entry into MVL, which is a solvent liquidation, though that does trigger a s.75 debt.

8. But this focus on insolvency events rather than insolvency per se has got us into difficulties. The case of Olympic Airlines is an example of that, and later in this paper I want to consider that case and the changes made by the Recast EC Insolvency Regulation from June 2017 and the PPF Entry Rules from April 2016.

9. However can I start more broadly by looking at the disparity between insolvency and insolvency events, with a little history.

Corporate Insolvency

10. A company is an association of members formed together for a common purpose. Until 1844 companies were created by Royal Charter (e.g. the East India Company in 1600) or by Special Acts of Parliament, but otherwise not at all.

11. In 1844 the Joint Stock Companies Act was passed. It introduced the concept of a company having a separate legal personality from its members. However it did not grant limited liability to shareholders. On the contrary, it made clear that shareholders remained liable just as though the company had not been incorporated. Section 66 of that Act provided that judgments against the company could be enforced against the company and against its shareholders. The ordinary course was to sue the company, attempt execution against its assets, then if that did not produce enough, issue execution against the shareholders (Oakes v Turquand (1867) LR 2 HL 325 at p.361).

12. Thus at this time there was far less of an incentive to set in train an insolvency process in order to get paid. If the company did not pay a creditor, the creditor sued its shareholders. Obviously those shareholders could be placed into an insolvency process, i.e. bankruptcy. That has an extremely long history, including the fact that only from 1705 did it release you from bankruptcy debts. Before then it simply got you a release from debtor's prison. It was possible for a company to commit an act of bankruptcy, and the rules applicable to bankruptcy were then applied, but as long as creditors could enforce against the company and then sue each shareholder individually there was less incentive to institute a formal insolvency process in respect of the company.

13. That all changed in 1855, when the Limited Liability Act afforded limited liability for members. This had been controversial. In R v Dodd (1808) 9 East 516 at p.527 Lord Ellenborough described limited liability as a "*mischievous delusion*". However it was duly introduced, and in 1862 the first specific regulation and procedure for winding up a company was introduced (the Companies Act 1862).

14. It was that Companies Act which changed a creditor's remedy away from issuing execution against shareholders and required him to execute against the company. If that did not satisfy the debt he had to compel a winding up of the company. That in turn caused all assets to be called in and distributed among creditors rateably, modelled on the rules in place for bankruptcy. The shareholders were still a source of funds, but rather than be sued individually they came under a liability to contribute to the assets of the company, up to the limit of unpaid portions of their

shares. That remains the case today: any calls on shareholders form a pool within the liquidation, for distribution to creditors.

15. What the cases from the time show is that liquidation was simply a way of seeking payment of a debt, but through a collective procedure. *Oakes* described it as "*but a mode of enforcing payment*" (Oakes v Turquand (1867) LR 2 HL 325 at p.363). That remains the essence of liquidation: in 1983 it was described by Oliver LJ as "*a form of collective enforcement*" (Re Lines Bros Ltd [1983] Ch 1 at p.13). It is marked by the imposition of a statutory scheme under which assets are realised and distributed, pari passu, to creditors, for the benefit of creditors as a whole.

16. Essential to that process happening successfully is the prohibition on creditors taking their own unilateral action to enforce. They are bound in to the statutory process, both in corporate and personal insolvency, to avoid a rush of individual attempts to wring money out of the poor insolvent entity. It is a case of liquidation in the statutory sense in order to avoid liquidation in the Godfather sense. But the process is concerned with collective enforcement of creditor rights. Once complete, the company is invariably dissolved.

17. Contrast administration and CVA. They were introduced by the Insolvency Act 1986 ("IA 86") as part of reforms to further a rescue culture. Before that Act the only insolvency procedures open to a company were liquidations (MVL, CVL or compulsory liquidation by a court order). If a business was to be rescued, or sold as a going concern to raise more money than in a liquidation, this was done by secured lenders appointing receivers. That had worked relatively well, and IA 86 sought to bolster the receivership process by giving it statutory recognition, by the appointment of "administrative receivers".

18. Administration changed again as a result of the Enterprise Act 2002, to focus it more clearly on the purpose of company rescue. So that Act replaced what had been four possible statutory purposes of an administration with one, which begins by requiring an administrator to perform his functions with the objective of "*rescuing the company as a going concern*". This is the objective unless the administrator thinks that it is not reasonably practicable or that realising property would achieve a better result for creditors as a whole. Administration was intended as a rescue mechanism. It results in a moratorium on legal proceedings against the company and gives the administrator the power to continue to trade the business. Originally the administrator had no power to distribute to creditors. His role was rescue; only if that proved impossible would distributions be needed and that had to be done by a liquidator.

19. Likewise CVAs, which gave statutory force to a company's ability to compromise with its creditors in order to continue to trade. Creditors are bound into a CVA if it passes with 75% approval, and cannot take unilateral action in respect of debts that are covered by the CVA, in return for agreeing to accept a proportion of their debts.

20. So if we come back to s.121 of PA 04 we see a range of insolvency processes all looking at rather different things.

21. Liquidation has a long history as a collective method of enforcement. Administration is a different tool, looking at company rescue. So too, in the eyes of IA 86, were administrative receivers. So too a CVA: a form of restructuring to allow continued trading.

22. These processes do all indicate some degree of corporate distress, but they certainly don't indicate the same thing. They may well not indicate "insolvency" in the sense that I expect Parliament had in mind when thinking of the companies whose schemes should enter the PPF as their employers could not support them. A company can enter administration on the basis it is, or "is likely" to become unable to pay its debts, which the courts have held simply means "*more probable than not*" (Re COLT Telecom Group plc [2002] EWHC 2815). However that test can be met by means of cash flow problems alone. Like the European operating company of the Lehman Group, the company may be able to pay all debts in full, with interest, but still be held unable to pay its debts and thus suitable to enter administration. Further, the holder of a Qualifying Floating Charge can appoint an administrator under paragraph 14 of Sch B1 to IA 86 without any evidence of likely insolvency. All it would need to show is a default or other event entitling it to enforce under its charge.

23. Finally on this point, if you were looking for indicia of employer financial distress, you would not limit the list to those in s.121. There's no mention of the appointment of a provisional liquidator, nor LPA receiver, nor a scheme of arrangement. Nor of overseas insolvencies, which was the issue that gave rise to the difficulties in Olympic Airlines.

<u>Olympic Airlines</u>

24. The difficulties in that case arose because of the focus in s.121 PA 04 on insolvency events in the UK. The EC Insolvency Regulation 2000 limits the availability of those UK insolvency events where a company has its centre of main interests (COMI) in other member states (save Denmark).

25. Olympic had its COMI in Greece. Accordingly, the EC Regulation meant it could only enter winding up in this country if it entered secondary proceedings, and that required it to have an "establishment" here at the time of the application to wind up.

26. The Supreme Court held ([2015] UKSC 27) that an "establishment" required there to be a minimum level of organisation and a degree of stability necessary for the purpose of pursuing an economic activity, which must include dealings with third parties, not just internal administration. Since Olympic was only engaged in internal winddown activities in the UK at the time the trustees applied to wind the company up in this jurisdiction, this test failed.

27. Thus by focussing on the need for a UK insolvency event, rather than insolvency per se, we have imported the technicalities of insolvency law and the principles governing it, both UK and European principles, to pensions law in order to form the main gateway for PPF entry.

Attempts to address the problem

28. The difficulty that faced Olympic will be improved somewhat from June 2017 by a Recast EC Insolvency Regulation. That will mean that rather than there needing to be an establishment at the time of the application to court to open secondary proceedings, it is enough that there was such an establishment in the three months prior to the main insolvency proceedings starting (see Article 2(10) of the Recast EC Insolvency Regulation).

29. That Regulation brings other changes too. It removes the need for secondary proceedings to be liquidations, thus encouraging a rescue culture; it codifies the existing definition of COMI that is currently to be found in the recitals; and there is a new framework for "group insolvency proceedings" dealing with corporate groups. That could be significant, as it seeks to limit the multiplicity of proceedings so ought to make it harder for secondary proceedings to be opened. A further mechanism is to allow the officeholder in the main proceedings to prevent secondary proceedings being opened at all by giving an undertaking to distribute local assets in compliance with local law. That is what secondary proceedings should achieve. The undertaking is to be approved by known local creditors, with local law on voting majorities applying to the approval. That probably means in the UK a majority by value. One can imagine the trustees of a scheme wanting to ensure secondary proceedings of an employer are commenced in this country, to allow PPF entry, while other creditors are content with the undertaking, and may even object to a multiplicity of insolvency proceedings. Certainly a key policy behind the Recast Regulation is to harmonise insolvency proceedings.

30. To my mind the key attempt to address the problem in Olympic is to be found in pensions law, namely the amendment to the PPF Entry Rules from 6 April 2016. These use the existing mechanism of securing PPF entry by use of s.129 of PA 04, but expand its application.

Section 129

31. Section 129 of PA 04 provides:

> *(1) Where the trustees or managers of an eligible scheme become aware that–*
>
> *(a) the employer in relation to the scheme is unlikely to continue as a going concern, and*
>
> *(b) the prescribed requirements are met in relation to the employer,*
>
> *they must make an application to the Board for it to assume responsibility for the scheme under section 128.*

32. Reading that together with amended Reg 7(5) of the PPF entry rules results in five requirements to secure the commencement of a PPF assessment period where an employer has, like Olympic, its COMI in another EU member state:

1) to show that the employer has its COMI in another EU Member State (other than Denmark)—reg.7(5)(a) of the PPF Entry Rules (as amended);

2) to show that relevant insolvency proceedings (within the EU Insolvency Regulation) had been opened against the employer in the other Member State—reg.7(5)(b) of the PPF Entry Rules. Presumably, in practice this will usually be relatively easy to prove;

3) to show that the employer does not have an "establishment" in the UK—reg.7(5)(c) of the PPF Entry Rules;

4) to show that the employer is "unlikely to continue as a going concern"—s.129(1)(a) of the Pensions Act 2004; and

5) to make an application under s.129(1) to the PPF Board in the prescribed form (and containing the prescribed information), and be made within the prescribed period—s.129(3) of the Pensions Act 2004.

33. That is certainly an answer for Olympic, and potentially any other UK employers with their COMI in another Member state.

34. However this route contains the test that has always been in s.129: the need to show the employer is "unlikely to continue as a going concern".

35. This may not be a straightforward test to meet. In Reg 7 of the PPF Entry Regulations the test is being applied to companies where the employer is already in an insolvency process in another member state. So it may well be easy to show it is unlikely to continue as a going concern. However insolvency processes focussing on rescue may not satisfy the test. Consider administration and CVA in this country. The purpose of administration is to rescue the company as a going concern, where possible. Thus this test could well be failed by some administrations, and most CVAs. It introduces a range of its own considerations: unlikely to continue as a going concern "for how long"? In which jurisdiction? What is particularly interesting though is that the test is not expressed in terms of cash flow or balance sheet insolvency.

Conclusion

36. There is much to commend a "going concern" test for the commencement of a PPF assessment period. It identifies employers that are in distress without needing a formal insolvency process trigger that might be out of reach (Olympic) or require the creation of a cash crisis. It avoids triggering the s.75 debt. It might be said that the need for an insolvency event is a bright line test. But the tests for the occurrence of an insolvency event are rarely bright line: for example a company can enter administration if a Judge considers it more probable than not it will become unable to pay its debts.

37. In my opinion the focus of the gateway in s.127 should be on identifying employers in financial distress, where it is appropriate for the PPF assessment period to begin if the employer sponsors an eligible scheme. That assessment is the key process to ascertain the scheme's needs, and the sources of funding for it (not only the employer's assets, but also scheme investments and moral hazard actions). The existence of an insolvency event in relation to the employer is of tangential relevance at that stage.

38. In my ideal world therefore we would be focussed on a wider question than just whether there has been a qualifying insolvency event. In my opinion that test has a role to play in some cases as

an indication of financial distress. But it is undesirable to have it as the sole gateway and the expansion of s.129 PA 04 from April this year is to be welcomed.

PPF entry and employers' financial distress

Jonathan Hilliard QC

1. In the written paper for my part of the talk, I will cover two areas:

   (1) how trustees should deal with the presence of the PPF in exercising their discretion in situations towards the end of a scheme's life; and

   (2) how reg.2(2) of the Pension Protection Fund (Entry Rules) Regulations 2005 (the "Entry Regs") applies in such situations.

<u>What role for the PPF in trustee discretion?</u>

2. The carefully reasoned decision in *ITS v Hope* [2009] PLR 379 is a helpful point of departure. Henderson J made clear that:

   (1) the availability of PPF compensation is not a relevant factor for trustees to take into account in the exercise of the buy-out power;

   (2) further than that he would not go in relation to other fact-sets not before the Court; but

   (3) he would expect a similar approach to be adopted in any instance where trustees seek to take advantage of the existence of the PPF as a justification for acting in a way which would otherwise be improper (para.119).

3. Therefore, the question is how a Court would approach these other fact-sets and the policy questions that arise in them. For present purposes, I shall focus on schemes toward the end of their life, because the PPF will be an important feature of the scheme's near to mid-term horizon and the possibility of PPF compensation important for its members. Will it *ever* be permissible to take the presence of PPF compensation into account when taking trustee decisions and if so how does one distinguish taking it into account in a *permissible* manner and taking it into account in an *impermissible* manner?

(i) Taking steps to facilitate PPF entry

4. For a multi-employer scheme with a tricky history, it can be complex to ensure that the whole scheme can enter the PPF rather than a part being left behind. Therefore it can sometimes be

necessary to undertake a number of actions that are only being taken to facilitate such entry. These can include:

- inserting newcos
- creating particular employment relationships for particular periods (such as for those to be employed by the newco)
- apportionment steps of various kinds
- and carefully managing the timing of the insolvencies.

5. In my opinion, such steps are permissible. The broad policy behind the PPF is that the members of eligible schemes whose employers fail leaving the benefits underfunded should be entitled to the protection of the PPF to ensure that they receive a certain level of pension benefits. Therefore, if the scheme is an eligible scheme whose employers fail leaving the scheme without sufficient funding, then they should be eligible for the PPF. Multi-employer schemes like the ones mentioned above pay their levies for the benefit of PPF protection and they should not be cut off from it through the happenstance of quirks in their history that mean that they need to take slightly more unusual steps to bring about PPF entry. And this is even before factoring into the equation the question of whether EU law demands this.

6. What indications we have on the topic give cause for optimism that a Court would be receptive to this argument. In *ITS v Hope*, Henderson recorded without disapproval the PPF's acceptance that "*it might be perfectly proper for trustees to have regard to the PPF in deciding whether, or when, to bring about a qualifying insolvency event, as part of the planning for an orderly running down of an under-funded scheme*", saying that he agreed that there could not be a one size fits all answer across all contexts to the question of the appropriate role of the PPF in trustee decision-making (para.106).

(ii) Bulk transfers and corporate reorganisations

7. There are at least three ways that the PPF might enter into the minds of the trustees in relation to a bulk transfer or corporate reorganisation.

8. First, the trustees will want to check whether PPF eligibility is compromised by the step in question. This is permissible, as the PPF and Henderson J accepted in *ITS v Hope* (para.106). In such a situation, the trustee is merely trying to preserve the status quo in this regard. It would be

surprising if trustees were required to put out of their minds that a transaction would remove members' PPF protection.

9. The conclusion that it is permissible to check that PPF eligibility is not compromised poses the following difficulty. If you can take account of the presence of the PPF in this respect, how is a trustee to distinguish between taking account of the PPF in this way and not taking account of it in other ways in reaching his decision?

10. Putting this a slightly different way, two models suggest themselves to deal with the trustee being able to take this into account:

    Model 1: Take into account the presence of the PPF generally in making the decision in question

    Model 2: (i) don't take account of PPF eligibility at the first stage of your decision and work out what you would want to do
    (ii) *then* check whether PPF eligibility is compromised by the proposal.

11. The argument against Model 1 is that the fact that it is permissible to take account of PPF eligibility in the context above does not automatically lead to the conclusion that it is permissible to take it into account in other contexts. This would be to fall into the trap identified by Henderson J in *Hope* of assuming that there can be one answer across all contexts to whether the presence of the PPF can be taken into account. Indeed, applying it directly to the facts of *Hope*, Model 1 would reach the conclusion that the scheme was a proper exercise of the trustee's powers, and is therefore inconsistent with the result reached in that case.

12. However, Model 2 is obviously more complicated than Model 1.

13. The second PPF angle to the proposal is the phenomenon of priority drift. The PPF pays greater compensation to those who have reached NRA by the time of the triggering event for the PPF assessment period. Accordingly, if a scheme that could easily trigger the start of a PPF assessment period does not do so, more members will reach NRA before the start of the assessment period, thereby increasing the number of members who receive a higher level of PPF compensation and the cost to the PPF of assuming responsibility for the scheme.

14. The question is whether this is something that trustees should be concerned about when taking their decision. One can see the appeal of this if one is to seek to protect the PPF here. However, the argument that they should not is that such a concern would be founded on very different reasoning to that in *Hope*. Far from excluding the presence from their consideration, trustees would be positively required to take the PPF's interests into account. Moreover, it is not clear where such a line of thought would lead. It seems to lead to the possibility that the trustees should take certain steps to try to protect the PPF against the extra cost of priority drift (such as by the trustee estimating the cost of such drift and then seeking to negotiate some sort of premium to cover this off as part of the proposal in question), but quite what the content of such a positive duty would be and how far it would go is unclear.

15. One solution to the problems thrown up by priority drift is to say that what the trustees should be doing, rather than asking what members would get if the scheme went into the PPF, is to ask what they would get if the scheme came to an end *without the PPF there to provide compensation*. An increasing number of members reaching NRA would disadvantage younger members, because the first group would get more on a wind up of the scheme under the s.73 Pensions Act 1995 priority order, and the trustee should take account of this disadvantage to younger members in deciding what to do. There is a purity to this, because it chimes with the underlying policy of *Hope* about putting the PPF out of a trustee's mind in certain respects. However, it might be objected that it is a rather circuitous way of dealing with the priority drift issue.

16. Finally, and more generally, a trustee might simply want to take account of the fact that the PPF is there to provide compensation as a comforting fallback when working out whether to take any risks inherent in the proposal. Can the trustee say to itself that one of the reasons why the proposal is acceptable is because effectively the PPF will cover off a lot of the downside risk by providing compensation at a level close to the promised scheme benefits if the proposed course of action goes wrong and the scheme fails later on?

17. One argument for a positive answer, which will be applicable to a good number of corporate or pension scheme reorganisations (like that in *Pollock v Reed* [2016] PLR 129), is that the purpose of the proposal is to *keep the scheme out of the PPF*, and therefore the policy in *Hope* does not apply here to stop the trustee taking into account the fact that the PPF is there to step in if the proposal goes wrong. In *Hope*, the objection was that the proposal was trying to take advantage of the PPF by increasing the burden on the PPF to the benefit of the members of the particular

scheme in question, whereas here, so the argument runs, the proponents of the proposal are trying to *relieve* the burden on the PPF by keeping the scheme out of it when otherwise it would have to pass to the PPF.

18. The counter-argument is that this line of thought, if applied, can lead a trustee to take (indeed, be required to take) a more risky course of action by relying on the PPF being there to step in than the trustee would otherwise take.

19. Therefore, this remains an open question that will have to be answered in future cases.

<u>The scope of reg.2(2) of the Entry Regs at the end of a scheme's life</u>

20. Another question that arises at the end of a scheme's life is whether it is possible to compromise a s.75 debt in a way that:

    (1) avoids it being invalid through the application of the principles in *Bradstock* [2002] PLR 327 (invalidating attempts to "contract out" of the consequences of the s.75 regime) while

    (2) steering clear of breaching reg.2(2) of the Entry Regs and thereby rendering the scheme ineligible for the PPF.

21. At one end of the spectrum, *Bradstock* suggests that one cannot validly take steps well in advance of a s.75 debt arising to exclude the application of the s.75 regime generally, and at the other, *L v M* [2007] PLR 11 explains that compromising a s.75 debt that has arisen will (at least where the debt has been certified) violate reg.2(2).

22. Therefore, the question arises of whether (even assuming that reg.2(2) extends to debts that have arisen but not yet been certified) there is some ground in the middle that falls between the two regimes. Warren J explained in *L v M* [2007] that it was an open question whether a compromise of a s.75 debt in an immediately impending scheme wind up would be invalid (para.30).

23. The arguments that there is no such safe middle ground, particularly not one defined by whether the s.75 debt is "imminent / impending" include the following:

(i) Allowing such a gap between the twin protections of reg.2(2) and the "contracting out" principles allows reg.2(2) to be evaded at will where it is known in advance that a s.75 debt will arise;

(ii) It is unclear what the difference of principle is between an agreement well in advance of a s.75 debt and one when a s.75 debt is imminent;

(iii) A test based on whether the s.75 debt is "imminent" is a slightly uncertain one to apply in practice;

(iv) It is generally assumed that one cannot compromise scheme specific funding ("SSF") contributions that have not yet fallen due, so why should one be able to compromise the other main type of pension scheme statutory debt?

(v) Warren J was pointing out that it was an open question whether a s.75 debt could be compromised when scheme wind up was impending, not purporting to answer that question.

24. However, argument (i) was run in *L v M* (para.62) and was not accepted as a decisive one by Warren J in interpreting the scope of reg.2(2), so one should arguably be reluctant to give it too much weight in determining when one can validly alter by agreement the amount of a s.75 debt that is recoverable. Moreover, it might also be said that any undesirable limits in reg.2(2) should be remedied by the slightly circuitous route of taking a broad view of the situations in which a s.75 debt can be compromised or otherwise dealt with by agreement, particularly as the s.75 regime predates reg.2(2).

25. Arguments (ii) and (iii), namely that it is difficult to see what is special about a situation where a s.75 debt is imminent, could arguably be met by drawing the line in a slightly different place, by focusing on whether the agreement relates to a *specific* s.75 debt. Trustees have power to compromise individual debts, including contingent debts, so it might be said that there is nothing objectionable with compromising a particular contingent s.75 debt any more than another type of contingent debt. There is some attraction to that stance. However, it is far from perfect, because if it is to be taken, it must be recognised that:

(i) this opens up the possibility of compromising s.75 debts *well* in advance, because such debts can be regarded as contingent from the moment an employer adheres to the scheme; and

(ii) it becomes difficult to explain why it is impermissible to compromise contingent SSF debts.

DB Schemes on the decline curve

Gary Squires of AlixPartners LLP and Robert Ham QC

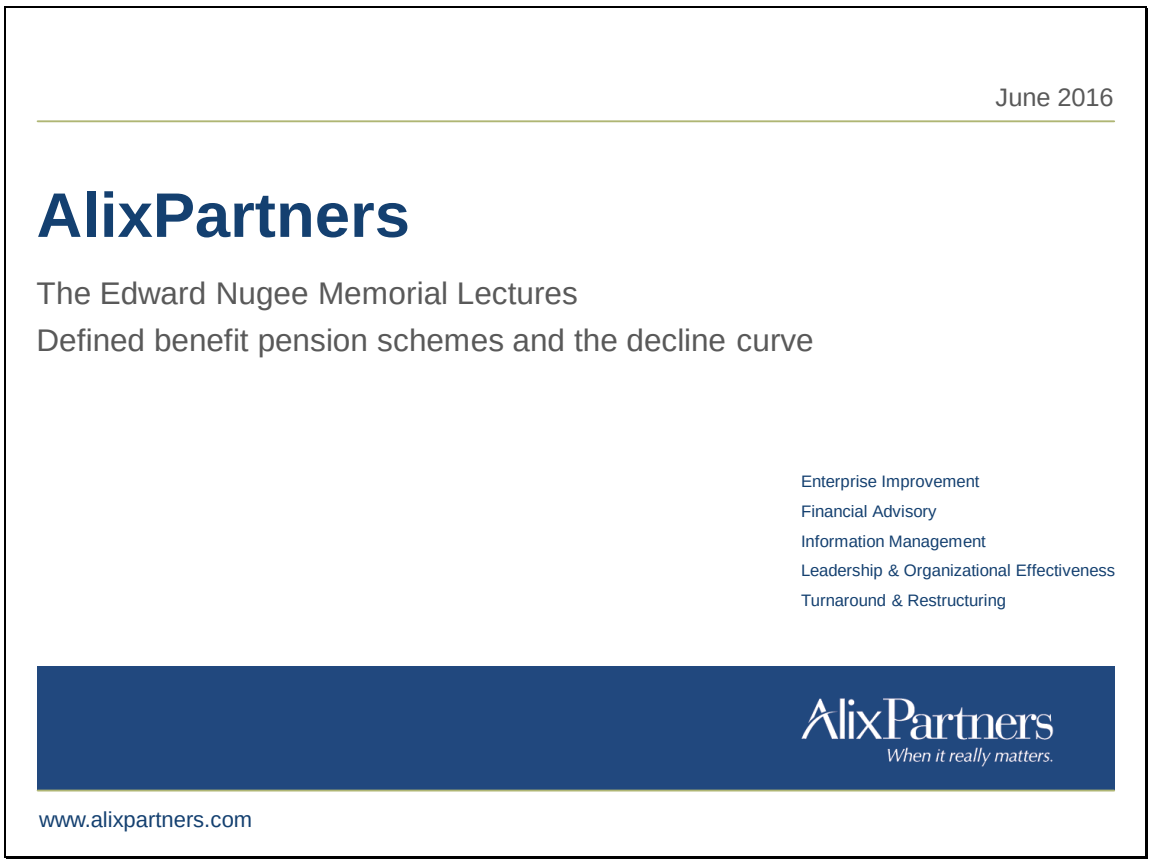
The fourth and final Edward Nugee Memorial Lecture of 2016 involved an innovation. For the first time there was an outside speaker, Gary Squires of AlixPartners who was able to address wider considerations than the purely legal. This would have pleased Ted Nugee who was always keen to look beyond the law.

Gary is one of the pioneers of the emerging art or science of employer covenant assessment and is a member of the Employee Covenant Working Group. He is one if not, the leading expert in the field. Gary has acted as an expert witness in litigation, and in the *Merchant Navy Ratings* case [2015] EWHC 448 (Ch) Asplin J found him to be a "careful and impressive witness". Gary's integrity and the quality of his evidence is illustrated by the fact that, although called on behalf a party attacking the trustees' decision the trustees themselves ended up relying on his evidence.

Gary gave the main presentation, with legal interludes from Robert Ham QC.

For present purposes, we reproduce Gary's slides and text with cross references to Robert's comments at the end.

Slide 1



When I was asked to present an employer covenant at the Nugee Memorial Lectures, I thought it would be a great opportunity to explore an issue that has been on my mind for some time.

That is an apparent inconsistency between insolvency law and pensions practice, which creates potential risks for companies continuing without financial restructuring because they remain cash flow solvent, but are balance sheet insolvent.

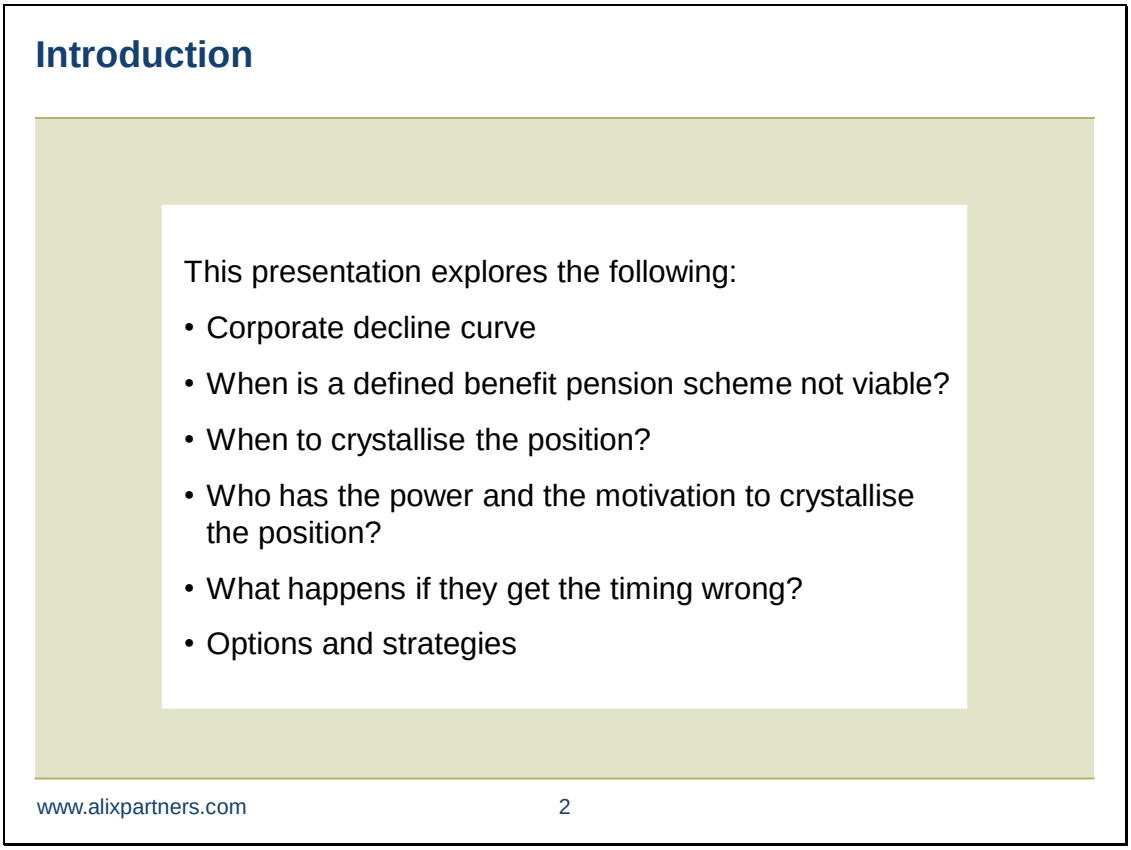
This has been a long standing point of debate but is particularly topical at the moment, for example with extensive media coverage of:

BHS is a recent high-profile example of a business that failed following an abortive attempt to compromise the pension scheme; and

Tata Steel may trigger the government to change the law regarding benefit changes.

As a result of these cases there is likely to be greater scrutiny of schemes with stressed employers.

Slide 2



The purpose of this presentation is to discuss the challenges facing DB stakeholders when employer covenant is stressed and may be in decline.

In particular, I want to talk about directors' duties in the 'twilight zone' of the decline curve. This is the point at which directors should be considering their duties to creditors rather than shareholders.

An important question in this context is "when is a defined benefit scheme not viable?". TPR's guidance on Integrated Risk Management means that such situations will become more apparent, as generally with weaker employers both cash contributions **and** investment returns will be constrained.

Once it is apparent that a scheme is not viable, the questions are:

When should the position be crystallised?

Who can do that?

Who should do that?

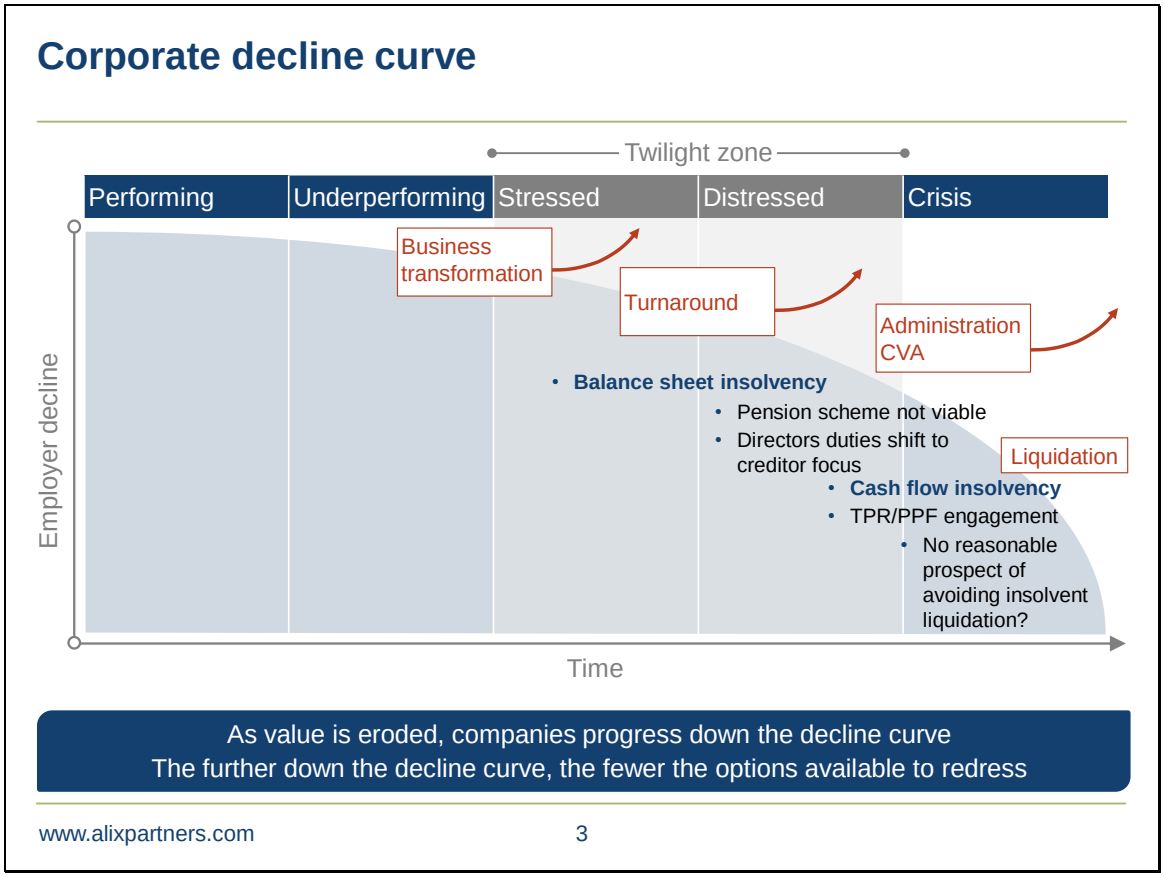
We'll then cover what happens if they get the timing wrong (principally in terms of implications for pension creditors and insolvency act remedies to restore value).

Finally we'll cover some options and strategies for employers and trustees faced with this difficult challenge.

In the interests of time, I'll skim some of the slides but please feel free to pick up any issues of interest in questions.

As Robert mentioned, this is a double act and as we go through you will see red text, which are 'hooks' for Robert to pick up on what we think are interesting legal issues.

Slide 3



The corporate decline curve is a well-known model for describing the features of companies whose fortunes are on a downward path.

When a business starts to underperform the focus will be on reviewing strategy to halt the decline in value and to turn the business around.

If efforts fail the business will then generally experience increasing levels of stress until it descends into crisis. In particular it may need to raise capital to fund a turnaround but a DB scheme, can be a blocker to this.

There are various financial and operational restructuring tools that can be used to rescue a company in decline. It is also possible to fall down the curve very quickly e.g. through fluctuations in commodities pricing. Generally, the further down the curve, the fewer the options available to redress.

A ‘twilight zone’ exists in the grey area between solvency and insolvency, where risks and options may not be clear and stakeholder interests may diverge.

In the twilight zone, directors’ duties switch to a focus on the interests of creditors, rather than shareholders, while at the same time pension trustees should be focusing more on the security of members’ benefits. However TPR and PPF tend not to engage in restructuring negotiations until cash flow insolvency is imminent, by which time there may not be much value remaining.

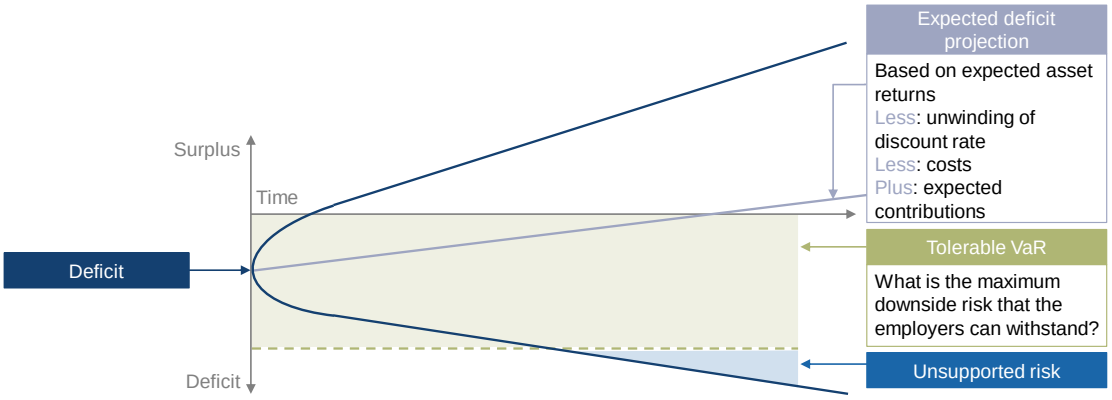
When there's a DB scheme, an important consideration in these circumstances is whether the scheme is viable…

Slide 4

When is a defined pension scheme not viable?

Integrated risk management – the cone of uncertainty

- We can use probability distribution to project the expected deficit over time as well as the level of risk in the scheme
- This is the 'cone of uncertainty'. It shows the projected expected deficit over time and defines the possible range of outcomes within a set probability



A range of outcomes can be projected, within a set probability
A certain level of downside risk may be supportable by the employer covenant

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Asset/liability (stochastic) modelling illustrated in the diagram is probably familiar to many of you and its important context for what comes later.

TPR's Integrated Risk Management guidance seeks to link covenant, investment strategy and funding decisions. The theory goes that the stronger the covenant the more flexibility there is available in investment strategy and funding assumptions. Conversely, the weaker the covenant, the lower the ability of the employer to underwrite down side experience and the less risk can appropriately be taken in pursuit of investment returns.

The diagram shows a typical scheme with a deficit and a recovery plan.

Over time, it is expected that the deficit will be funded via contributions and asset returns.

While the funding levels can be projected as a straight line, based on assumptions, the reality will be different and a "cone of uncertainty" shows the range of potential outcomes within a set of probabilities. Above the deficit line is 'outperformance' and below the deficit line is 'underperformance'. The green area shows the level of risk supportable by covenant and the blue area the unsupported risk.

Part of IRM is to question whether the downside risk can be supported by covenant.

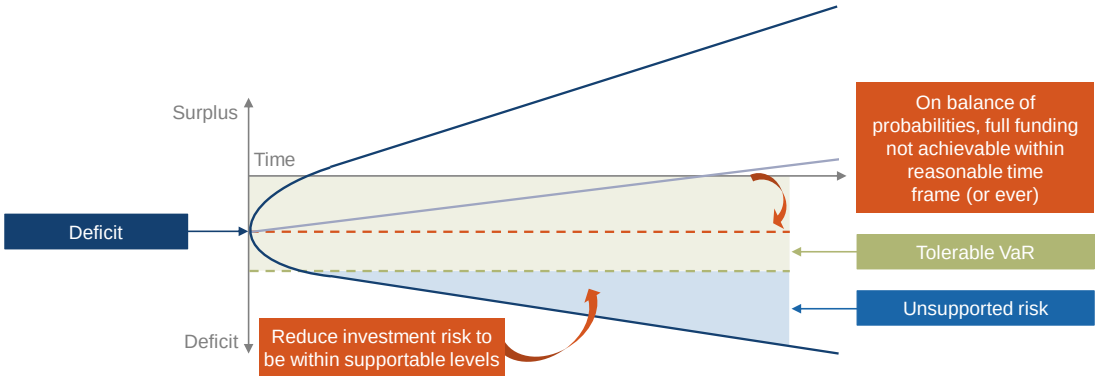
If it cannot be, then according to CoP3 the trustees should generally seek to reduce risk, by de-risking the investment strategy (or strengthening covenant if possible), as follows….

Slide 5

When is a defined pension scheme not viable?

Integrated risk management – determining pension scheme viability

- When employer covenant is insufficient to support downside risk, TPR guidance is that investment risk should be reduced
- If there is minimal investment risk, the deficit must be funded mainly by contributions
- If increased contributions are unaffordable, then the scheme may be unviable



If employer covenant cannot support downside risk and increased contributions are unaffordable, the scheme may not be viable and the employer may be insolvent

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The diagram shows the impact of reduced investment risk - while the down side line moves up, assuming cash is constrained, the expected recovery plan length increases.

Therefore if risk is taken out of the investment strategy, this puts more pressure on employer cash flows. If cash contributions are unaffordable, then (on the balance of probabilities) the scheme may not achieve full funding within a reasonable timeframe (or at all) and there may not be a viable recovery plan. I'll come onto the importance of the balance of probabilities later.

TPR's guidance does provide some flexibility. Per CoP 3:

'It may be appropriate to accept a higher level of risk in the scheme's investment strategy to allow for the employer covenant to strengthen (improving its ability to support adverse outcomes)'.

The trustees may be happy to accept higher risk in members' interests, but is it appropriate for the directors to do so on behalf of the company?

Presumably there should be reasonable expectations as to the company's ability to turn itself around. For example, if the required capital isn't available or the company operates in a market in structural decline, then this might not be an appropriate course.

So when is it appropriate to crystallise the position?

Slide 6

When to crystallise the position?

Insolvency tests

The Insolvency Act 1986 provides two tests of insolvency (to be applied on the balance of probabilities)

	Basic principles	Defined benefit pension considerations
Cash flow test Section 123(1)(e) IA86	"The company is unable to pay its debts as they fall due."	• Recovery plans are generally set based on 'affordability' and so are unlikely to trigger cash flow insolvency initially • However, a scheme still needs to pay members' benefits and it needs cash to do so – ultimately an underfunded scheme needs to be funded regardless of affordability but this may be a long way off
Balance sheet test Section 123(2) IA86	"A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities." Specific cases: • Eurosail (longer into the future = harder to demonstrate insolvency) • Casa Estates (longer into the future = harder to demonstrate solvency)	• Many companies with defined benefit pension schemes would have net liabilities when accounting for the full contingent and prospective pension liability • However, that does not mean these companies have no reasonable prospect of avoiding insolvent liquidation • The varying interpretations of the balance sheet test place different emphasis on how long term uncertainty should be treated and who bears the onus of proof

Quantitative integrated risk modelling can help identify when a scheme is no longer viable, indicating sponsor insolvency

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The Insolvency Act provides two tests of insolvency (to be applied on the balance of probabilities).

The cash flow test: a company is unable to pay its debts as they fall due. On the whole recovery plans are based on affordability so are generally unlikely to trigger cash flow insolvency. But at some point, a pension scheme itself can run out of assets so funding will be required, although this may be a long time in the future.

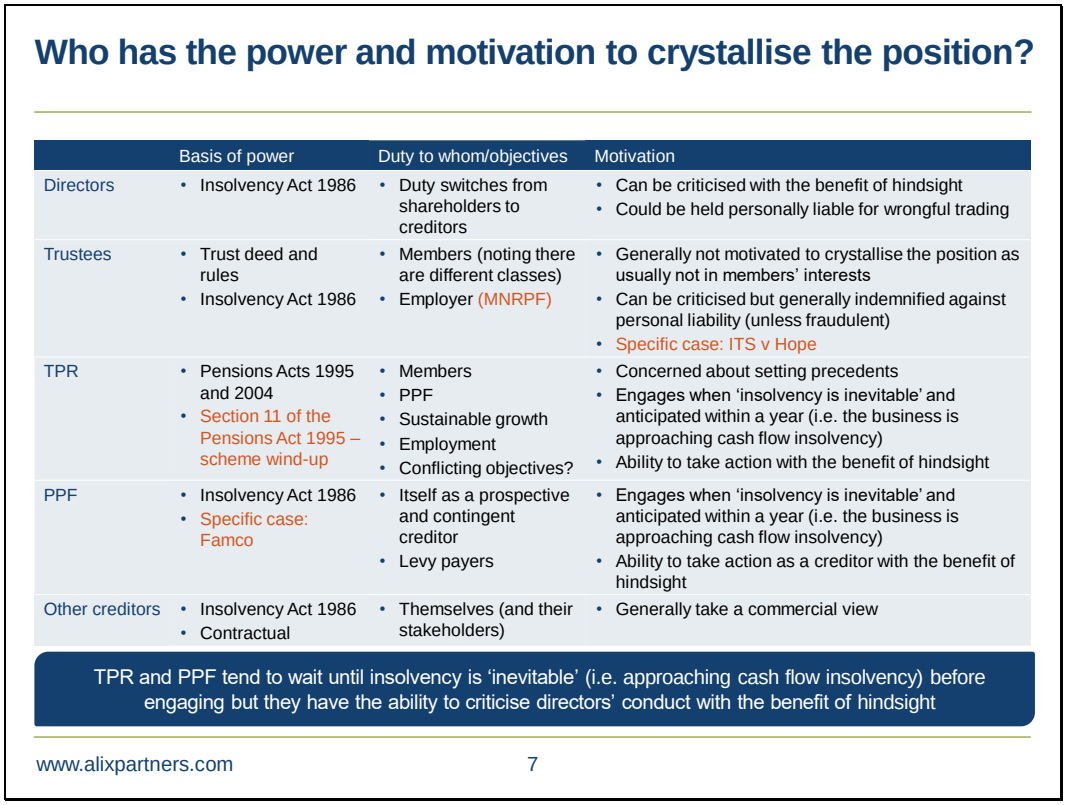
The balance sheet test is more challenging because pension schemes are very long term vehicles - however there have been some recent, relevant cases that need interpretation if they are to help, not least because they are apparently contradictory.

Eurosail's proposition – longer into future = harder to demonstrate insolvency

Casa Estates – longer into future = harder to establish solvency

Quantitative integrated risk modelling can help identify when, taking into account contributions that are reasonably likely to be affordable, a scheme is no longer viable, at least without taking inappropriate investment risk. If the scheme isn't viable then, without restructuring, neither is the employer.

Slide 7



There are a number of stakeholders involved who can crystallise the position – the Directors, Trustees, TPR, PPF and other creditors but few are actually motivated to do so.

Directors are not generally motivated unless there is a clear and present reason, but may be personally exposed.

As insolvency becomes inevitable, the directors' duty switches from promoting the interests of shareholders to protecting the interests of creditors. Is it safe to 'kick the can down the road' in the hope that something turns up? If they do not take proactive steps they can be criticised with the benefit of hindsight and could be held personally liable for wrongful trading. We'll come back to this in more detail later.

Trustees have a duty to act in members' best interests and may also have regard to the interests of the employer. This was clarified recently in MNRPF **[RH]**. Trustees typically aren't motived to crystallise the position as it's not generally in members' interests to close off ongoing benefit enhancements, which raises considerations analogous to ITS v Hope [**RH** – *ITS v Hope*]

TPR has conflicting objectives and is concerned about setting precedents. It has not often (or to my knowledge ever) used s11 PA 95 to wind up a scheme and, as I've said, tends to wait until cash flow insolvency is imminent to engage in restructuring discussions. S11 **RH**

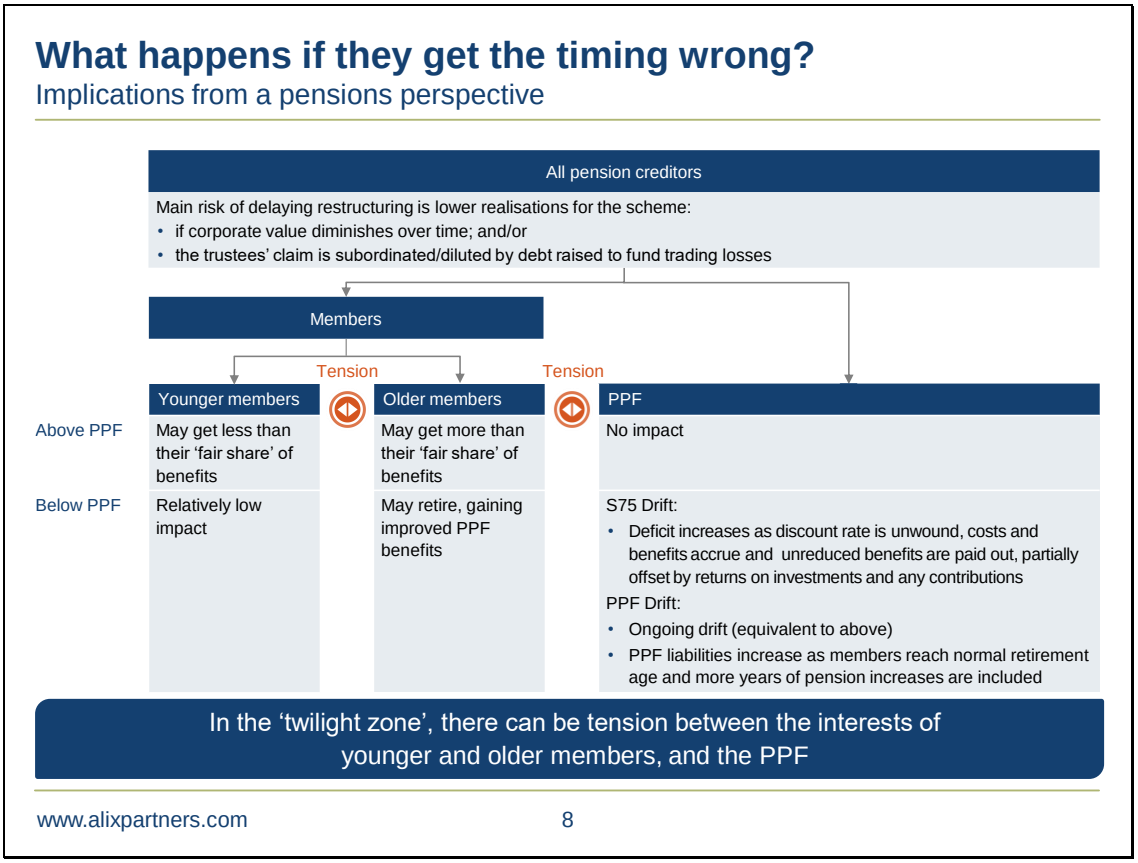
The PPF has greater motivation to take action if crystallising the position sooner can preserve value and reduce its exposure to drift, but unless insolvency is imminent tends to leave TPR to manage the

position through the scheme funding regime. An example of the PPF exercising its rights as a creditor is Famco **RH**

Other creditors such as banks are usually the parties that take proactive steps to initiate insolvency proceedings. However, they will act in their own interests, which will generally involve securing value for themselves to the detriment of the scheme.

So that brings us back to the Directors – who have the power, and can be challenged with the benefit of hindsight. But they can struggle to get engagement with pension stakeholders while in the twilight zone – a very unsatisfactory position.

Slide 8



Delaying insolvency can have three main risks for the scheme creditor:

- The liability can grow with drift and as pensions remain in full payment
- If corporate value is eroded due to mounting losses
- If the trustees' claim is subordinated / diluted e.g. by the employer raising secured debt to fund trading losses

These risks are the same regardless of the age of members and funding levels.

However, there are also risks that cause tension between different member classes and the PPF.

If the scheme is funded above PPF levels but is not going to be able to pay all members in full, while the scheme continues, older members are being paid more than their 'fair share' at the expense of younger members.

If the scheme is funded below PPF levels, then the exposure to PPF drift causes tension between the interests of members and the PPF because, as higher paid members reach retirement age, their benefits are uncapped, increasing the PPF's obligations.

This slide covers the risks of delaying insolvency but there are also risks to crystallising the position prematurely or unnecessarily. If this happens and it is not clear that members would not have received their benefits in full through continuation of the employer as a going concern, this may

result in accusations of scheme abandonment and consequent regulatory proceedings. As I've said, asset/liability modelling may assist here.

Ultimately it is a decision based on the facts of each situation.

Slide 9

What happens if they get the timing wrong?

Directors' duties – actions under UK insolvency law

Claim	Insolvency Act 1986 Section	Time limit	Remedy	Administrator	Liquidator
Misfeasance	212	Six years from date of misfeasance	Repayment, restore or account for money or property (including interest) or pay compensation	✗	✓
Transactions at undervalue	238	Two years from the onset of insolvency	Set aside the transaction	✓	✓
Preference transactions	239	Two years/six months from the onset of insolvency (connected/ unconnected person respectively)	Set aside the preference Can trustees be exposed?	✓	✓
Wrongful trading	214	N/A	Directors contribute to company's assets	✗	✓
Transactions to defraud creditors	423	N/A	Set aside the transaction	✓	✓
Fraudulent trading	213	N/A	Directors contribute to company's assets	✗	✓

There are various insolvency law remedies to restore value or avoid transactions that can be exercised with the benefit of hindsight

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There is a range of claims that can be brought to restore value following an insolvency event.

If wrongful trading or fraudulent trading are established, the directors themselves may be compelled to contribute to the company's assets. This can include corporates as shadow directors. Other remedies result in the transaction or preference being set aside.

A significant consideration for trustees in these circumstances is whether contributions to the scheme can be avoided as a preference – for example if special contributions are made in the twilight zone. And in that context whether the trustees are 'connected and associated' for the purposes of establishing the presumption. RH ON PREFERENCES

In the interests of time I won't dwell on all remedies but will focus in a bit more detail on wrongful trading.

Slide 10

What happens if they get the timing wrong?

Retrospective action – wrongful trading

	Breach of directors' duties under insolvency act (wrongful trading)
Summary	• Various actions are available under IA86 where directors have breached their duties • Wrongful trading is perhaps the most relevant in this context
Who is target?	• Directors and shadow directors
Who benefits?	• All creditors
Impact	• Wrongful trading relates to the timing of insolvency. A successful claim requires directors to make a contribution to the company's assets • Wrongful trading convictions do not require criminal intent but lesser failings • Specific cases – Ralls Builders (rational expectations/wilfully blind optimism) Hawkes Hill (actual loss required/confusion between aspiration and actuality)
Process	• Mediation • Court
Burden of proof	• Wrongful trading based on 'balance of probabilities' • 'Confusion between aspiration and actuality' and 'wilfully blind optimism' • That a loss was incurred as a result of trading when insolvency was foreseeable ('no reasonable prospect of avoiding insolvent liquidation') • Asset lability modelling could assist • Question: is scheme/PPF drift a 'loss'?

In addition to TPR's 'moral hazard' remedies, wrongful trading may put directors at risk personally

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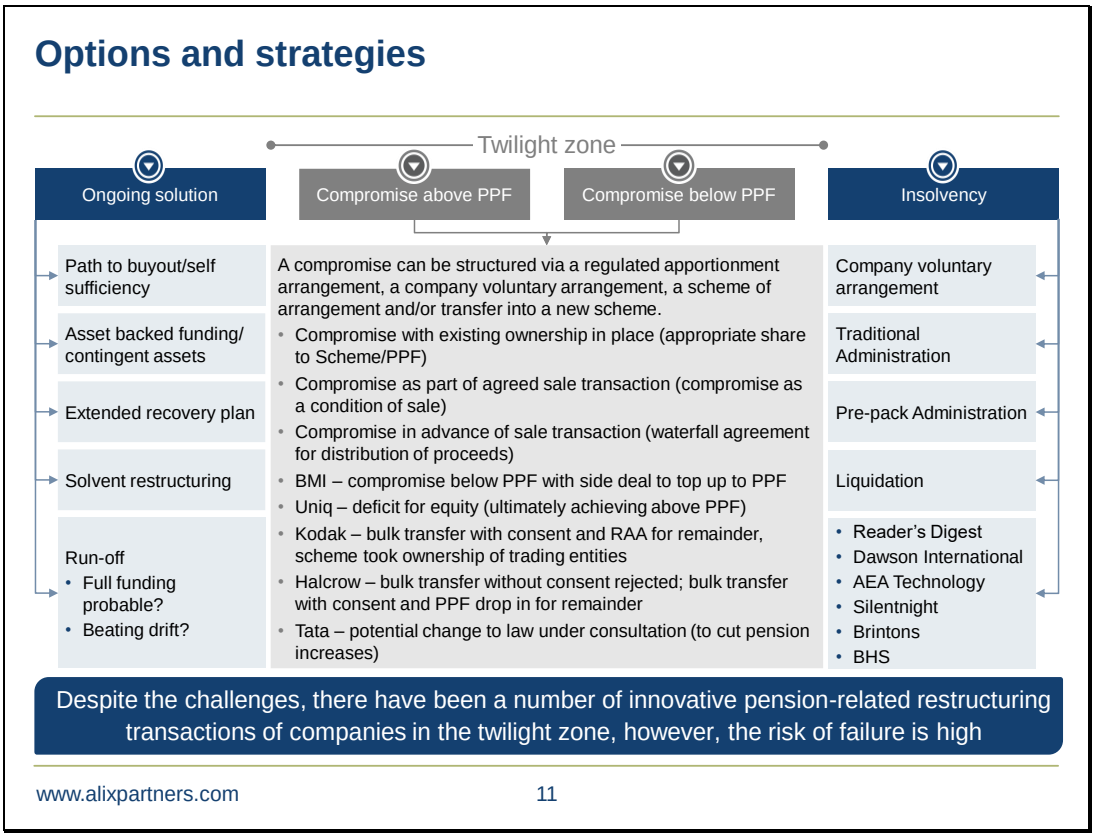
Wrongful trading applies to directors and shadow directors who at a point in time knew or ought to have known that the company could not avoid insolvent liquidation – the court can compel directors to personally contribute to the insolvent estate. It's decided on 'the balance of probabilities', rather than the criminal test of 'beyond reasonable doubt' and involves such failings as '**confusion between aspiration and actuality**' and '**wilfully blind optimism**', conditions that many of us may recognise!

RH on Ralls Builders and Hawkes Hill.

An important question here is whether 'drift' is a 'loss' for the purposes of establishing the conditions for a wrongful trading claim. Can causing the PPF greater exposure as a contingent and prospective creditor be valid grounds? RH ON DRIFT AS A LOSS

Following an insolvency event, the PPF and trustees in theory could benefit from either Pensions Act or Insolvency Act remedies. A point to bear in mind is that the Regulator's moral hazard powers are exercisable for the benefit of the scheme alone, whereas recoveries via Insolvency Act remedies benefit all creditors. If the source of restitution is the same, such as wider Group companies, and the pot is constrained, this may lead to a divergence of interests between the PPF and the general body of creditors, which will need to be managed carefully given that the PPF may be influential as the largest creditor. So a complex area, with a lot of judgments to be made.

Slide 11



There are many pitfalls but I thought we should end on a more positive note.

The diagram maps to the decline curve with options on the left hand side for businesses that are still solvent and options on the right that are for insolvent entities.

The section in the middle relates to compromises where members face a cut in benefits but the company continues, preserving value that may be eroded in formal insolvency proceedings.

Fundamental requirements for these solutions are that members are better off than they would be if insolvency occurred, and that insolvency is inevitable absent a compromise.

RAAs have been popular (at least with advisers) over the years but a CVA can be more effective if other creditors also need to be compromised.

Recent deals have also included the bulk transfer of members into a new scheme with reduced benefits (but still better than PPF benefits). This allows the scheme to continue with the prospect of paying members reduced benefits in full over time.

There is a great deal of innovation in this space (Halcrow and Tata Steel being current examples).

CLOSING MESSAGES – In closing I'd like to make three main points:

- There are potentially solutions for stressed employers with DB schemes
- There are dangers inherent in 'kicking the can down the road'
- The earlier that issues are recognised and addressed the more options are potentially available to preserve value

Further comments from Robert Ham QC

Slide 6:

As we all know, there are two main tests of a company's inability to pay its debts generally referred to for short as the cash flow and balance sheet tests which the Supreme Court analysed in *BNY Corporate Trustee Services Ltd v Eurosail* [2013] UKSC 28*,* another of the contributions to United Kingdom law stemming from the failure of Lehman Bros.

The judgments show that the two tests work alongside one another. The cash flow test looks not to the present but also the reasonably near future. But even then it is not an exhaustive test: as the example of a Ponzi scheme illustrates. Beyond that the balance sheet test is the only sensible one. It requires the court to take into account both present and future liabilities (discounted for contingencies and deferment). The Supreme Court held that the more distant the liabilities, the harder it is to deem a company that was currently able to pay its debts as they fell due to be insolvent

So far as good, but *Carman (liquidator of Casa Estates (UK) Ltd) v Bucci* [2014] EWCA Civ 383 the CA in the shape of Lewison LJ seemed to take a different view, namely that the more distant the liabilities the harder it would be to show that the company was solvent. Given that Lewison LJ relied on *Eurosail*, what is the explanation?

The answer is that in *Casa Estates* the issue arose because the liquidators were pursuing the company secretary and wife of the sole director for various transactions at undervalue. As she was a connected party there was a presumption of insolvency which she had to rebut. In other words, the burden of proof was reversed, with the result that the difficulty of establishing what will happen in the future operated against her.

Slide 7:

This slide calls for comment on four things

The first relates to the *Famco* case. It concerned a petition to wind up one of the Silentnight companies brought by the PPF. Newey J held that the PPF had standing to petition as a contingent creditor.

Secondly, Section 11(1) of the 1995 Act which gives the Regulator power to wind up a scheme in three circumstances:

(a) the scheme ought to be replaced;

(b) it is no longer required;

(c) winding up is "necessary to protect the interests of the generality of the members of the scheme"

Something on the lines of (c) was recommended by the Goode Committee, and the clause originally included in the Bill referred to winding up if it was in the interests of all the members. That was

dropped because of fears that it might be used to wind up schemes in surplus with provisions for mandatory augmentation. How times have changed.

But it must be stressed that the test is one of necessity, not desirability, and moreover necessity for a particular purpose –to protect the interests of the generality of members. Clearly, that does not include the interests of the PPF. Although it has an economic interest in the financial well-being it is a not a member, nor as Henderson J held in *Independent Trustee Services v Hope* [2009] EWHC 2810 (Ch) is it a contingent beneficiary. But does the reference to the interests of the members refer only to their interests in their capacity as members of the scheme? Or does it include their contingent rights to PPF compensation? Although there had been discussion of a possible centralized discontinuance fund before the 1995 Act, the PPF in the form in which it ultimately emerged was unknown, which perhaps suggests that the focus should be wholly on the interests of members as such. On the other, it seems unreal to leave out of account members' rights under the PPF, and on the whole I would favour the broader construction.

The next question is what does "the generality" mean? Is it simply a majority, (referendum 51%) or something more, and if so a majority by what measure: numbers of members or the value of their benefits and/or PPF compensation claims. There are no clear answers. And the uncertainty is such that it is perfectly understandable that the Regulator has not invoked this power to deal with the problems Gary describes.

The third thing to mention is the *Merchant Navy Ratings*: at long last, there is a clear judicial vindication of Edward Nugee's view that trustees' responsibilities are not only to members but also to the employer.

ITS v Hope

Picking up on something said by Jonathan Hilliard, QC, in the previous lecture, I want to say something about *ITS v Hope*, which is undoubtedly one of the most important pension cases of recent years.

Consider the position of a scheme with a deficit where the trustees chose not to exercise a power to wind up because (a) they will get in extra contributions in the meantime, and (b) in the meantime members will receive benefits unreduced by the limits applicable to the PPF.

A number of questions arise.

Is this "gaming" the PPF in the sense described by Henderson J? You may think this is another illustration of the dangers of metaphor as a form of legal reasoning. Is the failure to exercise the power and/or the continued payment of a breach of trust? And if so what is the remedy? It seems to me that the answer must be No. The members are better off. The loser here is the PPF, but Henderson J decided that it was not a beneficiary and so cannot claim compensation for breach of trust. Nor does there seem to be any basis for a duty of care in tort.

None of the Regulator's moral hazard powers seem to be in point, and on the face of it there would appear to be no remedy except the preemptive appointment of new trustees.

If I am right about this, then what it shows is that *ITS v Hope* only works where one is considering actions of the trustees, the validity of which can be impugned, not inaction.

Slide 10

This slide raises the possibility that some of the court's powers under the Insolvency Act might be invoked, and in particular those relating to wrongful trading.

Section 214 of the Insolvency Act gives the court power to require a director to contribute if he knew that the company had no reasonable prospect of avoiding insolvency, but did not take every step to minimise the potential loss to creditors. In the pensions context, is there a risk that the directors may be made liable for an increase in the section 75 debt.

So far as one can discover wrongful trading claims are rare, down to 2013 there were only 29 reported cases and only 11 successful claims. The Small Business Enterprise and Employment Act 2015 made a number of changes intended to make it easier to pursue a wrongful trading claim: it extended the legislation to administrations; and allowed office-holders to assign their officeholder causes of action. Conversely, changes following the Jackson review make it more difficult to fund claims. Officeholders like other fiduciaries should be slow to undertake speculative litigation.

But even if one has got over the funding hurdle there remain practical difficulties: it can be difficult to show when wrongful trading began. Directors are not required to be clairvoyant. There is a recent case called *Re Ralls Builders Limited* [2016] EWHC 243 (Ch) where the office holder got over that hurdle. But Snowden J still declined to make an order. He held that it has to be shown that there is a net increase in the company's liabilities after setting off liabilities that have been discharged during the period of wrongful trading. And it must also be shown that the increase in the company's deficit was caused by the wrongful trading. These are significant hurdles.

So while there is possible exposure it will be difficult to make good this sort of claim.

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