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The Edward Nugee Memorial Lectures

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Foreword

This is a book with the full text papers from the Edward Nugee Memorial Lectures for 2019.

Edward Nugee QC, who died in 2014, was the head of our chambers for over 30 years until 2006. He was a pre-eminent trusts lawyer who helped shape the modern law of pensions in seminal cases such as *Re Courage, Imperial Foods* and *Mettoy v Evans*. Under his leadership, Wilberforce Chambers became the leading set of pensions barristers with a strong tradition of expertise and specialisation in pensions law that continues and thrives today. This series of lectures is dedicated to his memory.

The past year has been a busy one for pensions practitioners at Wilberforce Chambers, with members appearing in major cases such as *British Airways, Lloyds Bank, Box Clever, Barnardo's, Keymed, Marathon Oil* and *Safeway* and much other litigation besides. However, in the Edward Nugee Memorial Lectures we try to focus less on litigation and more on technical issues of pensions law that are interest to those working on non-contentious matters as well as to litigators.

1. The first of this year's lectures, by Jonathan Hilliard QC, Sebastian Allen and Jonathan Chew focused on the tricky area of the limits of trustee duties in relation to investment decisions and member choices. How far are trustee boards obliged to review and potentially second-guess member decisions or advice from advisers?
2. The second, by David Pollard, Bobby Friedman and Tara Taylor looked at aspects of the law relating to the review of decisions by both employers and trustees, following the seminal decision of the Supreme Court in *Braganza v BP Shipping*. The papers look at when the Braganza duties apply, when a decision will be struck down as being perverse and how relevant factors are to be taken into account.
3. The third, given by James Walmsley, James McCreath and Michael Ashdown looked at lessons to be learnt from the *British Airways* litigation, in particular on the role of the proper purposes limitation on powers being exercised under pension schemes.
4. The last, by Robert Ham QC, Simon Atkinson and Daniel Scott considered the question of time limits for claim for DB benefits under trust based occupational pension schemes, in particular on the application of the Limitation act following the decision of Morgan J in the Lloyds Bank GMP litigation.

We hope the lectures were of interest and that this booklet, with the full texts, will be of continuing use.

If you have any questions arising out of the lectures or these papers, please do feel free to get in touch (contact details are on page 173). We would be very pleased to discuss them further with you.

David Pollard

The Speakers

Robert Ham QC
Robert was one of the first trust practitioners to specialise in occupational pension work and was invited to join the APL when it was established. He appeared in the first modern case in the Court of Appeal – *Kerr v British Leyland* – and the first modern case to go to the House of Lords – the *National Grid* case. More recently, he has been involved, both as counsel and as an expert witness, in contribution notice and FSD cases as well as the inevitable RPI/CPI cases. He is a longstanding member of the APL Pensions Litigation Committee. The 2019 edition of Chambers & Partners says that "*his knowledge of the law is encyclopaedic, his experience is unrivalled and he is trusted to give the right advice*". The same guide also describes him as "*one of the all-time greats*".

Jonathan Hilliard QC
"*Widely regarded as the go-to barrister for technical pensions issues*" (Chambers and Partners), Jonathan advises regularly on pensions restructuring, other corporate pensions issues, moral hazard concerns, RPI and CPI issues and other similar points. He regularly acts in rectification claims and in the compromises of complex pensions disputes. Recent high-profile cases in which he has been instructed include *British Airways plc v Airways Pension Scheme Trustees Ltd*, *Re Boxclever Pension Scheme* and *Re Silentnight Pension Scheme*. The 2019 edition of The Legal 500 describes Jonathan as "*a true star that is rising at a meteoric rate*".

David Pollard
David is a leading and highly experienced lawyer in the pensions field and related areas. He switched to practice as a barrister at the end of 2017, after 37 years practice as a solicitor, including 25 years as a partner in law firm Freshfields Bruckhaus Deringer. His practice as a solicitor included advising employers and trustees in relation to pension law matters, including corporate transactions, scheme funding, scheme mergers, scheme changes, employer insolvency and Pensions Regulator issues. He was chair of the Association of Pension Lawyers (APL) from 2001 to 2003, and has published four books in the areas of pensions, insolvency and employment law: "The Law of Pension Trusts"; "Corporate Insolvency: Pension Rights"; "Corporate Insolvency: Employment Rights" and "Employment Law and Pensions".

Sebastian Allen
Sebastian is a leading pensions junior who has a substantial litigious and advisory pensions practice. The legal directories describe Sebastian as "*first rate*" and as a "*strong advocate*" who "*instills complete confidence in clients*". He is regularly instructed in the largest and most high profile cases, including recently acting successfully in the Court of Appeal in both *British Airwways Plc v Airways Pensions Scheme Trustees Ltd* and *Safeway v Newton*. Sebastian also has extensive regulatory experience, having acted for or against the Pensions Regulator on numerous regulatory matters, including Silentnight, BHS, Tata Steel and Southern Water.

James Walmsley
James has extensive experience in the pensions field, building on his financial and policy experience before joining the Bar. His expertise covers both the regulatory (moral hazard powers, scheme funding, trustee appointment, regulatory fraud) and non-regulatory fields. He is recommended in both Chambers & Partners and The Legal 500 for his pensions work and is described as "*a key name for regulatory actions*", who is "*very responsive and technically brilliant*", and "*very client focused*". Recent high-profile cases in which he has been instructed include *Re Boxclever Pension Scheme* and *The Pensions Regulator v PAYAE & Ors.*

James McCreath
James has a growing reputation as an up and coming junior in Chambers' core areas, he was the first junior of his call to be ranked in Chambers & Partners' commercial Chancery category and was also "*highly recommended*" in Legal Week's 2016 'Stars at the Bar'. He continues to be ranked the pensions section of both Chambers & Partners and The Legal 500, with the latter stating that he is "*incredibly user friendly and fully dedicated to the client's cause*". James 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.

Jonathan Chew
Jonathan has acted for and advised a range of institutional and pensions professional clients, and has been involved in disputes affecting major schemes such as *Nortel* and the Sea Containers 1983 schemes. His pensions work includes not only litigation but also advisory work on transactional and regulatory matters. Jonathan's work spans the full range of pensions issues covering both the trusts aspects (including RPI/CPI and equalisation issues) and regulatory matters including section 75 debts and pensions liberation. As well as acting for and against the Pensions Regulator, Jonathan has acted as clerk to the Pensions Regulator's Determination Panel. The 2019 edition of Chmabers & Partners describes Jonathan as "*comprehensive in his approach, an impressive and effective advocate*".

Bobby Friedman
Bobby is "*a rising star*" of the pensions bar who "*has acted in some of the most high-profile pensions disputes and trials*" (Chambers and Partners). Pensions forms a substantial part of his practice and he has extensive experience across all areas of the field. He has been recognised in the legal directories as a leading pensions practitioner for a number of years (a perhaps unprecedented accolade for someone of his year of call). Bobby has particular expertise in pensions fraud/liberation, substantial regulatory matters, and pensions professional negligence.

Simon Atkinson
Simon is an experienced and in demand practitioner. He has a broad Chancery practice and believes that the giving of practical and clear advice, combined with persuasive and fearless Courtroom advocacy and an eye for detail, are qualities which clients rightly demand and which he brings to the cases on which he is instructed. Simon's pensions work encompasses contentious and non-contentious instructions relating to both defined benefit and defined contribution schemes. He has advised upon and has acted in numerous pensions matters: from regulatory proceedings to ombudsman disputes, from claims for rectification of governing documentation to professional negligence actions. Simon has acted for individual and institutional trustees, companies, members and representative beneficiaries; he has also acted for and against the Pensions Regulator.

Michael Ashdown

Michael has a busy and diverse chancery practice, with a particular focus on all aspects of litigation, advice and drafting relating to trusts and pensions, together with professional negligence in those fields. Michael's pensions practice including acting for both trustees and employers, as well as the Pensions Regulator and the Pensions Ombudsman. He is regularly instructed as sole counsel, but is equally happy as a junior in a larger team, and has appeared in important recent cases including *British Airways v Airways Pension Scheme Trustee Ltd*. Michael is also lecturer in law at Somerville College, University of Oxford, where he teaches and writes on the law of trusts and property. He was recognised by the Legal Week Private Client Global Elite 2018 as "One to Watch".

Tara Taylor

Tara is developing a broad commercial chancery practice spanning Chambers' main practice areas including commercial disputes, property, pensions, trusts and professional liability. She regularly appears in the High Court, County Court and tribunals both as sole counsel and as part of a larger team in more substantial cases, although her practice also involves a wide range of advisory work. Tara's experience in pensions in particular includes questions involving amendments to future service rights and RPI/CPI issues. She has worked on both domestic and international disputes, and is frequently instructed in complex commercial matters with an international element. Most recently this has included acting as a junior in a significant banking fraud claim brought under Russian law and, separately, in an international oil and gas arbitration.

Daniel Scott

Daniel is developing a diverse commercial Chancery practice that spans all of Chambers' practice areas. He is regularly instructed to appear as sole counsel in the High Court and County Court, and is often also instructed as part of a larger counsel team in more complex and high-value matters. Daniel advises regularly on pensions issues, including: scheme funding; equalisation; and all regulatory issues, including the use of moral hazard powers. His practice also includes clerking regularly for the Determinations Panel of the Pensions Regulator.

My brother's keeper? Duties to second-guess beneficiary and advisor decisions

Jonathan Hilliard QC, Sebastian Allen and Jonathan Chew

1. The impact on individual members of the loss of a substantial part of their pension (whether a loss in value of their "pot" in DC schemes or because the "pension promise" cannot be honoured in a DB scheme) has enormous real-life consequences.

2. There is an understandable policy reaction to ensure that, through the pensions, financial services, and tax regimes, there is greater awareness of the sorts of risks that can result in such losses and, where those losses occur, that they are spread across society, whether through an industry-wide PPF levy or by the imposition of liability on regulated persons who are required to maintain capital and indemnity insurance. While such rules may be the product of good intentions, their application in real life continues to prove difficult.

3. In most cases where members are properly warned that the action they are proposing poses a substantial risk to their pension they will heed that warning and follow a different course.

4. But we have all encountered members (or, as the FCA calls them, "insistent clients"[1]) who want to pursue their proposed course of action irrespective of the warnings they have been given or the advice they have received. These individuals are often induced into moving or investing their pension scheme assets by fraudulent introducers who purport to offer high investment returns or an early release of pension scheme assets. In those cases, how are scheme trustees and administrators supposed to balance the best interests of the members with their stated wishes? To what extent are trustees and administrators obliged effectively to protect members from themselves and in what circumstances can they be blamed by a disgruntled member or even a regulator for not having done so?

5. The purpose of this talk is to explore these questions in the different contexts in which they most frequently arise in pensions practice.[2]

6. We will consequently look at each of the following areas in turn:

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[1] See, for example, the FCA guidance entitled "pension reforms and insistent clients"

[2] Sections 1 and 4 have been drafted by Sebastian Allen and Sections 2, 3 and 5 have been drafted by Jonathan Hilliard QC and Jonathan Chew.

6.1. The obligations on pension administrators and trustees when dealing with transferring out to suspect schemes.

6.2. Self-Invested Personal Pensions ("**SIPPs**"), particularly in respect of investments instructed by members following the decision in *Berkeley Burke v Financial Ombudsman Service* [2018] EWHC 2878 (Admin).

6.3. The equivalent debate in the private trust context.

6.4. When *Pitt v Holt* [2013] 2 AC 108 will not provide an escape route for trustees, even when they are following advice that has been received.

6.5. Some other second-guessing situations that crop up in the ordinary administration of occupational pension schemes.

7. The conceptual issue that underpins each of these different areas of practice is the extent to which in each case there is a non-excludable residuary duty on the pension provider and, if there is, what that duty entails.

8. What the cases show is that the answer to the conceptual point may be different depending on the context in which the issue arises. What appears universal, however, is the trend to impose residuary duties and the need to flesh out what they mean in practice.

9. In what follows we hope to highlight some practical tips on how to deal with the task of handling "*insistent clients*" in these different pensions contexts.

I. 'Out of the frying pan into the fire': the practical problems with scheme transfers

A. The bottom line: the member's legal right to transfer out

10. The risks associated with scheme transfers in terms of the possibility of pensions liberation and related pension scams have become a well-established problem in recent years.

11. It is a situation where practitioners will most commonly have encountered "insistent clients" – typically because a member has been offered some form of incentive, such as early access to their pension assets, if the transfer proceeds. It is consequently quite often the case that, even once appraised of the risks, members will insist on proceeding with a transfer.

12. The bottom line in such cases is that a member will have a legal right to transfer out of a pension scheme where a valid transfer request has been made.

13. Such a right is not only typically contained within the governing documentation of the transferor scheme, but also exists as a matter of statute in ss.93 – 101 of the Pension Schemes Act 1993 ("**PSA 1993**").[3]

14. The relevant statutory context is, in summary, as follows:

14.1. A member accrues a right to take a cash equivalent of their pension benefits where:

(1) in the case of money purchase benefits the member has transferrable rights in relation to those benefits (s.94(2) of the PSA 1993); and

(2) in the case of non-money purchase benefits, on receipt of a statement of entitlement following an application made to the trustee or administrators of a pensions scheme under s.93A of the PSA 1993 (s.94(1) of the PSA 1993).

14.2. An application to transfer must be made by the member to the trustees or the administrators of the transferor scheme: s.95(1) of the PSA 1993.

14.3. Under ss.95(2) and 95(3) of the PSA 1993, so far as is relevant, the right to a cash equivalent transfer must be used for acquiring 'transfer credits' in an occupational pension scheme or for acquiring rights in a personal pension scheme.

14.4. In order to fall within the description of these pension schemes, the recipient scheme must be both:

(1) a registered scheme;[4] and

(2) a pension scheme satisfying the statutory definitions of an "occupational pension scheme" and a "personal pension scheme" respectively: s.1 of the PSA 1993.[5]

14.5. Where a valid application has been made, the trustees or administrators must do what is needed to carry out what the member requires within six months of either

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3 It should be noted that the right to transfer under the governing documentation of a scheme may not be the same as the statutory rights to transfer. It is common for governing documentation, for example, to vest a discretionary power in the trustees or administrators to determine whether to grant a transfer out.

4 See s.1 of the PSA 1993, the Occupational Pension Schemes (Transfer Values) Regulations 1996, and the Personal Pension Schemes (Transfer Values) Regulations 1987.

5 See, in particular, *Pi Consulting (Trustee Services) Ltd v Pensions Regulator* [2013] EWHC 3181 (Ch) for guidance on what is required for a scheme to be an occupational pension scheme.

(i) the date shown in the statement of entitlement or (ii) the date the application is made by the member: s.99(2) of the PSA 1993.

14.6. It is only once the trustees or manager has done everything required that the trustees or administrators shall be discharged from any obligation to provide benefits to which the cash equivalent related: s.99(1) of the PSA 1993.

15. Whilst not necessarily[6] affecting the legal right to transfer, it is also important to note in this context that s.164 of the Finance Act 2004 lists types of payments that are regarded as "authorised member payments", which include "recognised transfers" under s.169 of the Finance Act 2004. Under s.169 "*a "recognised transfer" is a transfer of sums or assets held for the purposes of, or representing accrued rights under, a registered pension scheme so as to become held for the purposes of, or to represent rights under (a) another registered pension scheme, or (b) a qualifying recognised overseas pension scheme, in connection with a member of that pension scheme*." What this means in practice is that if a transfer is wrongly made to a scheme that is not a registered pension scheme the transfer will be an unauthorised payment, with all the potential tax consequences that involves.

16. The fact that a member will typically have a right to transfer out appears to give some clarity and finality to what trustees or administrators must do in such circumstances: if member's have a right to transfer out then the trustees or administrators will be under a legal duty to accede to their request.

17. Yet the practical reality of getting to that point is often not as simple as it might first seem.

B. The duties of the trustees and administrators on receipt of an application to transfer out

18. The growing incidence of pension scams has brought with it a growing awareness of the responsibilities on trustees and administrators before accepting that a legal right to transfer exists in any given case.

19. In 2013, the Pensions Regulator published "*Pension liberation fraud. An action pack for pension professionals*" in conjunction with a number of bodies including HMRC and what is now the FCA, which was directed at how trustees, administrators and providers of pension schemes were expected to behave in such situations in ascertaining whether a legal right to transfer

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[6] It can, however, be the case that the governing documentation does not permit a transfer out where such a transfer would not be an authorised member payment and so it will become necessary in those circumstances to determine whether the transfer would be authorised or not as part of the assessment of whether there is a legal right to transfer out. In practice this will involve very similar considerations to the ones discussed below.

exists. Since then, numerous pieces of guidance have been published by these governmental bodies, in conjunction with a joint governmental task force set up in 2015 to tackle pensions fraud under the name "Project Bloom". More recently, the Pensions Regulator and the FCA have joined forces to launch its "ScamSmart" advertising campaign urging people to be aware of scammers targeting their pension savings after it was revealed that an average of £91,000 was lost per victim in 2017, with some people losing more than £1 million.

20. In addition to the regulatory guidance that has been published, is the voluntary *"Code of Good Practice in Combating Pension Scams*" produced by the industry body known as the Pension Scams Industry Group, first published in 2015 and with the latest version updated on 10 June 2019 (the "**Code of Good Practice**").

21. The consequence of the various guidance that has been produced is that the market has become increasingly alive to the fact that it is not sufficient for trustees or administrators to make a transfer simply because a formal request has been made to them by the member, no matter how insistent they are.

22. But how far do the obligations on trustees and administrators go when it comes to guarding against pensions fraud?

23. It is increasingly clear that trustees or administrators cannot just rely on the assurances of the member and that they may have to engage for themselves in a process of due diligence of the recipient scheme in order to evaluate whether the necessary legal requirements have been met before any transfer is made. This can often necessitate a fairly detailed investigation into the recipient scheme, particularly if the enquiries made reveal a number of "red flags", as well as effective communication with the member about the risks of transferring out to that scheme.

24. The specific duties on trustees and administrators in such circumstances will typically include a requirement:

    24.1. to comply with the trust deed and rules of the scheme;[7]

    24.2. to raise awareness of the risks of a transfer with the member;[8]

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[7] This is no more than a manifestation of the general duties on trustees to comply with the governing documentation of a scheme.

[8] See Principle 1 of the Code of Good Practice and the successful complaints made in ***Mr N v Northumbria Police Authority (PO-12763)*** at [64] – [99].

24.3. under ss.18 - 19 of the Financial Guidance and Claims Act 2018 to refer a member to appropriate pensions guidance and to ensure that the member is provided with an explanation of the nature and purpose of such guidance;

24.4. to carry out appropriate due diligence to ascertain whether the member has a legal right to transfer out;[9] and

24.5. in the case of a transfer out that results in "safeguarded benefits" being converted into "flexible" benefits, to ensure that independent investment advice has been taken by the member under s.48 of the Pension Schemes Act 2015.

25. The legal basis for the statutory duties and the duty to comply with the trust deed and rules of the scheme are self-explanatory.

26. The difficult issue for those advising trustees or administrators is in identifying what the legal basis is for the requirements of due diligence and member communication and, if such requirements can be characterised as "legal duties", what the scope of those duties will be in any given set of circumstances.

27. It is now clear that, as far as the Pensions Ombudsman is concerned, those requirements will at the very least form part of what is required in order to avoid a criticism of maladministration.[10] Whether the due diligence requirements go further than this and form part of the substantive legal duties imposed on trustees is still untested by the Courts, but the indication from the Pension Ombudsman cases is that they will be recognised as a residuary legal duty imposed on trustees through the general framework of the duties to act in the best interests of members and with reasonable care and skill.[11] They will also likely form part of the content of what is expected of trustees and administrators by their applicable regulators which, in the case of occupational pension scheme, will be the Pensions Regulator and, in the case of personal pension schemes, will be the FCA.[12]

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[9] See Principles 2 and 3 of the Code of Good Practice and the successful complaints made in *Mr N v Northumbria Police Authority (PO-12763)* at [64] – [99].

[10] See the decision of the Pensions Ombudsman in *Mr N v Northumbria Police Authority (PO-12763).*

[11] See, for example, paragraphs 21 – 23 of the determination of the Pensions Ombudsman in *Jerrard (PO-3809)* which have been repeated in a number of subsequent Pensions Ombudsman determinations. See also the reference to the "negligence" of the scheme administrators in *Mr R v London Pension Fund Authority (PO-10365)* at paragraph 17. It should also be noted that the remedy obtained in *Mr N v Northumbria Police Authority (PO-12763)* went beyond a typical maladministration award and included what were effectively damages for the losses suffered by the disgruntled member as a result of the failure to comply with the due diligence requirements.

[12] It should be noted in this context that the FCA sets out more detailed principles as to what is expected of regulated persons within its jurisdiction which are described in more detail in the next section of this paper.

28. The content of these duties – in terms of what they require from trustees and administrators in any given situation – will inevitably be informed by the regulatory guidance that has been published.[13]

29. What the guidance cannot do, however, is override or vary the legal rights of the member as set out in the governing documentation of the scheme and in statute and the duty on trustees and administrators ultimately to give effect to a member's rights without undue delay. The problem for trustees and administrators, therefore, is the inevitable tension that exists between conducting the required detailed due diligence to investigate for pensions fraud and the practical bottom line which means that – even if the due diligence process reveals real risks of pension fraud – the member has a legal right to transfer if a legally valid application has been made.

30. In this sense the duties on trustees and administrators referred to above run parallel with the duty to give effect to the member's legal rights, but are ultimately subsidiary to it. They are consequently more about process than they are about outcome – unless the investigations ultimately deter a member from proceeding or reveal no legal right to transfer.

31. That is not to underestimate the importance of proper compliance with those duties whether or not they result in the transfer out proceeding.

32. The recent Pensions Ombudsman determination in *Mr N v Northumbria Police Authority (PO-12763)* dated 11 July 2018 is a particular lesson on the dangers of not carrying out adequate due diligence and not giving members sufficient warnings.

33. In that case:

    33.1. The disgruntled member brought a successful complaint against the Northumbria Police Authority for having transferred his pension to a new scheme without having conducted adequate checks in relation to the receiving scheme and without providing him with sufficient warning.

    33.2. It was decided by the Pensions Ombudsman that the Authority had:

        (1) failed to carry out any investigations at all into the receiving scheme;

[13] See, for example, the comments of the Pensions Ombudsman in *Mr N v Northumbria Police Authority (PO-12763)*, in particular, at [65] and [75].

(2) failed to identify for the member the "red flags" that it would have noted if it had carried out that due diligence; and

(3) failed even to provide the member with the Pensions Regulator guidance packs on transferring out.

34. It was held that if the Authority had complied with these obligations the member would not have proceeded with the transfer and accordingly the Authority was ordered to reinstate the member's accrued benefits into the transferor scheme at its own cost, subject to a deduction being made for any sums that could be recovered from the recipient scheme.[14]

C. How far does the duty to carry out due diligence go?

35. What is required by way of appropriate due diligence will vary for different types of pension schemes.

36. It is also an iterative process and may require a greater level of investigation depending on the number of "red flags" revealed by the enquiries made. It is consequently not possible to be overly prescriptive as to what will be sufficient, but a sensible starting point is to base any investigations on what is recommended in the Code of Good Practice.

37. In that guidance, it is noted that in carrying out due diligence, trustees, providers and administrators should aim to collect information over the following areas where applicable:[15]

- Receiving scheme type
- Date of establishment.
- Legal status of the receiving scheme and any administrators or operators.
- Location of the receiving scheme and any administrators or operators in relation to the scheme member.
- Any employment link between the receiving scheme and the scheme member.

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[14] This case can be contrasted with the determination of the Pensions Ombudsman in *Mr R v London Pension Fund Authority (PO-10365)* where, despite the failure to give adequate warning, the evidence suggested that Mr R would have made the transfer even if the warnings had been provided.

[15] There is also a helpful scheme transfer checklist published by the Pensions Regulator: https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/pension-scams-action-pack.ashx

- Marketing methods; for example, ask scheme members to confirm how they became aware of the scheme to which they intend to transfer and establish if they have been contacted by an introducer or company through cold calling, unsolicited text messages or emails, or by being approached directly outside of their place of work, a common method known as “factory-gating”.

- Investment choice; for example, ask scheme members to confirm where the money is to be invested and the investment vehicle being used.

- Provenance of the receiving scheme; the FCA, HMRC, National Crime Agency and Companies House all provide information of possible assistance in checking the provenance of the scheme.

- Where advice is required, check who the advice is coming from (there can be two advisers, one that has permission to advise on pension transfers and the other adviser recommending the product and investments where the money is to be invested).

- It should also be checked that the entity has not been ‘cloned’.

38. This due diligence process has to be completed within the six month period that the statutory provisions give trustees and administrators in which to do what is needed to carry out the transfer under s.99(2) of the PSA 1993, subject to any extensions of time that are granted under s.99(4) of the PSA 1993 if any of the conditions in regulation 13 of the Occupational Pension Schemes (Transfer Values) Regulations 1996 are applicable.[16]

39. It will be seen below when it comes to discussing the limited circumstances in which trustees or administrators can legitimately refuse a transfer out that there is a dissonance between the levels of diligence canvassed and expected in the relevant guidance and the circumstances in which that due diligence could actually result in a refusal to transfer.

40. What is the purpose of this level of recommended due diligence if the ultimate bottom line from a legal perspective is that a member will have a right to transfer even if fraud is strongly suspected?

[16] It should be noted, however, that the trust deed and rules might set their own time frames for a transfer to be made that is different from that permitted under statute.

41. The answer is that even if that due diligence does not ultimately afford the trustees or administrators the right to prevent a transfer out if the member is insistent on proceeding, the due diligence is nonetheless important so that members can be properly warned of the "red flags" that the enquiries have identified. The policy basis for this is clear: the trustees and administrators of a pension scheme are far more likely to be able to investigate and recognise the risks involved in a transfer than a member, who is unlikely to be financially sophisticated and who may well be vulnerable to financial manipulation.

D. Commonly encountered "red flags"

42. The Code of Good Practice provides helpful guidance on the sorts of risk factors that commonly arise with pension scheme frauds.

43. Key points to look out for that can often arise in practice include the following:

- The receiving scheme is not registered, or only newly registered, with HMRC.
- The member is attempting to access their pension before age 55. This may be something the member mentions or may be in advertising materials sent to the member to encourage the transfer to be made.
- The member has pressured trustees/administrators to carry out the transfer quickly.
- The member was approached unsolicited.[17]
- The member has not been provided with the governing documentation of the recipient scheme.
- The employer of the transferring scheme has only recently been established.
- There is no obvious employment connection between the employer of the transferring scheme and the member. Where the member is made a director of the employer of the recipient scheme, the may be a disproportionate number of other directors of the same employer.
- The member has recently transferred out of an occupational pension with "safeguarded benefits" into a scheme with "flexible benefits" and is now seeking to

[17] With effect from 9 January 2019, "cold calling" has been banned pursuant to the Financial Guidance and Claims Act 2018 unless the caller is authorized by the FCA or is the trustee or manager of an occupational or personal pension scheme and the recipient of the call consents to calls or has an existing relationship with the caller.

transfer again to a different SIPP or SSAS. A transfer made in two steps can sometime be an attempt to avoid the requirements of independent advice being taken under s.48 of the Pension Schemes Act 2015 in relation to the transfer into the second scheme because once the "safeguarded benefits" have been converted, the requirement for independent advice falls away. By contrast if the transfer had been directly from the original occupational pension scheme to the second scheme, that would have required independent advice to be obtained under s.48.

E. When can trustees or administrators legitimately refuse to make a transfer?

44. Where due diligence has been conducted and "red flags" have been identified, the member will have a decision to make as to whether or not to proceed with the transfer.

45. If the member wants to proceed, the trustees or administrators are faced with the "unenviable" task of deciding whether to make the transfer – a task which the Pensions Ombudsman has described as follows:

> "[Trustees and administrators] *must decide between complying with what might have initially seemed a legitimate transfer request, and delaying the transfer, making further investigations and, potentially refusing it. If they comply with the transfer request, they are at risk of having made an unauthorised payment, with potential tax consequences. If they delay or refuse they are at risk of the member seeking to enforce the statutory right and succeeding, possibly claiming a financial loss. The strength of their reputation as an effective guardian of their customer's money is also at risk*".[18]

46. So in what circumstances can the trustees or administrators legitimately refuse to effect the transfer?

47. In practice the issue will generally turn on the answer to the following two questions:

    47.1. Is the recipient scheme registered with HMRC?[19]

    47.2. Is the recipient scheme a pension scheme falling within the relevant statutory definitions?

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[18] See paragraph 100 of the Determination of the Pensions Ombudsman in the case *Mrs Diane Kenyon (PO-1837)*

[19] As required by the Occupational Pension Schemes (Transfer Values) Regulations 1996, and the Personal Pension Schemes (Transfer Values) Regulations 1987.

48. It will only be if the answer to one or other of these questions is in the negative that a member will not have a statutory right to transfer out. However, it will be seen below that neither of these threshold requirements is a high one to cross.

(1) Is the scheme registered?

49. A pension scheme is a registered pension scheme under s.150(2) of the Finance Act 2004 if it is at that time registered under Chapter 2 of that Act.

50. In most cases this will simply require evidence that the scheme is on HMRC's register with its own Pension Scheme Tax Reference.

51. In its guidance entitled "*Transfer of pension scheme member's savings*", HMRC states that it will only confirm the registration status of a receiving scheme where both of the following apply:

    51.1. the scheme is registered;

    51.2. HMRC does not hold information to suggest that there is a significant risk of the scheme being set up or being used to allow pension liberation.

52. In responding to a request for confirmation as to the registered status of a scheme, HMRC will give one of two standard responses, either (i) Response 1, which is that both of those requirements apply or (ii) Response 2, which is that "[a]*t this time one or both of these conditions does not apply. HMRC is therefore unable to provide the confirmation you have requested*". If Response 1 is received that will answer the first issue of whether the recipient scheme is registered. But what are trustees and administrators to do if they receive Response 2?

53. The Code of Good Practice states at paragraph 6.3.1 that receiving a Response 2:

    "*might be considered to provide sufficient justification in isolation for you to refuse to make the transfer, irrespective of other information and concerns.*"

    albeit that it goes on to suggest that trustees and administrators take legal advice before refusing a transfer.

54. In taking that view, reference is made to the Pensions Ombudsman determination in *N v Zurich and Curtis Bank Ltd (PO-16907)* in which the Pensions Ombudsman rejected a claim for maladministration in circumstances where administrators had refused to make a transfer following receipt of a Response 2 from HMRC. In rejecting that complaint, the Pensions

Ombudsman concluded that a Response 2 meant that the receiving scheme could not "*establish its registered status*" and so the requirement that the receiving scheme be registered was not met. It was consequently concluded that there was no legal right to transfer and so no grounds for maladministration could be established.

55. Whilst this decision is welcome news in giving some much needed clarity to trustees and administrators in these situations, it is yet to be seen whether that approach will be followed in future cases beyond the Pensions Ombudsman.

56. One of the oddities on the facts of *N v Zurich and Curtis Bank Ltd (PO-16907)* was that Mr N had an HMRC print out showing that the recipient scheme was in fact on the register and had not been de-registered. In those circumstances, it is unclear why the fact that HMRC holds information to suggest that there is a significant risk of the scheme being set up to allow pension liberation affects its registration status. That information might be grounds for de-registration under ss.157 – 159 of the Finance Act 2004, but unless and until the scheme is de-registered it continues to be registered.

57. The argument might be that even if it can be shown that a recipient scheme is on the register at a given moment in time, the fact that HMRC has issued a Response 2 means that a trustee or administrator cannot safely assume that, when the transfer is actually made, the scheme will still be on the register given that HMRC has information that could provide grounds for de-registration.

(2) Is the scheme a pension scheme for the purposes of s.1 PSA 1993?

58. A "pension scheme" is defined in both s.1 of the PSA 1993 as "*a scheme or other arrangements, comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people (a) on retirement, (b) on having reached a particular age, or (c) on termination of service in an employment*".[20]

59. The definitions of both "*occupational pension scheme*" and "*personal pension scheme*" in s.1 of the PSA 1993 are built on this definition of "*pension scheme*".

60. In practice there are going to few situations where the recipient scheme does not fall within this definition. The reason for this is partly the width of the definition itself, which includes not just schemes that provide retirement benefits but also schemes which are "capable" of

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[20] The definitions of both "occupational pension scheme" and "personal pension scheme" in s.1 of the PSA 1993 are by reference to this definition of "pension scheme".

providing those benefits. It is also partly the product of the approach taken in _*Pi Consulting (Trustee Services) Ltd v Pensions Regulator*_ [2013] EWHC 3181 (Ch).

61. In that case the issue turned on whether the particular schemes that had been set up for the purposes of engaging in pensions liberation were an "occupational pension scheme" in the context of the exercise by the Pensions Regulator of its statutory powers to appoint independent trustees.

62. In reaching the conclusion that the schemes in question were occupational pension schemes, Mr Justice Morgan identified two tests that applied:

    62.1. The Purpose Test: the purpose of the scheme is key, rather than the intent of those establishing the scheme. This should be considered objectively, based on the scheme documentation. A scheme meets the test where the documentation is drafted with the purpose of providing benefits as envisaged by the legislation.

    62.2. The Establishment Test: the court must consider whether the founder of the schemes needs to employ someone of the relevant description at the time the scheme is established and also whether the founder did employ such a person at that time. Even where there is no evidence of any employees in the conventional sense at the time the schemes are established, it is enough that the directors of the founding companies themselves are 'employed' by the founding companies, even where they were not remunerated. It does not matter that such directors are not actually members of the schemes.

63. If this analysis were to be applied to personal pension schemes, it would result in an equally broad approach: there would be no difference in the Purpose Test, whilst the Establishment Test would be focused not on the issue of employment but on the requirement in s.1 of the PSA 1993 that it is "*established by a person within section 154(1) of the Finance Act 2004*".

64. The net effect of the approach taken in _*Pi Consulting*_ is that most schemes, even if they are part of a pensions scam, will be pension schemes for the purposes of s.1 of the PSA 1993 by reference to the documents by which they were established. If that is correct, there are likely to be few circumstances in which trustees or administrators could legitimately refuse to make a transfer out even to a scheme where there is a strong suspicion that the schemes was set up for the purposes of perpetrating a pensions scam.

65. It is worth exploring four main counter arguments that could be advanced to suggest a different conclusion – i.e. that if trustees or administrators conclude that a scheme has been set up to perpetuate a pensions scam that it is not a pension scheme.

66. These arguments are of interest because if any of them is correct, they could form a basis for a disgruntled member or regulator criticising trustees or administrators for acceding to a requested transfer.

(i) Shams

67. One feature of *Pi Consulting* was that it was accepted that - without prejudice to the Pension Regulator's ability to contend in due course that the schemes were shams - the Court should proceed on the basis that they were not[21] and Mr Justice Morgan expressly operated on that basis.

68. The argument would be that by establishing a scheme for the purposes of perpetrating a pensions scam, the trust documentation was set up with the intention that it be a sham or a front to obscure the pension fraud that was really planned.[22] The intention which would make it a sham was the intention to give the false impression to HMRC, the Pensions Regulator, the FCA and the member joining the scheme that the scheme set up to provide retirement benefits, rather than to perpetrate pensions liberation or some other pensions fraud.

69. To date, the sham argument has not been tested. To do so would require investigation of a number of points, including

    69.1. whose intention would count (e.g. whether the transferring trustee and/or member would need to be in on it), and

    69.2. whether the original trust documentation could be a sham without the people above being in on it, and if so what that means for the terms on which transfers into such scheme are held.

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[21] This was the explicit basis on which Mr Justice Morgan was operating: see, in particular, paragraph [21] of his Judgment.

[22] There is a long line of authorities dealing with sham trusts: see, in particular, Lewin on Trusts, at paragraph [4-19].

(ii) *Void for uncertainty*

70. A different line of argument might be that a trust used for pensions fraud is void for uncertainty.

71. It is perhaps unsurprising that pension scams do not always have the best drafted trust documents. If the description of the object to which the pension assets are to be applied is too vague to enable the court to enforce it – there will be no trust at all and so no pension scheme.

72. This line of argument was accepted in a different context in the recent decision of the Upper Tribunal in *Clark v The Commissioners for Her Majesty's Revenue & Customs* [2018] UKUT 0397 (TCC).[23]

73. In that case the issue related to unauthorised payments and whether a transfer to a pension scheme that was void for uncertainty was a "payment" at all for the purposes of the Finance Act 2004. It was accepted as part of the analysis that a trust that is void for uncertainty is not a pension scheme (and so not a registered scheme) at all.

(iii) *Gordon v The Commissioners for Her Majesty's Revenue & Customs* [2018] UKFTT 0307 (TC)

74. The issue that arose in this case was whether a transfer that had been made from a registered pensions scheme to a scheme called the Wenns International Pension Scheme ("**Wenns**") was an unauthorised payment.

75. The argument advanced by HMRC was that Wenns was not a "qualifying recognised overseas pension scheme" ("QROPS") even though it was registered with HMRC and was on the list of QROPS maintained by HMRC on its website. The position taken by HMRC was that – even though Wenns was registered at the time of the relevant transfers – Wenns was not really a pension scheme at all because it was simply a vehicle for pensions liberation. In order to be a QROPS, Wenns had first to be a pension scheme under s.150(7) of the Finance Act 2004 and if it did not fall within that definition then the transfer was an unauthorised payment.

76. The First-Tier Tribunal concluded that the members in the appeal had not demonstrated that Wenns was a "pension scheme" and so the transfers were unauthorised payments.

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[23] This case has an appeal to the High Court outstanding.

77. The relevant definition of "pension scheme" for these purposes was contained in s.150(1) of the Finance Act 2004, which is very similar terms to the definition in s.1 of the PSA 1993.

78. It was not considered relevant to the issue of whether Wenns was a pension scheme that HMRC had registered Wenns as a QROPS at the time the transfers had been made; that could not predetermine the legal issue of whether or not it was a pension scheme.[24]

79. The key point was that:

"*We had virtually no documentary evidence relating to Wenns other than its correspondence with HMRC. We had no publicity or other promotional material produced by it (or by Windsor), and no documents relating to its establishment or structure. The appellants also produced no evidence as to the benefits accruing under the scheme (despite having in some cases explicitly asserted to the transferring provider that they were aware of those benefits). The evidence on which HMRC relied was that it was clear that all four appellants were able to access their full pension funds in cash shortly after the transfer was made. In our view this evidence outweighs the evidence provided by Wenns' correspondence with HMRC, to the extent that might otherwise provide any support that Wenns was a pension scheme. It is quite clear that the ability of the appellants to access their funds was not dependent on retirement or attaining any particular age, or on any of the other matters referred to in s 150(1) , and that the purpose of the transfers was to obtain immediate access to the funds... Accordingly, we conclude that Wenns was not a pension scheme and therefore…the transfers were all unauthorised payments that were subject to unauthorised payments charges and surcharges*".

80. It is unclear the extent to which this analysis cuts across the objectivity of the Purpose Test laid down in *Pi Consulting* and that case was not referred to. A key difference between the two cases on the facts is that, unlike in *Pi Consulting*, there appears to have been little documentary evidence against which an objective assessment of the purposes of the scheme could be assessed. There is, therefore reason to think that this analysis would only apply in reasonably extreme cases.

81. The other point to note from the reasoning in this case was the absence of any evidence which meant that it was important where the burden of proof lay.

82. Where a claim to tax has been brought by HMRC, the burden of proof is typically on the members to show that the tax has been wrongly assessed, as the First-Tier Tribunal observed

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[24] See, in particular, paragraph [136] of the Decision.

at paragraphs [109] and [132]. In situations where a disgruntled member or a regulator is challenging the decision of trustees or administrators not to transfer, the burden would be on the trustees or administrators to establish that there was no legal right to transfer. This risks creating a peculiar situation where on facts like those in *Gordon v The Commissioners for Her Majesty's Revenue & Customs* it could be successfully argued that the scheme was not a pension scheme for the purposes of a tax assessment, but is a pension scheme for the purposes of determining whether trustees or administrators have legitimately refused a transfer request.

(iv) The meaning of "transfer credits"

83. A further possible argument where a transfer is being made to an occupational pension scheme is that a transfer to a scheme that has been set up for the purposes of pensions liberation does not involve the member acquiring "*transfer credits*" as required by s.95(2) of the PSA 1993.

84. The definition of "transfer credits" in s.181 of the PSA 1993 is:

"*rights allowed to an earner under the rules of an occupational pension scheme by reference to:*

(a) a transfer to the scheme of, or transfer payment to the trustees or managers of the scheme in respect of, any of his rights (including transfer credits allowed) under another occupational pension scheme or a personal pension scheme, other than rights attributable (directly or indirectly) to a pension credit, or

(b) a cash transfer sum paid under Chapter 2 of Part 4ZA in respect of him, to the trustees or managers of the scheme". (emphasis added)

85. The line of argument would be that in most pension scheme liberation cases the member is not actually employed by the recipient scheme and so cannot be an "earner" in relation to that scheme for the purposes of acquiring transfer credits.

86. Whilst this type of argument was initially successful in cases before the Pensions Ombudsman, it has more recently been rejected by the decision of the High Court in *Hughes v Royal London* [2016] 014 PBLR (010). In that case, it was decided that there was no requirement in the meaning of the words "transfer credits" for a member to earn an income from the employer of the recipient occupational pension scheme. A transfer must take place in such a case where a scheme member is an earner by reason of earnings from another source or sources even if those earnings are not linked to the scheme to which the transfer is sought.

87. A different way of deploying the argument seems to have been considered by the Pensions Ombudsman in *N v Zurich and Curtis Bank Ltd (PO-16907).*

88. In that case, having decided that a Response 2 from HMRC meant that it could not be established that the scheme was registered, the Pensions Ombudsman went on to consider the other "red flags" the administrator had discovered as part of its due diligence process.

89. The Pensions Ombudsman commented at paragraph 35 that:

> "*35. The type of concerns identified by Zurich/CB potentially link to an important part of the statutory transfer assessment process, that the transfer value must be used to obtain transfer credits in a receiving scheme. If there were serious doubts about that, then it could have been that the statutory cash equivalent right would, on that basis, not have been established*".

90. The suggestion that "serious doubts" could result in a member not acquiring "transfer credits" is an interesting one that has not yet been developed in subsequent cases. Whether the rationale for that might be that where a scheme is fraudulent the member does not acquire "rights" in that scheme that can be referenced to the rights acquired under a different scheme or, adopting an approach similar to that taken in *Gordon v The Commissioners for Her Majesty's Revenue & Customs* [2018] UKFTT 0307 (TC), the "serious doubts" mean that it cannot be established that the recipient scheme is a pensions scheme at all, remains to be seen.

F. The cost of getting it wrong

91. The cost of making the wrong decisions can be significant in these types of cases.

92. The Code of Good Practice recognises the invidious position faced by trustees and administrators at paragraph 4.5 where it is stated that:

> "*The difficulty for those faced with a suspected pension scam is that, on the one hand, the member may have a statutory transfer right (or a right to transfer under the scheme), but on the other, the trustee or provider has regulatory and other general responsibilities to act with due care and in the best interests of their scheme's members, who could risk losing their pension savings through pension scams. Whether the trustees or providers block or allow the transfer, there are potentially negative consequences for trustees/providers which must be considered*.

93. If trustees or administrators block a valid transfer request, the potential consequences include the following:

93.1. An action brought by the Pensions Regulator: s.99(7) of the PSA 1993

The Pensions Regulator can impose civil penalties on persons who have failed to take all such reasonable steps to ensure a transfer is made where a statutory right to a transfer exists. This can be a financial penalty of up to £1,000 in the case of an individual and up to £10,000 in any other case.

In practice, however, if there are reasonable concerns about the transfer being made to a scheme that is part of a pensions scam, the Pensions Regulator will take that into account in determining whether to pursue any action under s.99(7).

93.2. A complaint by the member to the Pensions Ombudsman or proceedings issued to require the transfer to be carried out:

If a member challenges the refusal to transfer where there is a legal right for the transfer to proceed, the trustees or administrators are liable not only to be directed to make the transfer but also to compensate the member for any financial losses caused by the transfer not having taken place. This will include any costs incurred by the member in bringing the action and, before the Pensions Ombudsman, compensation for any distress or inconvenience caused to the member.

93.3. The trustees or manager will have to recalculate and pay the transfer value.

93.4. There may be reputational issues for the trustees/providers if it is perceived that they have blocked a legitimate transfer request.

94. If trustees or administrators make a transfer to a scheme that it transpires is a pension scam vehicle, the potential consequences include the following:

94.1. They may have made an unauthorised payment:

This could result in tax penalties for both the member and the transferring scheme.

94.2. The member could complain to the Pensions Ombudsman that the trustees or administrators should not have made the transfer or bring proceedings to similar effect:

The reality, however, as explained above is that the member will find it difficult to make good any such complaint given how difficult it appears to be to establish in any particular case that there is no legal right to transfer.

However, if the trustees or administrators have not carried out adequate due diligence or given adequate information or warning to the member, they will be

exposed to the different line of attack taken in *Mr N v Northumbria Police Authority (PO-12763)* that, but for the trustees or administrators failures the member would not have pursued the application for a transfer. In such circumstances, trustees or administrators will be potentially liable to restore the benefits that were transferred to the extent those benefits are ultimately irrecoverable from the receiving scheme.

94.3. The trustees or administrators may not benefit from the statutory discharge from any obligation to provide benefits to which the transfer relates.

This means that, despite the trustees or administrators having transferred out the member's benefits, the member (and any contingent beneficiaries) could still claim benefits from the scheme.

94.4. Even if the member has signed a bespoke, non-statutory discharge, this may not bind contingent beneficiaries, meaning the scheme could face claims by contingent beneficiaries for benefits.

94.5. There may be reputational issues for the trustees/providers if it is perceived that they have not adequately safeguarded member benefits.

G. Practical tips on handling these situations

95. There are a number of practical tips that can help protect trustees and administrators confronted with an insistent client from future criticisms.

Tip 1: Read the Code of Good Practice carefully

96. The Code of Good Practice is perhaps the most useful guidance available and it will be difficult for any of the regulators to argue that trustees or administrators have not carried out sufficient due diligence or not given adequate warnings to members where that guidance has been complied with.

Tip 2: Have a check list for the enquiries that are being made

97. In checking off the list, do not underestimate the importance of seeing the governing documentation of the recipient scheme. These are likely to be the most useful documents in reaching a view on whether the recipient scheme is a pension scheme for the purposes of s.1 of the PSA 1993.

Tip 3: Arrange a telephone call with the member as soon as practicable

98. There are several practical advantages to arranging a telephone call, in addition to communicating by letter or email.

99. Given the time pressure within which to conduct the investigations, it speeds up the process and enables trustees and administrators to identify at an early stage what information and documents the member will have available to them, as well as their understanding of the scheme they are proposing to transfer into. It will also give trustees and administrators the opportunity to promote the understanding of the member on the risks posed by scheme transfers and the "red flags" to look out for.

100. All telephone communications should always be followed up in writing.

Tip 4: Set out the conclusions of the investigations for the member

101. Whatever the decision on whether to accede to a transfer request, it is always sensible to provide a member with a report setting out the conclusions from the due diligence process and identifying any "red flags" that have been encountered.

Tip 5: Think to apply for an extension at early stage

102. The practical reality is that if an application for an extension of time is made too late into the six month period, the Pensions Regulator will likely be forced to refuse it for that reason alone.

103. This is because under paragraph 1 of Schedule 2 to the Pensions Act 2004, the power to grant an extension of time under s.99(4) of the PSA 1993 is a reserved regulatory function exercisable only by the Determinations Panel. This means that in order to grant an extension, the Pensions Regulator will have to issue a warning notice and obtain a decision of the Determinations Panel before the six month period expires. It is consequently sensible in practice for trustees or administrators who suspect a pension scam to consider making an application as soon as their due diligence raises concerns and they consider that the criteria to request an extension are met.

Tip 6: Inform the Pensions Regulator or the FCA about what the investigations have revealed

104. The greater the level of concern that a transfer is to a suspect scheme the more sense there is in keeping the Pensions Regulator in the case of occupational pension schemes and the FCA in the case of personal pension schemes informed as to what the investigations conducted have revealed. This is not only likely to provide protection to trustees and administrators if they

ultimately make the wrong decision, but may also prove helpful if the proposed recipient scheme is one that is already on the radar of the relevant regulator.

II. SIPPs and ***Berkeley Burke***

105. SIPPs are operated in a web of overlapping duties from different sources, driven by different policy considerations, and which are difficult to untangle.

106. The decision in *Berkeley Burke*, in which the FOS Ombudsman's decision to find an SIPP administrator liable for executing the member's instruction, is controversial. An appeal is due to be heard on 15 October this year. We are aware of at least one other case, *Adams v Carey Pensions* in the Chancery Division, where a regulatory claim under FSMA is being brought. Judgment in *Adams* is awaited.

A. SIPPs' Place in the Pensions Universe

107. The term "SIPP" is purely historical. They were introduced in 1989, and the name defined in 2001 (Regulation 3 of the Personal Pension Schemes (Restriction on Discretion to Approve)(Permitted Investments) Regulations 2001/117). As the name suggests, they are and remain personal pensions. That 2001 definition was:

"*arrangements under which the member is able to direct the manner in which some or all of the contributions paid to the scheme are to be invested by the scheme administrator*"

108. While the term SIPP no longer features in the relevant pensions legislation, the touchstone of whether or not the member can direct the investment remains relevant. The current regime is the Finance Act 2004 (as amended by the Finance Act 2006) and SIPPs are a type of "investment regulated pension scheme" ("**IRPS**"):

108.1. In order to benefit from the tax advantages that are the inevitable desire of the members, the SIPP must, like any other pension scheme, be registered with HMRC under the regime of Part IV of FA 04. So, a SIPP must have an administrator (ss270-274 FA 04) who is made liable for reporting to HMRC and for any tax charges that arise.

108.2. Schedule 29A FA04 (inserted by FA06) is a specific regime applicable to IRPS. Schedule 29A applies (by paragraphs 1(1) and 1(2)) to a non-OPS if either:

"*(a) the member, or*

(b) a person related to the member,

is or has been able (directly or indirectly) to direct, influence or advise on the manner of investment of any of the sums and assets held for the purposes of an arrangement under the pension scheme relating to the member."

While the precise language differs from the 2001 definition, the principle is the same.

108.3. The remainder of Schedule 29A (a) defines relevant "taxable property" for IRPSs, what constitutes acquiring and holding such property and so would trigger a scheme chargeable payment (under section 241 FA04) and so a scheme sanction charge under section 239 FA04; and (b) defines how the "unauthorised payment" regime and associated tax charges apply to IRPSs.

109. So, pensions legislation applies to SIPPs to a relatively limited degree. The focus is on permitted taxable property and the appropriate tax regime, and the wide range of obligations imposed on occupational pension scheme trustees and administrators (beyond the tax consequences) does not apply.

110. The reason for this is that the principal applicable regime governing SIPPs is the financial services regime: the framework set by the Financial Services and Marketing Act 2000 ("**FSMA**"). Article 52 of the Regulated Activities Order makes "*establishing, operating and winding-up a…personal pension scheme*" a regulated activity to which the FSMA regime applies. This dovetails with the limited application of the pensions legislation: see section 154 PA04 providing that (in substance) an application to register a personal pension scheme may be made only if it has been established by a person with FSMA provision.

111. The interplay between the FSMA regime and the pensions regime creates a wide range of complexity. One such is the interplay between the FOS Ombudsman and the Pensions Ombudsman, discussed in last year's Nugee lecture by Paul Newman QC and Emily Campbell.

112. Our investigation shall have a slightly different focus: the regulatory regime applicable to SIPPs, what problems that can cause and how they are dealt with, and as part of this what if anything trust law adds to this.

B. The Source of Duties on the SIPP Trustee and Administrator

113. The three sources of duties on the SIPP Trustee or Administrator are (1) the express duties under the SIPP documentation; (2) trust law duties; and (3) regulatory duties.

(1) Express duties

114. The starting point for any claim, whether a private law claim or a FSMA claim, will be the governing documentation of the SIPP, which is ordinarily established under a trust with a Deed

and Rules (although such deeds and rules are usually much shorter than in DB schemes), and this paper assumes we are concerned with such a SIPP.

115. The following usual terms are likely to be relevant:

115.1. The terms setting out the trustee's powers and duties to invest;

115.2. The related terms on the member's ability to direct or instruct investments and the situation in which the trustee may decline to follow such an instruction;

115.3. Any clauses setting out the trustee's role, often making at least some attempt to exclude any positive duties of a trustee beyond responsibility to hold the assets. These are important clauses and drafted in a variety of different terms, which we shall return to later.

116. The obvious difficulty arising from the primacy of the wording is that each SIPP provider uses different language (and often there are terms and conditions alongside the deed and rules). The ordinary structure for investments is that the member directs the investment to be made, but that there is some leeway for the trustee or operator to refuse to act on such a direction if the directed investment is inappropriate.

117. Therefore, one tends to see the trustee referred to as an "asset" trustee, a "custodian" trustee or something else that is intended to connote that the trustee is meant to have a limited asset-holding role.

118. However, within that broad scheme is a wide range of potentially-different structures, such as:

118.1. the trustee is only given the right to object in narrow, tightly defined circumstances, such as the investment is not one to which the tax legislation gives tax relief;

118.2. the trustee is also given the power or obligation to refuse in some more loosely defined circumstances, such as if the investment is "inappropriate";

118.3. the trustee or SIPP operator being given the ability to formulate criteria or categories of investment that it is not required to accept instructions in relation to;

118.4. drafting that *requires* the trustee to refuse certain instructions ("*shall refuse*") and wording that *permits* the trustee to do so ("*may refuse*"); or

118.5. less developed drafting that does not deal in the detail with the above.

119. Tightly drafted wording may make clear that the trustee is obliged to act on the instruction outside tightly defined circumstances. In such situations, the intention of the *instrument* is clear. The arrangement with the SIPP operator and trustee is intended to be an "execution-only" one. The question then becomes whether this is consistent with general trust law or regulatory law obligations.

120. However, where- as is fairly often the case- the wording is not so clear and states for example that the trustee may refuse an instruction where the investment appears to be (seriously) inappropriate, the question arises of whether this therefore contemplates that the trustee must ask itself whether the investment is seriously inappropriate, and therefore undertake at the very least a limited monitoring role to check the investment.

121. Similarly, if the SIPP documentation gives the trustee the power (but not expressly the duty) to decline to execute an investment *if it is contrary to the trustees' duties including the duty to act in the best interests of members*, again this opens the door to an argument that the trust is intentionally going beyond just giving the trustee an "execution-only" role.

122. As set out below, these trust law questions also resonate with some of the questions being asked from the perspective of the *regulatory* obligations in the recent High Court decision in the *Berkeley Burke v Charlton* judicial review. A key part of that decision examines whether, once one acknowledges that those operating SIPPs have some duty to check the instructions given, such as to make sure the investment in question would attract tax relief and/or is not unlawful, there is a principled stopping off point for such a checking duty that falls short of checking whether the investment is seriously inappropriate.[25]

(2) Trust Law Duties

123. The starting point is to understand how, at a general level, ordinary trust law duties interact with the express terms of the documentation.

124. While trust law allows the backdrop to a trust, including its commercial setting and any larger contractual arrangement of which it forms a part, to shape the parameters of a trustee's role, it normally takes the approach that if you wish to exclude what would be an important ordinary incident of your trusteeship, you must be clear about it. One can see that from the treatment of exclusion clauses to take an example. There, the Courts restrictively interpret attempts to exclude ordinary liability for breach of trust.

[25] See §§135-137 of that judgment.

125. As the section on "anti-*Bartlett* clauses" in section III below brings out, there are examples of the Courts taking the same approach to attempts in the trust instrument to restrict the trustee's ordinary *powers* in a way that causes the Court to be concerned that the trust is starting to limit the trustee's core role.

126. Similarly, one can see a good example of this attitude from the Law Commission in its consultation paper on exemption clauses and similar provisions. It states that its view is that if a trust deed states that the trustee has no *obligation* to interfere in the affairs of an underlying company owned by the trustee, that is acknowledging that the trustee retains a *power* to do so, and therefore the trustee's fiduciary obligations require it to consider by way of monitoring role whether to exercise such a power (LC 301 (2006), App D §18, LC 171 (2002) §4.91).

127. Turning then to specific trust law duties, the two sources of duties in play are (a) ordinary equitable principles subject to the express terms of the trust deed; and (b) Trustee Act 2000 duties (excluded for occupational pension schemes but accordingly not SIPPs by s36).

128. An example of (a) is as follows. A SIPP is not a bare trust, not least as the trustee holds not only for the member but also for various people on his death, so the trustee is not required to (and cannot) transfer the assets to the beneficiary on demand, even putting to one side the question of whether any duties to decide whether the instruction is a valid one (e.g. whether the investment is one that would attract the desired tax treatment) are consistent with the trust being a bare trust. Therefore, as Paul Newman QC and Emily Campbell pointed out in their paper, there is a question of trust law as to whether it is possible to vest the investment function in a beneficiary (like the member in a SIPP) rather than the trustee, given that the beneficiary is subject to no fiduciary duties and therefore allowing such an arrangement means that there is no fiduciary oversight of the investment function. We will return to this in section III below on what we can learn from the private trust context.

129. An example of (b) is the section 4 duty to "have regard" to the "suitability to the trust of investments" and "the need for diversification…so far as is appropriate" "in exercising any power of investment". It seems to us that where the trustee executes the investment on the instruction of the member it would fall within this section.

130. It is suggested in Lewin on Trusts that the section 4 duty can be excluded by the terms of the instrument.

131. Even if that is right, then nevertheless where the instrument does not seek *expressly* to exclude the section 4 duty, but there is a clear intention to create "execution-only" SIPP services, a question of construction arises about whether the trustee must have regard to these matters,

and, if it does, would it be entitled to conclude that it would be "appropriate" or "suitable" not to interfere with the member's choice because that was the structure agreed. Specifically, if an express term of the instrument requires a particular investment to be held suffices to disapply the duty, analytically it is well arguable that an express term providing for the member to direct investment should also suffice. The circumstances of the trust are the analogous, in that the trustee is expressly not intended to have control over investment. (Similar issues arise if the carrying out of the investment is delegated to a third party by the requirements of s15.)

132. The regulatory regime places significant restrictions on SIPP providers' ability to exclude any duty or liability: it must be "*honest, fair and professional*" to do so (COBS 2.1.3, with effect from 1 October 2015).

(3) Regulatory Duties

133. As set out above, establishing and operating a SIPP is a FSMA-regulated activity (Article 52 of the RAO). Where carried on as business, it constitutes "*designated investment business*", and so the relevant person must be authorised. Note that such authorisation is different to an authorisation to advise.

134. The FCA Handbook accordingly applies, of which the relevant sections are:

134.1. The "Principles" which have been described as "the ever present sub-strata or overriding framework" (*Berkeley Burke* at [117]) and include:

> "*2. A firm must conduct its business with due skill, care and diligence.*
>
> *6. A firm must pay due regard to the interests of its customers and treat them fairly*."

134.2. The Conduct of Business Sourcebook ("**COBS**") applies, containing detailed "rules", the breach of which is actionable at the suit of a private person under FSMA and guidance, breach of which is not.

134.3. In addition to the rules in COBS, the FCA's "Perimeter Guidance" manual ("**PERG**") gives guidance on when certain activities constitute designated investment business. PERG 10 and PERG 12 relate to pension schemes.

135. Note that, on the analysis set out in PERG an "operator" of a SIPP is not necessarily the trustee. The "operator" is the person responsible to the members for managing and administering the assets of the SIPP, and the FCA's guidance is that this is usually the scheme administrator (see PERG 12 Q4). A member directing his investment is specifically excluded as being an operator. Thus, where there is a specific administrator, it rather than the trustee is likely to be the

relevant target for any regulatory claim. In any event, there will be a regulated entity to whom the regulated regime applies.

136. The provisions of COBS are at the heart of the regulatory regime applying to SIPP operators. A distinction is drawn between MiFID provisions and non-MiFID provisions. MiFID-regulated activity (i.e. by the EU Markets in Financial Instruments Directives) includes the making of a personal recommendation in relation to any financial instrument. While the execution of orders on behalf of clients is ordinarily regulated by MiFID, there is an exemption for the manger or depositary of pension funds, and as such SIPP operators would not ordinarily be caught by this regulation.

137. The principal provisions are:

137.1. COBS 2 (particularly 2.1.1R) requires the firm to act honestly, fairly and professionally in accordance with the best interests of its client. Ancillary rules at 2.1.2R and guidance at 2.1.3G restrict regulated firms' ability to limit their duties or liabilities. This rule applies to all SIPP providers, including "execution only" providers. (By COBS 3.2.3(2)R a member of a pension scheme is a "client".)

137.2. COBS 4 relates to obligations to communicate with clients clearly. A distinction is drawn between MiFID and non-MiFID communications (with COBS 4.5 applying to non-MiFID activities and 4.5A to MiFID).

137.3. COBS 9 imposes obligations on a firm to advise on suitability. Importantly, COBS 9.1.1R expressly provides that it applies to a firm which:

"*(a) makes a personal recommendation to a retail client in relation to a designated investment;*

(b) manages investments of a retail client of the firm;

(c) manages the assets of an occupational pension scheme, stakeholder pension scheme or personal pension scheme, other than in relation to its MiFID, equivalent third country or optional exemption business or to an insurance-based investment product."

137.4. It might be thought that a SIPP operator would "*manage investments*", but such an activity is defined as one which involves "*managing assets belonging to another <u>person in circumstances which involve the exercise of discretion</u>*" (underlining added). Where a service is execution only, that would not ordinarily involve the exercise of a discretion. However, it seems to us the position may be more involved than that:

(a) If it is accepted that the operator has a duty to consider the acceptability of the SIPP investment (either under the terms of the scheme, ordinary trusts law duties, or as part of its regulatory obligations), then there must be a discretion not to accept the relevant instruction.

(b) That instruction is likely to be to invest cash held in the SIPP or sell one asset and buy another. Where the operator has a discretion to refuse to execute that instruction, at the lowest, it may be argued that amounts to "*managing assets belonging to another person in circumstances which involve the exercise of a discretion*".

(c) The best answer to that argument seems to us to be that such an argument is to apply a literal rather than purposive approach to the COBS (and the entire handbook), which is intended to be interpreted in light of its purpose: GEN2.2.1R[26]. One would expect COBS 9 to apply to "active" asset management services. While as yet there is no definitive answer in the authorities in the SIPP context, there is authority in other contexts that execution-only services do not fall within COBS 9 (e.g. *City Index v Balducci* [2011] EWHC 2562 (Ch) at [29] and [35]), although these authorities are based on (i) arguments based on personal recommendations (not asset management) and (ii) contractual not trust arrangements such that the risk of a discretion and so "management" does not arise.

137.5. COBS 10 imposes obligations to assess the "appropriateness". This does not apply where the service is execution-only (see COBS 10.4.1 (1)(a)R). This could raise similar issues as "*suitability*" in determining whether a SIPP is in fact execution-only.

137.6. COBS 11 relates to "dealing and managing". It includes at COBS 11.2.19R a rule that: "*Whenever there is a specific instruction from the client, the firm must execute the order following the specific instruction.*" This rule was (unsuccessfully) relied upon in *Berkeley Burke* in an attempt to avoid liability. (Since 3 January 2018 i.e. since MIFID II, the applicability of COBS 11.2 has been limited, but COBS 11.2A applies more broadly and contains an equivalent provision at COBS 11.2A.12R.)

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[26] i.e. the "General Provisions" of the "High Level Standard" in the Handbook

137.7. COBS 19 contains pensions supplementary provisions. These largely relate to pension transfers. A previous provision (COBS 19.1.5R) that required a clear record in relation to execution-only transfers has been deleted from this section.

138. It is important to understand the development of regulatory thinking and guidance over time in this area.

139. Having started regulating SIPPs in 2007, the FCA published reports into SIPP operators in 2009 and 2012. The 2012 review raised concern about the adequacy of due diligence requirements relating to the identification of potential risks to the members or firms. This review identified inadvertent investment in taxable property and potentially-fraudulent investments rather than an assessment of suitability.

140. Following a consultation in 2012, the FCA issued "*SIPP operator guidance*" in October 2013. In relation to the "due diligence" Principle 2, that guidance was:

"*All firms should ensure that they conduct and retain appropriate and sufficient due diligence (for example, checking and monitoring introducers as well as assessing that investments are appropriate for personal pension schemes) to help them justify their business decisions. In doing this SIPP operators should consider:*

•*ensuring that all investments permitted by the scheme are permitted by HMRC, or where a tax charge is incurred, that charge is identifiable, HMRC is informed and the tax charge paid*

•*periodically reviewing the due diligence the firm undertakes in respect of the introducers that use their scheme and, where appropriate enhancing the processes that are in place in order to identify and mitigate any risks to the members and the scheme*

•*having checks which may include, but are not limited to: ensuring that introducers have the appropriate permissions, qualifications and skills to introduce different types of business to the firm, and undertaking additional checks such as viewing Companies House records, identifying connected parties and visiting introducers*

•*ensuring all third-party due diligence that the firm uses or relies on has been independently produced and verified*

•*good practices we have identified in firms include having a set of benchmarks, or minimum standards, with the purpose of setting the minimum standard the firm is prepared to accept to either deal with introducers or accept investments, and*

•*ensuring these benchmarks clearly identify those instances that would lead a firm to decline the proposed business, or to undertake further investigations such as instances of potential pension liberation, investments that may breach HMRC tax-relievable investments and non-standard investments that have not been approved by the firm.*"

141. There was also further due diligence guidance in relation to Unregulated Collective Investment Schemes, with particularly opaque and risky investments such as overseas property, green energy initiatives and overseas property funds.

142. The above focused on due diligence in respect of *introducers*, but the Dear CEO letter in July 2014 turned to the due diligence procedures that SIPP operators use to assess non-standard investments, and warned that the FCA considered that there were a significant number of operators who were failing to meet the standards that the FCA expected. The Annex stated that:

> "*Principle 2 of the FCA's Principles for Business requires all firms to conduct their business with due skill, care and diligence. SIPP operators should ensure that they conduct and retain appropriate and sufficient due diligence, for example, assessing that assets allowed into a scheme are appropriate for a pension scheme. Our thematic review found that most SIPP operators failed to undertake adequate due diligence on high-risk, speculative and non-standard investments despite being aware of the Financial Services Authority (FSA) guidance originally published in 2012 which clarified our expectations of firm conduct.*"

143. More fundamentally, the Annex went on:

> "*We found that most firms do not have the expertise or resources to assess this type of business, but were still allowing transactions to go ahead. This increases the risk that a pension scheme may become a vehicle for high risk and speculative investments that are not secure assets, many of which could be scams. It is not acceptable for firms to put consumers at risk this way.*"

144. This brings out vividly the tension at the heart of regulatory obligations on modern low-cost SIPP providers between (a) the due diligence obligation, as set out in the FCA Guidance and underpinned by Principle 2, and (b) the "member directed" principle of investment choice underpinning SIPPs, represented at their most extreme by the "execution-only" SIPP operators. To the extent this due diligence obligation and the use of a trust structure gives rise to the question of discretion, that could in principle open up the SIPP provider to related challenges on other grounds, e.g. that COBS 10 applies because of the exercise of a discretion.

C. *Berkeley Burke* and the Application of the Regulatory Regime

145. In *Berkeley Burke*, Mr Charlton complained about Berkeley Burke's acceptance into his SIPP of an investment into "Sustainable AgroEnergy" as part of a green energy scheme in Cambodia relying on jatropha plants (a highly toxic plant used, when not for biofuel, in basketmaking and tanning, also known as "nettlespurge"). The investment promised very high returns. The operator Berkeley Burke Sipp Administration Limited ("**BBSAL**") was an execution-only SIPP

provider which made the investment on Mr Charton's instruction, and Mr Charlton was introduced to BBSAL by an unregulated introducer.

146. In a turn of events familiar to all pensions lawyers who operate in the area, it transpired Sustainable AgroEnergy did not have title to the land in Cambodia, that the land was probably not suitable for jatropha cultivation in any event, and that making a business success of jatropha-based energy was unlikely to be successful. Sustainable AgroEnergy went into administration, freezing orders were obtained, and the administrators reported that the extent of the assets were some plant and machinery in Cambodia of little realisable value. Mr Charlton had invested his entire private pension provision, £24,000, into the SIPP. As part of the investment, Mr Charlton had signed documentation indicating that he understood the high-risk nature of the investment and that BBSAL would not be liable in respect of the same.

147. After an initial ombudsman's decision in favour of Mr Charlton was remitted for reconsideration by another ombudsman, who upheld Mr Charlton's complaint.

148. The core of that analysis was:

148.1. The core question was whether BBSAL had acted fairly and reasonably by "*accepting Mr C's…investment into his SIPP*". The ombudsman's jurisdiction was to determine what was fair and reasonable in all the circumstances, including but not limited to the FCA guidance and good practice at the relevant time. This was done particularly by reference to principles 2 and 6.

148.2. BBSAL accepted that its due diligence obligation required it to assess whether the investments was "SIPP-able" i.e. an investment that would obtain the tax benefits of the pension regime. It denied that due diligence required to go beyond that, and particularly that "commercial" due diligence was required.

148.3. On the particular facts in relation to this investment, the ombudsman found that BBSAL should have, at least:

"*Identified SA as a high-risk, speculative and non-standard investment, so it should have carried out sufficient due diligence.*

Considered whether SA was appropriate for a pension scheme.

Ensured that the investment was genuine and not a scam, or linked to fraudulent activity.

Independently verified that SA's assets were real and secure, and the investment operated as claimed.

Ensured that the investment could be independently valued, both at point of purchase and subsequently.

Ensured Mr C's SIPP wouldn't become a vehicle for a high-risk and speculative investment that wasn't a secure asset, and could be a scam"

148.4. Accordingly, the ombudsman held that BBSAL did not act with due skill care and diligence, or treated Mr Charlton fairly, in accepting the investment into his SIPP. Specifically:

"*I'm not making a finding that BBSAL should have assessed the suitability of the SA investment for Mr C. I accept BBSAL had no obligation to give advice to Mr C, or to ensure otherwise the suitability of an investment for him. My finding isn't that BBSAL should have concluded that Mr C wasn't a candidate for high-risk investment. It's that BBSAL should have concluded the investment wasn't acceptable for his pension scheme and thereby failed to treat Mr C fairly or act with due skill, care and diligence when accepting the investment.*"

148.5. The Ombudsman rejected BBSAL's argument that such a finding was contrary to the rules including COBS 11.2.19 requiring BBSAL to execute an order. His reasoning was that the execution obligations was logically subsequent to the decision to accept or not the investment into the SIPP. Execution issues only arose once the investment was accepted. Since the investment should not have been accepted into the SIPP, execution issues never arose.

149. BBSAL's only recourse was to seek judicial review of the FOS decision. This they did, on two grounds of error of law. The principal ground was whether an execution-only SIPP provider, who is prohibited from giving investment advice, was obliged to carry out the extensive inquiries into the investment instructed by the member (and to refuse to include it in the SIPP despite instructions to the contrary)(see [42] of the appeal). This ground was split into four arguments:

149.1. The "consultation argument" that the Ombudsman created a new duty which the industry had not been consulted on (contrary to the statutory requirements) [47]ff;

149.2. The "augmentation argument" that the Ombudsman had created new unexpected duties. In the context of (a) COBS 9 and 10, which provided a regulatory regime for advice on suitability or the assessment of appropriateness, and (b) the fact that COBS 9 and 10 did not apply to the SIPP provider, it was wrong in law to interpret the general principle of due diligence to require an assessment of whether a particular product was acceptable for a SIPP. [51ff]

149.3. The conflict argument, that the due diligence duty as found contradicted COBS 11.2.19 requiring execution of instruction given by the client. [57]ff

149.4. An overarching error of law argument, that the Ombudsman had found a duty of enquiry or investigation when in fact BBSAL's role was administrative. [60-61]

150. Each ground was rejected, and the decision upheld. Jacobs J commenced his analysis by identifying the Ombudsman's jurisdiction as one where he applied a subjective test, where he is dealing with "complaints" rather than causes of action [79-80]. The judge also accepted that while the construction of the rules is a matter for the court, the application of those rules is for the ombudsman (at [82]). Thus, BBSAL needed to show an error of law. They failed to do so.

150.1. The consultation argument was rejected on the grounds that the Ombudsman did no more than apply the pre-existing principles to the facts he found (at [85]ff particularly [86]).

150.2. The augmentation argument failed for largely the same reason: the Ombudsman's decision did no more than apply the existing duties in Principles 2 and 6 (at [98]ff). Indeed, the entire "augmentation" argument was rejected as flawed on the basis that the principles were intended to be broad and of general application, and not a detailed code [104]. What BBSAL characterised as "augmentation" was in fact the entire regulatory scheme: the application of broad principles to the given facts, with that application being the subjective purview of the Ombudsman.

150.3. The conflict argument was rejected, on the basis that when construed purposively (including by reference to MiFID), the execution provisions related to the manner in which an instruction is to be carried out. The reference to "*specific*" instruction provides an exception from the general duty to carry out the client's general instruction so as to obtain the best possible result: it went to the manner of execution, not whether the instruction should be accepted (see [120]ff especially at [125]).

150.4. Accordingly, there was no error of law.

151. Permission to appeal to the Court of Appeal has been granted, with the appeal to be heard in October 2019.

D. Where does *Berkeley Burke* leave SIPP operators?

152. As *Berkeley Burke* is a judicial review of the FOS decision, the SIPP operator necessarily starts on the back foot in attacking it. Therefore, the appeal may well be unsuccessful.

153. However, that is only the beginning of the answer to these issues.

154. Therefore, it is important to examine what practical points are left over.

<u>(i) High court claims</u>

155. First, we are aware of High Court litigation (*Adams v Carey Pensions*) where a claim has been brought in the High Court (rather than before FOS) against an execution-only SIPP provider. Judgment is awaited.

156. By way of background, claims over £150,000 (prior to 1 April 2019) or £350,000 (from 1 April 2019) be brought in the High Court.

157. If the *Carey Pensions* judgment goes in the SIPP provider's favour, taking a markedly different approach to FOS on the relevant points, this will raise quite vividly the question of whether it is appropriate for FOS- unlike the Pensions Ombudsman- to take such a different approach to the High Court on the questions raised.

158. There are arguments for taking a different approach to the *Berkeley Burke* analysis at High Court level. Even putting to one side the debate about the scope of COBS 11.2.19:

    158.1. it arguably pays insufficient regard to the agreed allocation of risk between the parties and the scope of the obligation the SIPP provider has taken on; and

    158.2. the breadth of the approach to "due diligence" in reality approximates it to advice on suitability or appropriateness and so cuts across the regulatory regime.

159. Taking the first point, it may be argued that the decision pays insufficient regard to the scope of the duty undertaken by the SIPP providers. The *content* of the principles (to act with due care skill and diligence, and treat "fairly"), so the argument runs, do not inform the *scope* of action to which those principles apply. A duty to act fairly or to act with due diligence must always relate to something, rather than existing in the abstract.

160. The scope of the duty undertaken by BBSAL in this case clearly excluded any duty to advise on the underlying investments. Indeed, it would have been illegal for them to have done so. In those circumstances, it is difficult to see how it is "unfair" not to carry out substantive investigation into the underlying investments that results in the same conclusion in substance.

161. Taking the second point, both the Ombudsman and Jacob J were alive to the extensiveness of the due diligence finding. Jacob J did not demur from the BBSAL's characterisation of obligations imposed as "*extensive*", but because he characterised the Ombudsman's decision as one applying the existing principles to the given facts, refused to find an error of law. The Ombudsman's rejection of this submission was one of form: because he characterised it as relating to "due diligence" the arguments based on the non-applicability of suitability and appropriateness duties were irrelevant.

162. Whatever the right answer on a *judicial review*, if as a matter of substance, the due diligence duty ends up covering the same field as suitability and appropriateness obligations, but those obligations do not apply, it suggests the due diligence duty is being wrongly applied. To use the principles in substance to cut across the careful regulatory regime seems misconceived.

163. Indeed, Berkeley Burke were not authorised to *advise* on the suitability of the investments. Therefore, if they did the due diligence and informed the member that they would not recommend the investment, that might be thought to be advice. If one seeks to avoid that by saying that they should instead have turned down the investment flatly without giving advice about it, then one is imposing a stricter obligation on them than an advice obligation.

(ii) PO claims

164. The appropriate interrelationship between the principles applied by the PO to such cases and those applied by FOS will- in the event of the judicial review being successful- remain unsatisfactory.

165. In practice, the effect of the disconnect is lessened by the incentive for a member to bring his complaint to FOS rather than the PO, but that lessens rather than removes the problem.

166. The Pensions Ombudsman certainly takes a different approach (although as recognised in *Berkeley Burke* there is a different statutory scheme). In Mr N's determination (PO-5881) in relation to The Essential SIPP, a complaint that the trustee failed to undertake the appropriate level of due skill care and diligence in allowing a SIPP investment into African land was rejected. It was not the trustee's role to undertake the level of due diligence suggested by the member. Certainly, this reflects the wider understanding of SIPPs. The fact pattern of Mr N and Mr Charlton's investments is similar: both indicated they understood that there was no advice given, that the investments were member-directed, and that investment risk was understood. A point of difference, though, is that the trustee offered Mr N an alternative portfolio. A paper-based due diligence exercise was carried out

167. The Pensions Ombudsman held, applying COBS 2.1.1 at [31]:

"*Specifically, under Rule 2.1.1 Stadia were required to "act honestly, fairly and professionally in accordance with the best interests of its client." I do not find that Stadia set aside their professional duty to Mr N by carrying out insufficient due diligence on the African Land investment.* ***<u>Their primary role was to check that it was a permissible investment and this aspect was carried out</u>***."

168. The equivalent conclusions were reached by reference to the trustee's duty of care. The Ombudsman held that the duty of care was excluded because "*the selection of investments is not a decision of the trustee*" (at [41]). The Ombudsman continued:

"*42. The limit of Stadia's responsibility as administrator is to consider whether or not an investment falls within the list permitted by HM Revenue & Customs (HMRC). Whilst they can choose not to allow an investment even if it is permitted by HMRC, there is no requirement on them to do so. HMRC allow SIPPs to invest in a very wide range of investments. The fact a specific type of investment is available to invest in a SIPP does not confer any suitability on the investment itself.*

43. If the duty of care applied then Stadia would be required to arrange investments and periodically review them in the manner of occupational schemes and private trusts which would be entirely inconsistent with the purpose of a SIPP."

169. Mr N's argument that there was not sufficient regulatory due diligence carried out was rejected: the "*basic checks*" and "*warnings*" were sufficient for the regulatory regime at the time of the investment in 2012 (at [56]). The issuance of the more recent guidance, though, may have changed the position.

170. Notably, the Pensions Ombudsman therefore concluded that the relevant duty went no higher than whether it was permitted by the tax regime.

<u>(iii) Trust law points not yet dealt with</u>

171. To date, there has not been significant focus on the trust law elements of the SIPP relationship that we have discussed above.

172. This is largely because of the regulatory overlay, which has caused the focus to be on COBS.

173. However, at some points these issues will inevitably need to be grappled with.

<u>(iv) s.27 FSMA</u>

174. Where section 27 FSMA applies to an agreement, that agreement is unenforceable. Section 27 applies to an agreement made by an authorised person carrying on a regulated activity (not

contravening the general prohibition in s19(1) of carrying on regulated activities unless authorised or exempt) but where that agreement is made "*in consequence of something said or done by another person in the course of a regulated activity carried on by the third party in contravention of the general prohibition*)(s27(1)(d)).

175. Where such an agreement is unenforceable, section 28 applies. By s28(3) the court may allow the agreement to be enforced or money and property transferred under the agreement to be retained. However, in s27 cases, the court is obliged to have regard to whether the provider knew that the third party was (in carrying out the regulated activity) acting in breach of the general prohibition.

176. In *Berkeley Burke*, the SIPP was established with instructions to make a specific investment, and the scheme was promoted and advised upon by an unregulated person (which would be a breach of the general prohibition, in that giving advice and arranging investments are regulated activities). This could give rise to a claim under s27 (and such a claim is being made in *Carey Pensions*).

177. The arguments against the s.27 claim include:

177.1. The causation test, that the entry into the contract must be "*in consequence of something said or done*" focuses on the contract between the SIPP provider and the individual. Ordinarily, this will be the SIPP itself and it is hard to see how statements in relation to a particular investment caused the SIPP contract to be concluded. That said, where, as in *Berkeley Burke*, the SIPP was concluded and the investment intended to be made, one can see the argument that the two contracts may be thought of as part of a single package, such that statements in relation to the investment did cause the SIPP to be entered into.

177.2. In a different context (in relation to the exclusions in the RAO to "arranging" activities), PERG 2.8.6A provides that "*A person will bring about a transaction or a contract or plan variation only if his involvement in the chain of events leading to a transaction or contract or plan variation is of sufficient importance that, without that involvement, it would not take place. This will require something more than the mere giving of advice*". If this analysis is applied to section 27, it would be difficult to argue that the giving of advice means a SIPP contract is "brought about in consequence" of (mere) advice. It may be that, qualitatively, advice is not enough

178. Nevertheless, this provides yet another further practical trap for SIPP providers. It is at least risky, and possibly wrong, to think they can stand by, hiding behind what is thought of as a

limited role as administrator, allowing the individual to invest. This applies even more strongly if the SIPP provider knows that the member is relying on unauthorised advice.

(v) Practical points

179. Most important of all is how SIPP providers should act after *Berkeley Burke*.

180. The starting point is to identify what the decision suggests is required of SIPP providers in exercising due diligence. We consider there is a scale of what "due diligence" could require of a provider, with four key points on that scale. From lowest to highest:

180.1. An obligation solely to ensure that the investments are "SIPP-able" i.e. that they do not contravene the provisions of Schedule 29A and are "valid" investments from a tax perspective.

180.2. A due diligence obligation to ensure not only that the investments are SIPP-able, but also that the investments are genuine and secure. In Mr Charlton's case, this duty would have required BBSAL to ensure that there was title to land and to have identified the issues with the investment company's accounts, and the risk of scam.

180.3. A further obligation to identify whether the investment is commercially suitable for any SIPP, given its nature as a pensions product. It may be difficult to separate this from the previous obligation, but it seems to us there are genuine but very high-risk investments which are not a scam and title and custodianship is secure, but which are not appropriate for pension provision.

180.4. At the highest, an obligation to exercise commercial due diligence not only in relation to the commercial suitability in general terms, but in relation to this particular client's SIPP. This would require the SIPP provider to take into account an individual's circumstances.

181. In *Berkeley Burke*, the Ombudsman rejected the argument that the threshold was at (1) above (in contrast to the PO in *Mr N*). While there were elements both of scam/unsecure investments (i.e. (2)) and commercial unsuitability, it appears to us the Ombudsman went to the top end of the scale, by his finding that "*BBSAL should have concluded the investment wasn't acceptable for his pension scheme*" (emphasis added). This suggests that the position of individual members is relevant.

182. Given the suggestion in the FSA 2014 Dear CEO letter that most firms did not have the expertise or resources to assess this type of business, one option would be for firms to stop taking such

business or to introduce strict parameters around the types of investment they were willing to allow to be held in the SIPPs they operate.

183. Another option is to charge slightly more and put in place a procedure for assessing unsecured investments that fall outside particular ordinary categories. Such procedure would necessarily need to be moderately crude were it to avoid becoming a process that would require the involvement of specialist lawyers. Sketching this out by reference to the July 2014 Dear CEO letter:

(1) checking the type of asset proposed to be invested in: are they orthodox investments or something more esoteric; are they in established markets or frontier markets; do they appear liquid, or is there a concern about liquidity;

(2) checking whether a proposed investment is in respect of a members' entire SIPP giving rise to concerns over a lack of diversification;

(3) checking whether any introducer or financial adviser referred to in any investment documentation is regulated;

(4) checking that it is easy to verify that the assets exist;

(5) checking how high the rate of return is (with promised or projected returns above a certain level being dismissed as likely meaning the investment is too high risk);

(6) checking the investment can be independently valued at the point of purchase and subsequently;

(7) checking to see if there is any publicly available information (e.g. filed accounts) that inform whether the investment would be impaired or not.

184. The challenge this poses though is the level of sophistication or training needed to carry out these checks. As the first section above on suspicious transfer out demonstrates, even experienced occupational pension scheme administrators and specialist lawyers can find it difficult enough themselves. Moreover, a number of items on the July 2014 list require specialised legal input.

185. Therefore, the practical question will be whether this can be done in a way that is practical and satisfies the FCA.

186. The other practical point is what an operator should do when faced with a client who, having been told that the investment is not appropriate, wishes to proceed. In an advisory situation,

furnishing the client with an explanation of the risks and potential unsuitability (in clear language) should be enough. *Berkeley Burke*, though, suggests that if the SIPP provider is unsatisfied with the outcome of its due diligence, it should not allow the investment at all.

187. The broader point this raises is that the practical cost of the sort of processes needed to operate this would- SIPP administrators would argue- have a significant impact on SIPP administrators and associated fees. Due diligence of the type suggested by *Berkeley Burke* would be difficult and expensive. Particularly where low fees are charged and low-value pension pots (such as Mr Charlton's) are invested, one can easily imagine how such a due diligence requirement would lock people like Mr Charlton out of the personal pension market. This would run contrary to the direction of pensions policy in recent years.

188. These practical consequences of increasing regulation in order to societalise risk are not restricted to the pensions field. Lord Sumption, in his recent Reith lecture[27], described the dilemma as follows:

"*Let us now turn to the other major factor behind the growing public appetite for legal rules, namely the quest for greater security and reduced risk. This is particularly important in the areas of… consumer protection, which are the areas that present the main risks to our wellbeing and account for a high proportion of modern law making. People sometimes speak as if the elimination of risk to …wellbeing was an absolute value but we don't really act on that principle, either in our own lives or in our collective arrangements…*

eliminating risk is not an absolute value, it's a question of degree."

III. The Private Client Debate: Trustees' Duties of Oversight?

189. The issues that are being grappled with in the SIPP context are far from unique. Where beneficiaries of a trust or those setting them up are given powers to direct how the trustee behaves or otherwise to take charge of particular responsibilities within the trust structure, this can at the margins lead to questions of the extent to which this is acceptable or to which the trustee still retains some residual monitoring function.

190. There are three pockets of case-law and statutory provisions from the private trust context that help to shed some light on the questions identified above about how far trustee investment duties may be cut down. Given the involvement of Edward Nugee QC in one of the

[27] "Law's Expanding Empire", Reith Lecture No 1 of 2019. Transcript at http://downloads.bbc.co.uk/radio4/reith2019/Reith_2019_Sumption_lecture_1.pdf

leading cases in relation to them, it seemed to us appropriate to examine them in a little more depth.

191. The first relates to what are known as anti-*Bartlett* clauses. The case of *Bartlett v Barclays Bank* [1980] 2 WLR 430 establishes that a company owned by a trust is a trust asset like any other and therefore that the trustee must take steps to keep a careful eye on how it is performing.

192. Accordingly, often trusts holding companies contain clauses that seek to limit the duties of trustees to involve themselves with the running of the company. Like clauses in the SIPP context dealing with trustee duties, they can come in different shapes and sizes, some just providing that the trustee need not interfere in the affairs of the underlying companies and some much longer versions going far further and seeking to bar the trustee in doing so and in taking steps like obtaining information about the companies save in limited circumstances, such as where they have notice of wrongdoing at the company level.

193. The two main cases that have considered such clauses have both concluded that the trustees in those cases were left with a residual monitoring obligation. The first, *Appleby Corporate Services (BVI) Ltd v Citco Trustees (BVI) Ltd* [2014] BVIHC 0156, concerned the shorter form of the clause mentioned in the last paragraph. The Judge, Mr Justice Bannister, a former English chancery practitioner, held that while the clause excluded the duty to interfere it did not purport to exclude the prior duty to monitor the company in the first place. In the second, *Zhang Hong Li v DBS Bank* [2018] HKCA 435 (currently on appeal to the HK Court of Final Appeal), the clause was in the latter, longer form, but the Court nonetheless held that the trustee retained a residual monitoring obligation to check that the investments made by the underlying company were appropriate ones.

194. Therefore, these cases highlight that so far in that area, the Courts have been reluctant to allow trustees to relieve themselves entirely of duties to monitor underlying investments.

195. The second area concerns “illusory” trusts. The recent High Court decision in *Pugachev* [2017] EWHC 2426 (Ch) holds that the retention of powers by a settlor can cause a point to be reached at which the trust is no longer valid. In *Pugachev* , the settlor for example retained personal powers to remove the trustee.

196. While the decision on this point has attracted a range of views from commentators, the important point that it illustrates is that domestic Courts will tend to view with scepticism the idea that a trustee can restrict his role beyond a certain point.

197. The third area concerns investment directions. Offshore structures often grant the ability to direct investments to someone other than the settlor, such as a third party whose directions are stated within the trust instrument to be binding on the trustee. The power might be vested in a professional with investment expertise, but could equally be vested in the settlor or an individual known to them. Where one cannot construe this third party as being intended to act in a fiduciary role, this gives rise to a question as to whether such arrangement would be a valid trust. In the offshore context, this question has been dealt with in relation to the vesting of the power in the settlor by the promulgation of legislation making clear that a settlor can reserve a variety of powers without affecting the validity of the trust and that a trustee who acts on a valid direction is not acting in breach of trust e.g. Trusts (Jersey) Law 1984 art.9A and the Trusts (Guernsey) Law 2007 s.15.

198. In the pensions context, one often sees in old schemes custodian trustees or similar concepts. However, that is normally accompanied by someone with a fiduciary responsibility, like a "managing" trustee, being given the task of directing how the custodian trustee should act, so the task of investment remains subject to fiduciary oversight. That is an important difference to a SIPP established under trust.

199. Therefore, this leaves open the question of what the position is where the person who gives the directions is not a fiduciary.

IV. The *Pitt v Holt* Escape Route

A. The "safe harbour" provided by professional advice

200. In most of the situations where we encounter insistent clients that have been discussed so far, the clients tend to be operating either without specific advice or sometimes even contrary to the advice received.

201. In those situations, it is instinctively unsettling to lawyers that relevant professional advice is either not in place or is not being followed. This is partly because we have in mind the well-established principles in *Pitt v Holt* [2013] UKSC 26 and the "safe harbour" that following properly obtained professional advice can provide when it comes to claims of breaches of duty.

202. The principle set out by Lord Walker at paragraph [80] is that:

"*it would be contrary to principle and authority to impose a form of strict liability on trustees who conscientiously obtain and follow, in making a decision which is within the scope of their powers, apparently competent professional advice which turns out to be wrong*".

203. The phrase "safe harbour" does not actually appear anywhere in the Judgment in *Pitt v Holt*. It has nevertheless been taken as authority for the proposition that trustees cannot be criticised for a decision taken within the scope of their powers unless they are acting in breach of their fiduciary duties and, where they are following apparently competent professional advice, there will be no breach of those duties, even if that advice turns out to be wrong.

B. How safe is the "safe harbour"?

204. So are we right to feel more comfortable where what insistent clients want to do is supported by relevant professional advice?

205. The practical reality is that where trustees have properly obtained and followed professional advice in pursuing an action which is within the scope of their powers, the forensic challenge of criticising the trustees for breaches of fiduciary duty is considerable.[28]

206. The "safe harbour" is, however, far from impregnable.

207. This was recognised by Lord Walker himself in *Pitt v Holt* where he commented at [78] and [80]:

> "*It is undoubtedly correct that trustees may be liable for breach of trust even though they have acted in accordance with skilled professional advice. Such advice cannot protect trustees from potential liability for a loss to the trust fund resulting from a decision that is, judged objectively, beyond the trustees' powers and detrimental to the trust…*
>
> *Trustees may be liable, even if they have obtained apparently competent professional advice, if they act outside the scope of their powers (excessive execution), or contrary to the general law (for example, in the Australian case, the law regulating entitlement on intestacy). That can be seen as a form of strict liability in that it is imposed regardless of personal fault. Trustees may also be in breach of duty in failing to give proper consideration to the exercise of their discretionary powers, and a failure to take professional advice may amount to, or contribute to, a flawed decision-making process*".

208. The main circumstances in which the decisions of trustees are liable to challenge, even where advice has been obtained, are as follows:

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[28] The fact that trustees have obtained and followed appropriate advice will also assist in: (i) protecting trustees from claims they have not exercised reasonable care and skill, (ii) obtaining the Court's protection under s.61 of the Trustee Act 1925 and (iii) deflecting regulatory scrutiny.

208.1. Advice not “conscientiously obtained and followed”

In order to benefit from the “safe harbour” the advice must be “conscientiously obtained and followed”: see paragraph [80] of the Judgment of Lord Walker in *Pitt v Holt*. It consequently follows that if the instructions by which the advice was obtained were not complete or conscientiously put together to ensure the key issues are considered, the advice that is produced may not provide the requisite protection.

208.2. Excessive execution

The “safe harbour” also does not apply to acts done that are outside the scope of the trustees’ powers, as Lord Walker himself explained in the passages from *Pitt v Holt* quoted above. No amount of advice can permit trustees to do something they have no power to do.

208.3. Acting for an improper purpose

It is axiomatic that trustees have to exercise their powers for a proper purpose and it is no safeguard for trustees against a claim of that nature that they obtained and followed legal advice.

The obligation dates back to at least *Lane v Page* (1754) Amb 233 and has been consistently applied in the trusts, company law and pensions contexts.[29] It was run successfully as a ground of challenge against trustees of a pension scheme most recently in the Court of Appeal decision in *British Airways v Airways Pension Scheme Trustees Limited* [2018] EWCA Civ 1533. What is relevant for present purposes is that in the British Airways case the trustees had taken copious professional advice on the decisions they made but that was not any form of answer to the challenge that they were acting for an improper purpose.

208.4. Irrationality

In theory it is no protection from a challenge based on irrationality that professional advice has been obtained and followed. In practice, however, where reputable advisers have given advice in relation to a particular course of action that is followed, it will be extremely difficult to convince a Court that it is an irrational thing to do given the high threshold necessitated by such a challenge.

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29 See the summary of the principle given by the Supreme Court in *Eclairs Group Ltd v JKX Oil & Gas* [2015] UKSC 71.

C. Relevant/irrelevant considerations

209. The traditional application of the *Pitt v Holt* "safe harbour" is in defence to an allegation that trustees have taken into account irrelevant considerations or have failed to take into account relevant considerations.

210. This was the scenario that arose in *Pitt v Holt* itself where it was being suggested that the fact that the tax advice that had been obtained turned out to be wrong meant that the trustees had taken into account an irrelevant consideration. Whilst this argument was rejected on the facts of *Pitt v Holt* because the trustees could not be said to be acting in breach of duty where they have conscientiously obtained and followed advice which turns out to be wrong, there is still a great deal of uncertainty as to the extent of that "safe harbour" in such circumstances.

211. When it comes to advising trustees on the extent to which the "safe harbour" applies to them, there are numerous difficulties that are often encountered in practice and which have not yet been answered by the Courts.

212. The sort of situations that can often arise include the following:

212.1. It is sometimes suggested that if trustees have taken legal advice on what are the relevant considerations, they cannot be criticised if that legal advice turns out to be wrong.

Whilst this may seem to be a straight application of *Pitt v Holt*, it is arguably something rather different. There is a difference between the output of the advice being the consideration taken into account (as was the case in *Pitt v Holt*) and trustees purporting to limit the considerations they take into account by reference to legal advice obtained. Whilst what is and is not a relevant consideration is a legal question, what the Court has to determine in answering that question is what an ordinary body of trustees would consider is or is not a relevant consideration in the circumstances. It might be argued, therefore, that it is not a task that trustees can effectively delegate to legal advisers, even though it is ultimately a legal issue.

212.2. Trustees will often want advisers to state what they would or would not do in the circumstances.

Where an adviser provides their own views on matters that are strictly for the trustees, it is unlikely to be a relevant consideration for trustees to take into account or to provide additional "safe harbour" protection for any decision taken. In practice, however, these sorts of requests are frequently made and in most cases it is unlikely

that, simply because an adviser offers their own views, it would (without more) invalidate a decision taken as a breach of duty for having taken it into account.

212.3. Trustees will often want to take considerations into account that may not be identified by legal advice as relevant considerations.

These sorts of situations are inevitably fact sensitive but there is a good argument that, subject to certain obvious considerations that are relevant and need to be taken into account, there is a certain amount of flexibility for trustees to take things into account that are neither obviously relevant nor obviously irrelevant. These are the sorts of considerations where the trustees will not be in breach of duty whether or not they are taken into account.

212.4. Trustees are sometimes advised that a particular consideration is the "key consideration" or the "most important" consideration.

An example of this in the pensions context is where trustees are advised that benefit security is the "most important" consideration. The difficulty with that sort of advice is that a consideration is either relevant or it is not relevant – with the weight to be given to the consideration a matter for the trustees, not the Court. Such advice may consequently be a reflection of the point above, that there are some obviously relevant considerations that need to be taken into account and some considerations that are neither obviously relevant nor obviously irrelevant, which can be taken into account but need not be. Such statements may also in substance be a reflection of the perceived purposes of the power being exercised so that what is really being advised is that the power should not be exercised for a purpose that jeopardises benefit security.

V. OPS: Members and Employers

213. It would be impossible to touch on every situation in which, in an occupational scheme, employers and trustees have input into members' decisions. To give two examples, member's decisions will be based on trustee or employer input on (a) deciding to transfer out (whether on a proposed bulk transfer or individually based on the provision of CETV), or (b) decisions to retire based on benefit statements or to continue to take late retirement.

214. In certain circumstances, an employer has a duty to advise an employee of the existence of certain pension benefits. In *Scally v Southern Health and Social Services Board* [1992] 1 AC 294, the House of Lords held that it was a term implied in law into the employment contract to take

reasonable steps to draw to the employee doctors' attention the existence of the opportunity to purchase additional years of service (to top up pensionable service). In *Scally*, the terms on which additional years could be purchased became more expensive over time, such that there was a window on commencing employment to take the benefits. The obligation to take reasonable steps to bring the term to the employees' attention would arise only where:

214.1. The terms have not been individually negotiated with the employee (e.g. in *Scally* the doctors' contracts were the subject of collective bargaining);

214.2. A particular term of the contract makes available to the employee a valuable right contingent on the employee taking action to benefit himself of it; and

214.3. The employee cannot in all the circumstances reasonably be expected to be aware of the term unless it is drawn to his attention.

215. In *Scally*, the duty was held to exist, and the employer was liable.

216. However, attempts to apply the *Scally* duty have generally been unsuccessful. A good contrast is *University of Nottingham v Eyett* [1999] IRLR 87. A lecturer chose to take early retirement. Had he chosen to retire one month later, his pension benefits would be significantly enhanced because a recent pay rise would be taken into account in determining pensionable salary. There was no duty to draw the point to the employee's attention: he knew of his pension benefits and it was possible to work out the financial implications of his decision from the handbook provided. So understood, *Scally* is not about "advising" an employee in the proper sense, but ensuring the employee is aware of his rights (which fits with other employer obligations e.g. to provide written particulars of the employment contract). Given the limited scope of the contractual *Scally* duty, there is no scope for a wider duty of care in tort: *Outram v Academy Plastics* [2000] Pens LR 283.

217. Similarly, attempts to widen the *Scally* duty have ordinarily failed: it only applies to the contract of employment. It does not apply to pension enhancements negotiated as part of a transfer from one scheme to another: *Ibekwe v London General Transport Services* [2003] IRLR 697 (the first instance decision, the Court of Appeal declining to express a view but rejecting the appeal on other grounds).

218. Of course, where an employer *does* give information to a member (whether obliged to or not), it must take reasonable care in so doing: *Hagen v ICI Chemicals* [2002] IRLR 31.

219. A similar approach has been taken in relation to trustees. In *Hamar v Pensions Ombudsman* [1996] Pens LR 1[30], Collins J summarised the approach as follows at [46]:

"*What is suggested here is that there was a duty on the trustees not only to inform of rights, but also to inform as to how those rights could be properly exercised or, more importantly perhaps, that those rights were not being properly exercised. It seems to me that that is to extend, beyond anything that has hitherto been suggested, the supposed duties of trustees. It is certainly the case that there is an obligation to give information to a beneficiary of the existence of the trust and, by showing him documents, to give information. What is, in my judgment, not supported by the authorities is a duty to go further and to give explanations. No doubt the trustees frequently will, but they do not have to. Still less are they obliged, in my judgment, to give information as to how a particular beneficiary may obtain his portion in a particular trust fund or may exercise his statutory rights particularly where, as here, they form the view that it was not in the interests of the remaining beneficiaries that he should be able to obtain the money in question. It is a statutory right that is here under consideration. It is a right in respect of which the beneficiary who wishes to effect the transfer may seek advice. It is up to him to follow the correct statutory procedure. It is not, in my judgment, the duty of the trustees of the fund to point him in the right direction or to tell him of his errors, if he has made them, even assuming they are aware that those errors existed.*"

220. Practically, we consider the safest way for trustees (and employers) to proceed given the risk of maladministration or breach of trust claims is threefold:

220.1. Ensure accuracy where possible. While this as a goal is obvious, when faced with practical administrative difficulties (e.g. recordkeeping over a long period of time), it requires trustees or administrators to be aware of potential issues with their own schemes.

220.2. Ensure any communication cannot be misconstrued as advice. When dealing with member communications or on the phone, ensure that the message is provided clearly to members: you should take your own advice, we are not advising you, we are only providing the information on which you make your decision.

220.3. Appropriately caveat any information: to avoid the risk of estoppel claims, ensure that where what is given is an estimate, that is clearly stated, and where benefits are summarised, ensure the deed and rules prevails.

[30] Overturned by the Court of Appeal on different (procedural) grounds relating to the limited scope of a right to appeal from the Ombudsman, not considering this issue: *Hamar v French* [1998] Pens LR 321.

Aspects of the *Braganza* duties: Review of employer and trustee decisions

David Pollard, Bobby Friedman and Tara Taylor

1. *Braganza* – a landmark case

1.1 *Braganza v BP Shipping Ltd*[31] is a key case in British jurisprudence. Elsewhere[32], David Pollard has deliberately drawn a parallel with the negligence case, *Donoghue v Stevenson*[33] (the one about the snail), on the basis that *Braganza* is a landmark decision and has already been cited in many later cases.

1.2 *Braganza* is a landmark decision of the highest UK court confirming that in private law cases a bare minimum standard of review equivalent to that used in public law following *Wednesbury*[34] can be applied in relation to decisions under a private law agreement. This generally seems to apply to most decisions of an employer or trustee under an occupational pension schemes. Some of the case law after *Braganza* is looking at the very question of whether or not a *Braganza* limit applies.

1.3 Similarly to the laws of negligence following *Donoghue v Stevenson*, the boundaries of *Braganza* will need to be worked out by later caselaw on a case by case basis (a comment also made in *Pitt v Holt*[35]).

Later cases

1.4 *Braganza* was decided just over four years ago (in March 2015) but there are now over 50 decisions in England and Wales on Westlaw referring to it.

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31 [2015] UKSC 17, [2015] 4 All ER 639.

32 David Pollard "*Braganza: the new Donoghue v Stevenson*" Association of Pension Lawyers Summer conference (July 2018).

33 *Donoghue (or M'Alister) v Stevenson* [1932] AC 562, HL(Sc).

34 *Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1948] 1 KB 223, CA. It is perhaps ironic that in public law cases the test of *Wednesbury* unreasonableness is having a lesser role in recent years in public law cases. Richard Nolan made this point in '*Controlling Fiduciary Power*' [2009] CLJ 293 at 302. See also Lord Carnwath (extra judicially) '*From rationality to proportionality in the modern law*' (2014) 44 HKLJ 447.

35 [2013] UKSC 26, [2013] 2 AC 108 per Lord Walker at [94]: "the working out of these principles will raise problems which must be dealt with on a case by case basis".

1.5 There have also been decisions referring to *Braganza* in Singapore[36], Scotland[37], Australia[38], New Zealand[39] and Hong Kong[40]. The decision in *Braganza* is also referred to in decisions in Fiji[41] (but dealing with legitimate expectations in a public law context) and Ireland[42] (but there dealing with the factual question of whether someone jumped from a window or fell).

IBM

1.6 The Court of Appeal in the *IBM case*[43] in 2017 on the exercise of employer (and principal company) powers under an occupational pension scheme relied heavily on *Braganza*. The Court of Appeal held that the irrationality test in *Braganza* and *Wednesbury* should apply to non-fiduciary decision makers under a pension scheme.

1.7 The relevant factors limb was not argued, so the employer decision was reviewed by reference to the "no reasonable decision maker" limb. The Court of Appeal overturned Warren J at first instance and held that the employer (and principal company) had not acted irrationally in that sense.

British Airways

1.8 The recent *British Airways case*[44] (*BA case*) also involved an occupational pension scheme (APS). In this case the trustee was exercising a unilateral amendment power under the trust deed to confer a discretion to grant pension increases, which power it then proposed (having taken advice, including legal and actuarial advice) to use. The employer sought to challenge and set aside these

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36 *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 (George Wei J). At least three earlier decisions in Singapore on discretions followed similar lines and cited the English cases on which *Braganza* is based, including both *Wednesbury* and *Socimer*: *MGA International Pte Ltd v Wajilam Exports (Singapore) Pte Ltd* [2010] SGHC 319 at [105], *Edwards Jason Glenn v Australia and New Zealand Banking Group Ltd* [2012] SGHC 61, *ABN AMRO Clearing Bank NV v 1050 Capital Pte Ltd* [2015] SGHC 271 (George Wei J) at [73] to [80].

37 *Teoranta v Opito Ltd* [2018] CSOH 10 (Lord Bannatyne).

38 In particular *Mineralogy Pty Ltd v Sino Iron Pty Ltd (No 6)* [2015] FCA 825, 329 ALR 1 (Edelman J) at [1011]; and *Bartlett v Australia & New Zealand Banking Group Ltd* [2016] NSWCA 30. *Hannover Life Re of Australasia Ltd v Jones* [2017] NSWCA 233 referred to, but did not apply, the *Braganza* test (on the grounds that in Australia decisions of insurers are subject to a different general reasonableness review). *Braganza* was also mentioned by Edelman J in the High Court of Australia in a public law review case, *Minister for Immigration and Border Protection v SZVFW* [2018] HCA 30 at [133].

39 Eg the cases discussed below: *Peregrine Estate Ltd v Hay* [2017] NZCA 496 and *Wellington City Council v Local Government Mutual Funds Trustee Ltd* [2017] NZHC 2901 (Collins J).

40 *FWD Life Insurance Co (Bermuda) Ltd v Poon Cindy* [2019] HKCA 697 (Lam VP, Cheung and Chu JJA) at [35] and *Pa Sam Nang v The Hongkong and Shanghai Banking Corporation Ltd* [2016] HKCFI 409 (Deputy High Court Judge Paul Lam SC).

41 *Fiji Times Ltd v Solicitor General* [2016] FJHC 548.

42 *Platt v OBH Luxury Accommodation Ltd* [2015] IEHC 793.

43 *IBM United Kingdom Holdings Ltd v Dalgleish* [2017] EWCA Civ 1212, [2018] IRLR 4, [2018] Pens LR 1. Allowing an appeal from the decisions of Warren J [2014] EWHC 980 (Ch) and [2015] EWHC 389 (Ch). References in this paper to "*IBM*" are to the Court of Appeal decision unless otherwise stated.

44 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533, [2018] Pens LR 19 Lewison and Peter Jackson LJJ (Patten LJ dissenting), overturning Morgan J at first instance: *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch), [2017] Pens LR 16.

decisions by the trustees on various grounds, including on the basis that they were made for an improper purpose and inadequate deliberation (ie in effect the first limb of the *Braganza*/*Wednesbury* tests, although neither of these cases is mentioned in any of the judgments).

1.9 At first instance, Morgan J rejected the claims, but the employer appealed on the proper purpose ground (but not the relevant factors ground). The Court of Appeal (by a majority) upheld the appeal, holding that the power was being exercised for an improper purpose (the relevant factors challenge was not appealed – Patten LJ at [31]).

1.10 At first instance in the *BA case*[45], Morgan J referred to various of the trustee cases, including *Dundee Hospitals*, *Scott v National Trust*, *Edge v Pensions Ombudsman*[46] and *Pitt v Holt*[47]. The employer sought to challenge the decision making process as being (at [494]) pre-determined, not taking into account all relevant considerations and taking into account some irrelevant considerations. A challenge based on the decisions being irrational and perverse was not ultimately pursued.

Papers on Braganza

1.11 There have been a number of useful papers[48] on *Braganza*, but mainly focusing on its application outside trusts or pensions. The October 2017 APL talk[49] on the Court of Appeal decision in *IBM*[50] dealt with the "irrationality test" and hence *Braganza*.

2. The *Braganza* rationality Test

2.1 The finding in *Braganza* was that the decision in that case must be exercised rationally (and consistent with its contractual purpose). Rational in the public law (*Wednesbury*) sense has two limbs and means[51]:

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45 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch), [2017] Pens LR 16 (Morgan J) (at [482] on).

46 [2000] Ch 602, CA.

47 [2013] UKSC 26, [2013] 2 AC 108.

48 See eg: Michael Bridge '*The exercise of contractual discretion*' (2019) 135 LQR 227; Ernest Lim and Cora Chan '*Problems with Wednesbury Unreasonableness in Contract Law: Lessons from Public Law'* (2019) 135 LQR 88; Jason Varuhas '*Judicial Review beyond Administrative Law: Braganza v BP Shipping Ltd and Review of Contractual Discretions*' U.K. Const. L. Blog (31st May 2017); Peter Susman '*Braganza and beyond: judicial review of the exercise of contractual discretion in private law*' (2017) 5 JIBFL 280; Wayne Courtney '*Reasonableness in contractual decision-making*' (2015) 131 LQR 552; David Foxton '*A good faith goodbye? Good faith obligations and contractual termination rights*' (2017) LMCLQ 360 and the paper by David Foxton of his talk in January 2018 to the Attorney General's Chambers, Singapore, on *Controlling contractual discretions*.

49 "*The Practical implications for employer and trustees of the Court of Appeal decision in IBM v Dalgleish*" (17 October 2017) Suzanne Duff, Daniel Schaffer, Fraser Campbell and Jonathan Hilliard QC.

50 *IBM United Kingdom Holdings Ltd v Dalgleish* [2017] EWCA Civ 1212, [2018] IRLR 4, [2018] Pens LR 1.

51 *Braganza*: Lady Hale at [30], Lord Neuberger at [103].

- *Process:* taking into account all relevant matters and excluding all irrelevant matters; and.

- *Outcome:* reaching a decision which is not so unreasonable that no reasonable decision-maker could have come to it.

2.2 The Supreme Court was clear that the Court is not substituting its own decision on what is reasonable[52]. Thus Lady Hale at [18]:

> "Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest. That conflict is heightened where there is a significant imbalance of power between the contracting parties as there often will be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused. They have done so by implying a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given."

2.3 This use of the two limb test is not new in private law, but until *Braganza* the use of the public law test in relation to a private law instrument had not been expressly approved in these terms by the Supreme Court[53]. The express application in *Braganza* of the public law *Wednesbury* concepts looks to be directly contrary to the reservations expressed two years earlier in *Pitt v Holt* on their use in relation to trustee discretions.

2.4 In 2008 in *Socimer International Bank Ltd v Standard Bank London Ltd*[54] (a case involving a challenge to a bank's valuation of securities on a default under a forward sale contract) Rix LJ had summarised the position at [66]:

> "[A] decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of

52 Although on the facts and the 3-2 split on application of the public law *Wednesbury* test, the final decision came close to doing just that.

53 Although equivalent concepts of rationality had been mentioned in various cases – eg trustees in *McPhail v Doulton* [1971] AC 424 per Lord Wilberforce at 449C and employers in *UC Rusal Alumina v Miller* [2014] UKPC 39 at [51] and [55].

54 [2008] EWCA Civ 116, [2008] Bus LR 1304, [2008] 1 Lloyd's Rep 558.

arbitrariness, capriciousness, perversity and irrationality. The concern is that the discretion should not be abused. Reasonableness and unreasonableness are also concepts deployed in this context, but only in a sense analogous to *Wednesbury* unreasonableness, not in the sense in which that expression is used when speaking of the duty to take reasonable care, or when otherwise deploying entirely objective criteria: as for instance when there might be an implication of a term requiring the fixing of a reasonable price, or a reasonable time."

Rix LJ went on to draw a distinction with purely objective reasonableness:

> "In the latter class of case, the concept of reasonableness is intended to be entirely mutual and thus guided by objective criteria. ... Laws LJ in the course of argument put the matter accurately, if I may respectfully agree, when he said that pursuant to the *Wednesbury* rationality test, the decision remains that of the decision-maker, whereas on entirely objective criteria of reasonableness the decision-maker becomes the court itself."

This summary by Rix LJ in *Socimer* was cited in *Braganza*, by Lady Hale at [22] and Lord Neuberger at [102].

2.5 In the public law area, the classic principle was that laid down in *Associated Provincial Picture Houses Ltd v Wednesbury Corpn*[55] by Lord Greene MR:

> "The court is entitled to investigate the action of the local authority with a view to seeing whether they have taken into account matters which they ought not to take into account, or conversely, have refused to take into account or neglected to take into account matters which they ought to take into account. Once that question is answered in favour of the local authority, it may still be possible to say that, although the local authority have kept within the four corners of the matters which they ought to consider they have nevertheless come to a conclusion so unreasonable that no reasonable authority could ever have come to it".

2.6 Thus there are two limbs of *Wednesbury* unreasonableness (see Lady Hale at [24]), which are flagged below as being "process' and "outcome":

> **1. Process:** "The first limb focusses on the decision-making process – whether the right matters have been taken into account in reaching the decision."

[55] [1948] 1 KB 223, CA per Lord Greene MR at pp233 and 234. An unreserved judgment.

2. Outcome: "The second focusses upon its outcome – whether even though the right things have been taken into account, the result is so outrageous that no reasonable decision-maker could have reached it.

The latter is often used as a shorthand for the *Wednesbury* principle, but without necessarily excluding the former."

2.7 Lady Hale continued at [30]:

"For my part, I would include both limbs of the *Wednesbury* formulation in the rationality test. Indeed, I understand Lord Neuberger (at para 103 of his judgment) and I to be agreed as to the nature of the test."

Rationality or reasonableness?

2.8 Rationality is a better term to use than "reasonableness": Lady Hale in *Braganza* at [22], *IBM*[56] at [226].

2.9 In a different context (reasonableness of belief in a harassment claim) Lord Sumption made the same point in *Hayes v Willoughby*[57] (cited in *Braganza* by Lady Hale at [23] and by Lord Neuberger at [102]):

Rationality is not the same as reasonableness. Reasonableness is an external, objective standard applied to the outcome of a person's thoughts or intentions … A test of rationality, by comparison, applies a minimum objective standard to the relevant person's mental processes. It imports a requirement of good faith, a requirement that there should be some logical connection between the evidence and the ostensible reasons for the decision, and (which will usually amount to the same thing) an absence of arbitrariness, of capriciousness or of reasoning so outrageous in its defiance of logic as to be perverse.

(Emphasis added by Lady Hale)

2.10 In *Braganza* this was contrasted by Lady Hale with objective reasonableness:

"30. It is clear, however, that unless the court can imply a term that the outcome be objectively reasonable – for example, a reasonable price or a reasonable term – the court will only imply a term that the decision-making process be lawful and rational in the public

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56 [2017] EWCA Civ 1212.

57 [2013] UKSC 17, [2013] 2 All ER 405 at [14].

law sense, that the decision is made rationally (as well as in good faith) and consistently with its contractual purpose. For my part, I would include both limbs of the Wednesbury formulation in the rationality test. Indeed, I understand Lord Neuberger (at para 103 of his judgment) and I to be agreed as to the nature of the test."

2.11 An objective test will apply to some provisions, for example ones relating to a reasonable price (eg s8, Sale of Goods Act 1979) or requiring "consent not to be unreasonably withheld": *Crowther v Arbuthnot Latham*[58].

2.12 Lord Hodge (plus Lord Kerr) agreed with the two limb approach at [53]

> "Like Baroness Hale DPSC, with whom Lord Neuberger PSC agrees on this matter... I think that it is difficult to treat as rational the product of a process of reasoning if that process is flawed by the taking into consideration of an irrelevant matter or the failure to consider a relevant matter. While the courts have not as yet spoken with one voice, I agree that, in reviewing at least some contractual discretionary decisions, the court should address both limbs of Lord Greene MR's test in *Associated Provincial Picture Houses Ltd v Wednesbury Corpn*"

2.13 So did Lord Neuberger (plus Lord Wilson) at [103]:

> "Like Baroness Hale DPSC, I consider that there is considerable force in the notion that this approach is, and at any rate should be, the same as the approach which domestic courts adopt to a decision of the executive... I do not think that there is any inconsistency of approach between Baroness Hale DPSC and Lord Hodge JSC or myself in this connection."

2.14 Lord Sumption's comment in *Hayes v Willoughby*[59] was also cited by the Court of Appeal in *IBM*[60]. The Court of Appeal went on to comment at [228] that the relevant second limb challenge:

> "needed to be tested by reference to one or both of these formulations: was the decision by Holdings or by UKL so outrageous in its defiance of logic or accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it, or is it completely lacking in any logical connection between the relevant circumstances and the ostensible reasons for the decision?"

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58 [2018] EWHC 504 (Comm) (Judge Waksman QC).
59 [2013] UKSC 17, [2013] 2 All ER 405 at [14].
60 [2017] EWCA Civ 1212.

3. Who is the decision maker?

3.1 It will be relevant in many cases to consider the context for any review of a discretion or decision, in particular the identity of the decision maker.

Pension schemes: employer/principal employer/trustee/actuary

3.2 In relation to pension schemes, the context means that the most relevant issue in deciding whether or not the *Braganza*/*Wednesbury* rationality test applies, will be which decision maker is making the relevant decision or determination:

(a) Employer decisions re pensions – yes[61] (*Braganza*, *IBM*[62]). This is in addition to the usual contractual MDTC: *Faieta v ICAP*[63], a garden leave case.

(b) Principal employer or principal company[64] decisions – yes. In *IBM* at [232] the Court of Appeal held:

> "The correct approach is to apply a rationality test equivalent to that in *Wednesbury* (see paragraphs [45] and [46] above) in order to decide whether a decision by a decision-maker such as Holdings, as Principal Employer under a pension scheme, or UKL as employer, is valid and lawful having regard to the *Imperial* duty and the contractual duty of trust and confidence."

(c) Decisions by a shareholder or parent company that influence decisions of an employer or principal company – no (*IBM* at [368]).

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61 The comments of Sir Andrew Park in *Smithson v Hamilton* [2007] EWHC 2900 (Ch), [2008] 1 All ER 1216 at [82] to the contrary must now be regarded as needing to be limited on this point. Sir Andrew Park refused to allow a challenge by an employer of its own decision to adopt a new definitive deed (which it claimed included a more generous early retirement rule than it had intended), arguing that it should be able to rely on the *Hastings-Bass* principle that it needed to consider all relevant factors. Sir Andrew Park refused to allow this, partly on the basis that this would be "rectification by the back door", but also on the basis that the trustees and members benefited from any error and were not challenging. He held at [82]:
" …. the rule in *Hastings-Bass* applies to things done by trustees. It does not apply to things done by settlors in the context of private trusts or by employers in the context of pension trusts."
This was a decision given before *Pitt v Holt* and *Braganza*. Arguably it may just reflect the principle later laid down in *Pitt v Holt* that it should generally be for the other affected party to sue for a breach of duty under the due consideration test (see below).

62 [2017] EWCA Civ 1212.

63 *Faieta v ICAP Management Services Ltd* [2017] EWHC 2995 (QB), [2018] IRLR 227 (Moulder J).

64 Ie usually the original sponsor or establisher of the scheme. The title will vary from scheme to scheme. The term "principal employer" is common, ~~but,~~ but potentially slightly confusing as there is often no need for it to be an actual employer (eg under the legislation).

(d) Pension Trustee decisions – probably yes. Before *Braganza*, the caselaw on pension trustees often looked at similar rationality tests. For example, Glidewell LJ in *Harris v Lord Shuttleworth*[65]:

> "Trustees "must not arrive at a perverse decision, ie a decision to which no reasonable body of trustees could arrive, and they must take into account all relevant but no irrelevant factors."

This was followed by Chadwick LJ in *Edge v Pensions Ombudsman*[66], noting the similarity to public law principles and citing extensively from Lord Greene MR in *Wednesbury.*

In our view, it would be strange to have a lesser review ground for trustees (as fiduciaries) compared to employers (as non-fiduciaries).

(e) Actuaries – potentially yes, although we disagree amongst ourselves as to the likelihood. In the context of experts see the comments by the NZ CA in *Peregrine Estate v Hay*[67]:

> "the identification of a potential or actual conflict of interest as a touchstone for deciding whether the *Braganza* duty should be implied suggests a way of distinguishing cases where a decision-making function is entrusted to an independent expert. Similarly, it might be said that an actuary does not have his or her own skin in the game such that there is no (or an insufficient) conflict for the duty to be implied."

4. Trustees and *Braganza*?

4.1 Is it right to apply some public law principles to decisions by trustees? The tests in *Braganza* seem to apply ~~to~~ equally to trustees acting as a decision maker, but *Braganza* was, of course, a case involving an employer.

Good faith: *Gisborne*

4.2 There is much previous caselaw on the review of decisions by trustees, stating that they will not be reviewed if made in good faith and for a proper purpose, citing the 1877 decision in *Gisborne*

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65 [1994] ICR 991, [1995] OPLR 79, CA. Adopted and followed in *Wild v Pensions Ombudsman* [1996] OPLR 129 by Carnwath J (at 135) observing that, to a public lawyer, those words were virtually identical to the *Wednesbury* principles. Cited by Chadwick LJ in *Edge* at 628.

66 [2000] Ch 602, CA per Chadwick LJ at 628.

67 [2017] NZCA 496 at [37].

v Gisborne[68]. But this now looks too narrow[69] and later cases have added the nuance that decisions will be reviewed if taken arbitrarily or capriciously or failing proper consideration.

4.3 It could be argued that the terminology of "bad faith" or "mala fides" under *Gisborne* in a trustee context could extend to include perversity[70]. But good faith (or bad faith) seems to be better seen (in a trustee context at least) as involving a subjective standard (similar to dishonesty). David Maclean in '*Trusts and Powers*'[71] commented that a decision can be (say) perverse without being made in bad faith, citing *Tabor v Brooks*[72] and that "Mala fides is not constituted by honest blundering, carelessness or even gross negligence"[73],

4.4 The concept of "good faith" is tricky[74]. It appears in various areas of the law, in each case with a "distinct body of authority as to its meaning and application" [75].

4.5 It seems to be better to see this as moving away from a good faith/bad faith test as being the only grounds of review (rather than trying to construe bad faith as encompassing irrationality or perversity, eg as attempted in *Jacobs' Law of Trusts in Australia*[76], unless perhaps a deliberate and wilful refusal to carry out due consideration).

4.6 In *Dundee General Hospitals Board of Management v Walker*[77], Lord Reid held that even where trustees are expressed to have an absolute discretion:

> "If it can be shown that the trustees considered the wrong question, or that, although they purported to consider the right question they did not really apply their minds to it or perversely shut their eyes to the facts or that they did not act honestly or in good faith, then there was no true decision and the court will intervene."

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68 (1877) 2 App Cas 300, HL.

69 See eg Maurice Cullity '*Judicial control of trustees' discretions*' (1975) 25 UTLR 99.

70 See eg Michael Ashdown '*Trustee Decision Making*' (2015, OUP) at 3.36

71 D M Maclean '*Trusts and Powers*' (Sweet & Maxwell, 1989) at p58, fn78.

72 (1878) 10 ChD 273 (Malins V-C).

73 Citing *Jones v Gordon* (1877) 2 App Cas 616 at 628-629 and *Karger v Paul* [1984] VR 161 at 164. See also to the same effect *Royal Brunei Airlines v Tan* [1995] 2 AC 378, PC at 389.

74 See Richard Nolan and Matthew Conaglen '*Good faith: What does it mean for fiduciaries and what does it tell us about them?*' chapter 14 in '*Exploring Private Law*' (Elise Bant and Matthew Harding eds, CUP, 2010), Lusina Ho '*Good Faith and Fiduciary Duty In English Law*' [2010] 4 J Eq 19 and Charles Mitchell '*Good Faith, Self-Denial and Mandatory Trustee Duties*' (2018) 32 TLI 92.

75 *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* [1993] FCA 638, 45 FCR 84 per Gummow J at [31].

76 J D Heydon and M J Leeming '*Jacob's Law of Trusts in Australia*' (8th ed, 2016, LexisNexis) at [16-09].

77 [1952] 1 All ER 896, HL per Lord Reid at 905. Cited by Robert Walker J in *Scott v National Trust* (see below) and discussed by the Scottish Law Commission in its report on Trust Law – see below.

4.7 Robert Walker J (as he then was) followed this in an unreserved judgment in *Scott v National Trust*[78]:

> "Certain points are clear beyond argument. Trustees must act in good faith, responsibly and reasonably. They must inform themselves, before making a decision, of matters which are relevant to the decision. These matters may not be limited to simple matters of fact but will, on occasion (indeed, quite often) include taking advice from appropriate experts, whether the experts are lawyers, accountants, actuaries, surveyors, scientists or whomsoever. It is however for advisers to advise and for trustees to decide: trustees may not (except in so far as they are authorised to do so) delegate the exercise of their discretions, even to experts."

Cases on Braganza type review and Trustees

4.8 Many cases[79] before *Braganza* had raised the principles, seemingly similar to that applicable in public law under *Wednesbury*, that trustees should comply with both limbs of the test. They:

- "must take into account all relevant but no irrelevant factors"; and
- must not reach a decision that no reasonable trustee would make.

4.9 On the relevant factors limb, this is the effect of the whole line of cases based on the rule in *Re Hastings-Bass*, culminating in the 2013 decision of the Supreme Court in *Pitt v Holt*[80]. Effectively this rule looked at setting aside a decision made by trustees because they had not considered properly a relevant matter (eg tax). This paper looks at *Pitt v Holt* and its inter-relation with *Braganza* below.

4.10 In 1991 in *Stannard v Fisons Pensions Trust Ltd*[81] the Court of Appeal upheld the overturning of a decision by pension trustees about the amount of a bulk transfer payment to another scheme. The decision was overturned because they had not considered the increase in value of the fund over the interim since the relevant valuation. They had not given "properly informed consideration" to the discretion they had to exercise[82].

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78 *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705 at 717.

79 See generally Geraint Thomas, '*Thomas on Powers*' (2nd ed, 2012, OUP) at [10.75] to [10.145], although note that this book predates the decisions of the Supreme Court in both *Pitt v Holt* and in *Braganza*. It does however refer to the decision of the Court of Appeal in *Pitt v Holt*.

80 [2013] UKSC 26, [2013] 2 AC 108.

81 *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27, [1991] PLR 225, CA. Lord Walker commented on this decision in *Pitt v Holt* at [34], noting that the scale of the change is crucial.

82 Dillon LJ at [37], having cited Fox LJ in *Kerr v British Leyland* (1986).

4.11 In 1993 in a pensions case concerning an ill-health retirement, *Harris v Lord Shuttleworth*[83], Glidewell LJ approved the reasoning of Judge Moseley QC at first instance[84] and held that trustees:

> "must not arrive at a perverse decision, ie a decision to which no reasonable body of trustees could arrive, and they must take into account all relevant but no irrelevant factors."

4.12 The two limb approach was applied by Scott V-C at first instance[85] and by Chadwick LJ in the Court of Appeal in *Edge v Pensions Ombudsman*[86]. Scott V-C held (at p534B):

> "It is the trustees' discretion that is to be exercised. Except in a case in which the discretion has been surrendered to the court, it is not for a judge to exercise the discretion. The judge may disagree with the manner in which trustees have exercised their discretion but, unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one that no reasonable body of trustees properly directing themselves could have reached, the judge cannot interfere."

4.13 Later in *Edge*, dismissing the appeal, Chadwick LJ cited (at p627) the passage above from Glidewell LJ in *Harris* and held (at p631) that on the facts in *Edge*:

> 'The decision cannot be challenged on the ground of manifest irrationality.'

He continued (at p633):

> 'the trustees' decision can be set aside if it can be shown that they failed to consider matters which were relevant, or took into account matters which were irrelevant.'

Court approval of momentous decisions

4.14 A similar approach applies where the court is asked by trustees to approve a "particularly momentous" decision. The court will check if:

> "the trustee has taken into account irrelevant improper or irrational factors or whether it has reached a decision that no reasonable body of trustees properly directing themselves could have reached."

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83 [1994] ICR 991, [1995] OPLR 79, CA per Glidewell LJ at 999G. Followed in Australia in a unit trust case, *Ying Mui v Frank Kiang Ngan Hoh (No 6)* [2017] VSC 730 (Vickery J) at [408].

84 *Harris v Lord Shuttleworth* [1992] OPLR 151 (Judge Moseley QC) at 159, citing Denning LJ in the valuation case, *Dean v Prince* [1954] Ch 409 at 418.

85 *Edge v Pensions Ombudsman* [1998] Ch. 512 (Scott V-C).

86 [2000] Ch 602, CA.

Per Blackburne J in *Merchant Navy Ratings Pension Fund Trustees Ltd v Chambers*[87], citing Scott V-C and the Court of Appeal in *Edge*. This is obviously referring to the same tests as apply for review (rather than validation) of a decision.

5. First limb – process: relevant factors

5.1 As Lady Hale stated in *Braganza* at [24]:

> "The first limb focusses on the decision-making process – whether the right matters have been taken into account in reaching the decision."

Terminology: Matters/Considerations/Factors

5.2 In relation to this first limb, the caselaw refers variously to what needs to be taken account of as relevant:

(a) "matters" (*Wednesbury*, *Edge*, *Pitt v Holt*, *Braganza*, *IBM, Fletcher Challenge*[88], *Mettoy,* s172, Companies Act 2006); or

(b) "considerations" (*Braganza, Hastings-Bass, Mettoy, Abacus v Barr*[89]); or

(c) "factors" (*Stannard v Fisons*; *Harris v Lord Shuttleworth*, *Edge, Khatun*[90]).

These terms all seem to mean much the same thing. This paper tends toward using the term "factors".

5.3 This limb is a process test. This sounds a simple test, but it does inevitably lead to a number of questions[91]:

- Have the relevant factors been considered?
- What are the relevant factors
- All relevant factors?

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87 [2002] ICR 359, [2001] OPLR 321, [2001] PLR 137 (Blackburne J) at [7]. Applied by Asplin J in *Merchant Navy Ratings Pension Fund Trustees v Stena Line* [2015] EWHC 448 (Ch), [2015] PLR 239 at [16] and [161]. Similarly David Richards J in *Re MF Global UK Limited* [2014] EWHC 2222 (Ch) at [32].

88 *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2001] OPLR 249, PC, per Lord Millett at [29].

89 *Abacus Trust Co (Isle of Man) v Barr* [2003] Ch 409 (Lightman J).

90 *R (Khatun) v Newham LBC* [2004] EWCA Civ 55, [2005] QB 37 a public law case – see below.

91 See Chapter 5 '*Applying the Hastings-Bass Rule*' in Michael Ashdown '*Trustee Decision Making*' (2015, OUP).

- Who decides what is relevant?
- What weight is given to each factor?
- What if the decision maker would have made the same decision anyway? Ie even if he or she had considered only the correct relevant factors.

What are relevant factors?

5.4 The factors to be taken into account must be those consistent with the contractual/trust law purpose of the term. This may be expressly defined in the contract or trust[92]. Otherwise it is necessary to look at the context: Lady Hale in *Braganza* at [31].

5.5 This looks very similar to the test of deciding what are the proper purposes of a power. In the Supreme Court decision on proper purposes in *Eclairs Group Ltd v JKX Oil & Gas plc*[93], Lord Sumption commented:

> [30] …. "The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument. Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context.
>
> [31] The purpose of a power conferred by a company's articles is rarely expressed in the instrument itself. It was not expressed in the instrument in any of the leading cases about the application of the proper purpose rule to the powers of directors which I have summarised. But it is usually obvious from its context and effect why a power has been conferred, ….."

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92 There are statutory examples of this in the pensions area:
Pensions Regulator: Factors (non-exclusive) to be considered by the Pensions Regulator before making orders for contribution notices or financial support directions are set out in ss38(7) and 43(7), Pensions Act 2004 - See Chapter 4.10 in *Freshfields on Corporate Pensions Law 2015* (Bloomsbury Professional).
Directors: in making a decision which a director "considers, in good faith, would be most likely to promote the success of the company", the director is required "to have regard (amongst other things) to the matters listed – including the interests of the company's employee" (s172(1), Companies Act 2006).

93 [2015] UKSC 71, [2016] 3 All ER 641 per Lord Sumption at [30] and [31]. See Pollard '*Exercising Powers: Proper Purposes rather than Best Interests: Fiduciaries and Eclairs'* (2016) 30 TLI 71 at 91.

5.6 Lord Sumption describing working out the proper purpose as "usually obvious" seems to me to underplay the difficulties for decision-makers and their advisers in working out what are "proper purposes" or, similarly, relevant factors[94].

5.7 Similar difficulties arise in the implied MDTC duty for employers. Warren J put this well in *IBM*[95] at first instance:

> 'Whatever reservations one might have had about the creation of what was, essentially, a new duty, it is now well established. It is easy to state but often very difficult to apply in practice: the present case is an example of difficulty in practical application."

5.8 As previously mentioned (and as cited in *Braganza*) Mocatta J commented in *The Vainqueur Jose*[96]:

> "it would be a mistake to expect [of a lay body] the same expert, professional and almost microscopic investigation of the problems, both factual and legal, that is demanded of a suit in a court of law.'

5.9 Lady Hale in *Braganza* approved this:

> "[31] But whatever term may be implied will depend upon the terms and the context of the particular contract involved. I would add to that Mocatta J's observation in *The Vainqueur Jose*, that 'it would be a mistake to expect [of a lay body] the same expert, professional and almost microscopic investigation of the problems, both factual and legal, that is demanded of a suit in a court of law' ([1979] 1 Lloyd's Rep 557 at 577). Nor would 'some slight misdirection' matter, at least if it were clear that, had the legal position been properly appreciated, the decision would have been the same. It may very well be that the same high standards of decision-making ought not to be expected of most contractual decision-makers as are expected of the modern state."

5.10 Deciding on the relevant factors may well be difficult. *Braganza* is itself an example of judges reaching different conclusions on the relevance of factors. Thus even in the Supreme Court, a minority would have upheld BP's decision, even though applying the same test as the majority. Both the majority and the minority cited Mocatta J's judgment in *The Vainqueur Jose*.

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94 See for example Richard Nolan '*Controlling Fiduciary Power*' [2009] CLJ 293 at 307 "it is not clear what fiduciaries should or should not take into account when making a decision".

95 *IBM United Kingdom Holdings Ltd v Dalgleish* [2014] EWHC 980 (Ch), [2014] PLR 335 (Warren J) at [354].

96 [1979] 1 Lloyd's Rep 557 (Mocatta J) at 577. Also cited by Lord Neuberger in *Braganza* at [122].

5.11 In the Court of Appeal in *Pitt v Holt*[97], Lloyd LJ commented:

> "117 As counsel pointed out, the extent of the proper consideration on the part of the trustees would be affected by the nature and circumstances of what was proposed. It might be different if what was proposed was the release from the trust of a relatively modest sum of capital to meet an extremely urgent need of one of several beneficiaries. In such a case it might not be necessary to undertake the same degree of inquiry and examination as it would be if the proposed transaction affected a very large proportion of the trust fund, or was not required as a matter of extreme urgency.
>
> 118 It is not possible to lay down any clear rule as to the matters which trustees ought to take into account when considering the exercise of a power of advancement or some other dispositive discretionary power. Circumstances will differ a great deal from one trust to another, and even within one trust they may change from time to time or according to the nature of the particular exercise which is under consideration."

5.12 Newey J has commented[98] (extra-judicially) that:

> "perhaps it will be easier to specify the matters relevant to the exercise of an administrative power than a dispositive power. For example, trustees deciding how funds should be invested should clearly have regard to the potential rewards and risks of different investments. There may be more room for argument as to quite what is relevant to the exercise of, say, a power of appointment in favour of a wide class[99]."
>
> [footnote in original]

Purposes of a power can define the relevant factors

5.13 The relevant factors will often depend on and draw on the proper purpose of the power or discretion[100]. Generally it may also be necessary to identify the "target" of the duty and the discretion: *Watchfinder*[101].

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97 [2012] Ch 132 at [118].

98 Newey J (extra judicially) in chapter 2 '*Constraints on the exercise of trustees' powers*', at p51, in the book 'Equity and Administration' (P G Turner ed, 2016, CUP) (note that the Supreme Court decision in *Braganza* was given after this chapter was written).

99 Some guidance can, however, be derived from *McPhail v Doulton* [1971] AC 424 (especially at 449) and *Re Hay's Settlement Trusts* [1982] 1 WLR 202, 209-10.

100 See eg Nicholls V-C in *Re Thrells Ltd (1974) Pension Scheme v Lomas* [1992] OPLR 22 and Newey J (extra judicially) in chapter 2 '*Constraints on the exercise of trustees' powers*', at p51, in 'Equity and Administration' (P G Turner ed, 2016, CUP).

101 *Watson v Watchfinder.co.uk Ltd* [2017] EWHC 1275 (Comm) (Judge Waksman QC) at [105].

5.14 For example Leggatt LJ in *Equitas*[102], having referred to *Socimer* and *Braganza*:

> "What is honest and reasonable is judged by reference to the purpose(s) which the contract requires or permits the party exercising the relevant power to pursue."

5.15 In *British Telecommunications plc v Telefónica O2 UK Ltd*[103] Lord Sumption (with whose judgment the other Justices agreed) said:

> "As a general rule, the scope of a contractual discretion will depend on the nature of the discretion and the construction of the language conferring it. But it is well established that in the absence of very clear language to the contrary, a contractual discretion must be exercised in good faith and not arbitrarily or capriciously. This will normally mean that it must be exercised consistently with its contractual purpose." (citations omitted)

5.16 Deciding what is the proper purpose can also be rather tricky. A recent good example of the difficulties is the decision of the Court of Appeal in the pensions case, *Palestine Solidarity Campaign*[104]. The Court of Appeal overturned the first instance decision and held that it was within the purpose of the statutory guidance provision for the Secretary of State to issue guidance stating that the relevant public sector pension schemes should not invest in a way that is contrary to Government foreign or defence policy. The Court of Appeal considered that this was consistent with any "pensions purpose" of the relevant power. Sir Stephen Richards held[105] (at [20]) that the Secretary of State could have regard to "the wider public interest":

> "Since the Secretary of State is empowered to give guidance as to an authority's investment strategy, it seems to me to be equally plainly within the scope of the legislation for the guidance to cover the extent to which such non-financial considerations may be taken into account by an authority. The detailed content of that guidance is a matter for the Secretary of State, subject to *Wednesbury* reasonableness. In particular, I can see nothing objectionable in his having regard to considerations of wider public interest, including foreign policy and defence policy, in formulating such guidance. In no way does that run counter to the policy and objects of the legislation. The public service pension schemes to be established under the 2013 Act include central as well as local government schemes. It

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102 *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd* [2019] EWCA Civ 718 per Leggatt LJ at [151].

103 [2014] UKSC 42, [2014] Bus LR 765 at [37]. Cited by Leggatt LJ in *Equitas* at [154]

104 *R (on the application of Palestine Solidarity Campaign Ltd) v Secretary of State for Communities and Local Government* [2018] EWCA Civ 1284, overturning the Administrative Court (Sir Ross Cranston) at first instance [2017] EWHC 1502 (Admin).

105 With whom Davis and Hickinbottom LJJ agreed.

> must be possible to have regard to the wider public interest when formulating the investment strategy for central government schemes; and it would be very surprising if it could not also be taken into account in the giving of guidance to local government authorities, themselves part of the machinery of the state, in relation to the formulation of the investment strategy for schemes administered by them."

Sir Stephen Richards went on to consider any implied limitation based on a "pension purpose', concluding that this is wide enough to cover foreign and defence policy matters:

> "[21] With great respect to the judge, I think that his analysis in terms of the "purpose" for which the relevant part of the Guidance was included is unduly narrow. If one approaches the matter on the basis that the powers conferred by the legislation must be exercised for a "pensions purpose", then in giving guidance as to the extent to which non-financial considerations might be taken into account in an authority's investment strategy the Secretary of State was in my view acting for an obvious pensions purpose; and the fact that he took into account considerations of foreign policy and defence policy in formulating the relevant part of the Guidance did not convert it from a pensions purpose into a non-pensions purpose. So too, whilst the judge took the view that the Secretary of State had to justify the distinction drawn between the relevant part of the Guidance and the parts relating to other non-financial considerations by reference to a pensions purpose, the Secretary of State was entitled in my view to take into account wider considerations of public interest in drawing the distinction he did, and by drawing such a distinction he did not cease to act for a pensions purpose in issuing the Guidance. For my part, however, I would avoid the language of "pensions purpose", which is at best a shorthand and is liable to mislead; and I would say the same about the expression "from a pensions perspective" which was used by the judge. In considering whether the relevant part of the Guidance falls within the scope of the 2013 Act and the 2016 Regulations, I find it more helpful to put the question in terms of whether the legislation permits wider considerations of public interest to be taken into account when formulating guidance to administering authorities as to their investment strategy; and as I have said, given the framework nature of the statute and the broad discretion it gives to the Secretary of State as to the making of regulations and the giving of guidance, I can see no reason why it should not be so read."

5.17 This is a good example of two courts coming to radically different views on the nature and extent of a power based on its purpose. Similar concerns apply to the "relevant factors" issue.

Relevant factors are fact and context specific

5.18 It is impossible to produce a general checklist of factors that decision makers should consider (or not consider). Even restricting the range to decisions under or in relation to ~~a~~ pension schemes, the facts and context are too diverse to allow such a general list to be produced. Indeed (as discussed below) to some extent the range of factors may be a judgment call for the decision maker itself.

5.19 As already mentioned above, Lloyd LJ in the Court of Appeal in *Pitt v Holt*[106] confirmed this:

> '[118] It is not possible to lay down any clear rule as to the matters which trustees ought to take into account when considering the exercise of a power of advancement or some other dispositive discretionary power. Circumstances will differ a great deal from one trust to another, and even within one trust they may change from time to time or according to the nature of the particular exercise which is under consideration.'

5.20 In many ways it is easier for courts to specify in a particular case (where usually an existing decision is under review[107]) a factor that should not have been considered (or which should have been considered) than to list exhaustively those which should be considered[108]. Similar issues arise under the proper purposes test in deciding what are proper and improper purposes[109].

5.21 What are the relevant factors that a decision maker should consider? There are two preliminary stages:

1. decide on purpose and scope of both the trust/scheme and the power; and
2. decide on the relevant factors to consider in the light of the purpose and scope.

These can be tricky issues – they may be contentious and not obvious.

5.22 The answers to these connected questions in a pensions context:

(i) what are the proper purposes of the power? and

(ii) what are the relevant factors to consider?

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106 *Pitt v Holt; Futter v Futter* [2011] EWCA Civ 197, [2012] Ch 132.

107 But contrast an application to court to approve a proposal in advance.

108 See David Foxton '*A good faith goodbye? Good faith obligations and contractual termination rights*' (2017) LMCLQ 360 at 370/371.

109 See Pollard '*Exercising Powers: Proper Purposes rather than Best Interests: Fiduciaries and Eclairs*' (2016) 30 TLI 71 at 89.

will depend on the wording of the power, circumstances of the scheme, attitude of the employer, attitude of the members, state of the caselaw etc.

Pensions relevant factors

5.23 Some general thoughts can be tentatively advanced in a pensions context. Potential relevant factors in the context of the exercise of discretions by trustees or employers (these may not apply in all cases) that can, and where appropriate should, be considered include the following:

(a) impact on scheme funding – *Fletcher Challenge*[110]; *Stannard v Fisons*

(b) impact on member benefits;

(c) impact on individual member;

(d) impact on member's reasonable expectation – *IBM* at [229]. But this is not usually an overriding factor: *IBM* at [229], [232] and [268], overturning Warren J at first instance:

> "Members' expectations … do not constitute more than a relevant factor which the decision-maker can, and where appropriate should, take into account in the course of its decision-making process"

(e) impact on the employers – *Edge*[111] and *MNRPF*[112]*;*

(f) taxation and "fiscal consequences" – *Pitt v Holt* at [65].

(g) (probably) any comments or matters raised in any relevant consultation – eg with the members[113] or the employer[114].

Pensions: Surpluses

5.24 Some cases have discussed relevant factors or considerations on the use of surplus in a pension scheme.

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110 *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2001] OPLR 249, PC.

111 *Edge v The Pensions Ombudsman* [2000] Ch 602, CA.

112 *Merchant Navy Ratings Pension Fund Trustees v Stena Line* [2015] EWHC 448 (Ch), [2015] PLR 239 (Asplin J).

113 *IBM* at [430] to [441], seemingly even where a statutory consultation under the Pensions Act 2004 and despite the exclusion in s259(3). In *IBM* this issue was not challenged before the Court of Appeal – see [431].

114 For example (by analogy) the decisions on consideration of consultation responses in the public law cases: *R (Law Society) v The Lord Chancellor* [2018] EWHC 2094 (Admin), DC at [141]; *R (Kohler) v Mayor's Office for Policing and Crime* [2018] EWHC 1881 (Admin), DC at [66] to [68] (summary of consultation responses inadequate); *R (Morris) v Newport City Council* [2009] EWHC 3051 (Admin) (Beatson J); and *Draper v Lincolnshire County Council* [2014] EWHC 2388 (Admin).

5.25 In relation to the application of a surplus on a scheme winding-up[115] – see *Thrells*[116], a case involving the surrender of the relevant discretion to the court, Nicholls V-C held that material circumstances included:

- the scope of the power;
- the purpose of the power;
- the source of the surplus;
- the size of the surplus;
- the financial position of the employer; and
- the needs of the members of the scheme.

5.26 In relation to an employer discretion over surplus on a scheme winding-up, see *UC Rusal*[117].

5.27 In *Edge v Pensions Ombudsman*[118], Chadwick LJ gave some examples of relevant factors, in the context of trustees agreeing with the employer benefit increase to use surplus in an on-going pension scheme. Paraphrasing his comments, these include (in this context):

- the circumstances in which any surplus has arisen.
    - In deciding what is fair and equitable in all the circumstances, the trustees may be expected to give weight to the claims of those whose contributions are, or will be, the effective source of the surplus.
    - For example, in a pure "balance of costs" scheme, trustees may properly take the view that an actuarial surplus which has arisen through past overfunding ought to be reduced by allowing the employers a future "contributions holiday:" see the observations of Millett J, in a different context, in *In re Courage Group's Pension Schemes* [1987] 1 WLR 495, 515.

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115 See '*Winding-up the Scheme: Surpluses*' ch36 in Pollard '*Corporate Insolvency: Pension Rights*' (6th ed, 2016, Bloomsbury Professional).

116 *Re Thrells Ltd (1974) Pension Scheme v Lomas* [1992] OPLR 22 (Nicholls V-C).

117 *UC Rusal Alumina Jamaica Ltd v Miller* [2014] UKPC 39 at [54] to [57]. Briefly discussed in Chapter 36 (Surpluses) in Pollard '*Corporate Insolvency: Pension Rights*' (6th ed, 2016, Bloomsbury Professional).

118 *Edge v The Pensions Ombudsman* [2000] Ch 602, CA per Chadwick LJ at pp626 and 627.

- the main purpose of the scheme—to provide retirement and other benefits for employees of the participating employers.
- the effect that any course which they are minded to take will have on the financial ability of the employers to make the contributions which that course will entail.
    - Trustees must be careful not to impose burdens which imperil the continuity and proper development of the employers' business or the employment of the members who work in that business. The main purpose of the scheme is not served by putting an employer out of business.
- the level of benefits under their scheme relative to the benefits under comparable schemes; or in the pensions market generally.
- whether the scheme is attractive to the members whose willingness to continue paying contributions is essential to its future funding.
    - Are the benefits seen by the members to be good value in relation to the contributions; would the members find it more attractive to pay higher contributions for higher benefits; or to pay lower contributions and accept lower benefits?
    - The main purpose of the scheme is not served by setting contributions and benefits at levels which deter employees from joining; or which causes resentment.
- whether the benefits enjoyed by members in pension have kept up with increases in the cost of living; so that the expectations of those members during their service—that they were making adequate provision for their retirement through contributions to an occupational pension scheme—are not defeated by inflation.
- Given that the consent of the employers to any benefit changes was needed, the trustees should act fairly:
    - 'The ombudsman criticised the trustees for making only such recommendations as they felt to be fair to everyone involved in the funds. His criticism suggests that, for the trustees to escape censure, they should have put forward proposals that they did not think were fair to the employers. We find that an astonishing proposition.' (at p634)

- ‘The trustees were almost wholly dependent on the goodwill of the employers to obtain any increase in benefits at all. To make only such recommendations as they felt to be fair to everyone involved in the fund was the only sensible and proper course which the trustees could adopt in the circumstances.’ (at p635).

5.28 Chadwick LJ emphasised that this is not an exhaustive or prescriptive list. He noted:

> “It is likely that, in most circumstances, pensions trustees who fail to take those matters into account will be open to criticism. But there may well be other matters which are of equal or greater importance in the particular circumstances with which trustees are faced. The essential requirement is that the trustees address themselves to the question what is fair and equitable in all the circumstances. The weight to be given to one factor as against another is for them.”

Two Examples

5.29 Two further examples of potential discretions of trustees and some pensions cases discussing the relevant factors are discretions in relation to:

(a) the amount of a bulk transfer payment to another scheme or insurance policy- see *Stannard v Fisons*[119]; *Fletcher Challenge*[120] and *ITS v Hope*[121];

(b) the amount of commutation factors[122] (either converting a pension to a lump sum or converting a money purchase AVC account to a pension).

Deciding on relevant factors: examples

5.30 By way of illustration, we give below two examples of the difficulties in deciding on relevant factors for discretions of trustees. These two are: (1) the decision in New Zealand in the *Wellington City Council* case on relevant factors for a commercial trust; and (2) a brief overview of the issues

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119 *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27, [1991] PLR 225, CA: decision about a bulk transfer flawed because trustees not told about increase in fund value: per Dillon LJ at [33] and per Staughton LJ at [65]. The scale of the change is crucial: Lord Walker in *Pitt v Holt* at [34].
Similar principles apply requiring trustees of a family trust to be aware of the extent of the trust property when making an appointment out of the trust to a beneficiary: *Gany Holdings (PTC) SA v Khan* [2018] UKPC 21 per Lord Briggs at [54] and [55], applying *Pitt v Holt*.

120 *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2001] UKPC 23, [2001] OPLR 249, [2002] 2 NZLR 1, PC.

121 *Independent Trustee Services Ltd v Hope* [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J). Discussed (with *Fletcher Challenge*) in Pollard ‘*Application of the proper purpose test to pension schemes*’ (2016) 30 TLI 159 at 170-174.

122 See Tim Cox ‘*Some legal aspects of actuarial factors*’ (APL conference, Nov 2007) and the discussion (in a proper purposes context) in Pollard ‘*Application of the proper purpose test to pension schemes*’ (2016) 30 TLI 159 at 177-179.

where trustees have a discretion about which inflation index to use in increasing pensions (the CPI/RPI issue).

Example 1: Working out relevant factors – Wellington City Council

5.31 There is an interesting example in deciding "relevant factors" in the New Zealand case, *Wellington City Council v Local Government Mutual Funds Trustee Ltd*[123] This involved a commercial trust under which local authorities contributed to a trust fund, called 'Riskpool', on the basis that the trustee had a discretion to use the funds to meet claims on the local authority for damages for "water ingress" in buildings. Wellington Council made a claim and (several years later) the trustee rejected it.

(a) On a challenge to that rejection, Collins J referred (at [167] and [170]) to *Braganza* and applied the irrationality test, holding that "No material differences were identified between the claims based on breach of contract and those that alleged that [the trustee] had breached its fiduciary duties to the council."

(b) Wellington Council argued that the trustee had taken into account some irrelevant factors, namely that the Council had left Riskpool, that the Council had received more in benefits than it had contributed to Riskpool and that paying the Council might mean a contribution call on the other council members of Riskpool. Collins J thought (at [173]) that these were irrelevant considerations and would have meant a breach of the *Braganza* test as being "discriminating against the council and exercising its discretion for an improper purpose". But in fact the considerations were "minor considerations" (at [172]) or were "not a significant factor" (at [178]) and so this challenge did not succeed.

(c) This shows the difficulty in deciding what are irrelevant factors. In a pensions context, it would often seem highly relevant for trustees to consider the impact on the funding position of the scheme (eg if agreeing to scheme amendments). But in other cases (eg whether to apply pension increases or apply a reduction to early payment of a pension) the purpose may guide the impact on scheme funding as being irrelevant.

Example 2: Working out relevant factors: Trustee moving from CPI/RPI?

5.32 Depending on the terms of a pension scheme, a trustee may have the power to decide on a change in the index used for increasing pensions in payment (this will depend on the scope of the

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[123] [2017] NZHC 2901 (Collins J).

power and the impact of the restrictions in s67, Pensions Act 1995[124]) and is considering a change from RPI to CPI.

5.33 As already mentioned, in working out the relevant factors to consider, the trustee board should consider (a) the purpose and scope of both the scheme and the power; and then (b) decide on the relevant factors to consider in the light of the purpose and scope

5.34 It seems to us[125] that the purpose (and relevancy) of indexation provisions – and the power to change the index – could well mean that the following are relevant factors to be considered:

- that the aim of the power is to give flexibility in giving some protection against the effects of inflation or, potentially the cost of living;
- considering how "fair" or suitable the index is, compared to the previous index;
- the extent of the benefits already given to the members or available in the market – *Edge*[126]*;*
- that there should not generally be an element of windfall for the members – *Foster Wheeler*[127]*;*
- that reasonable expectations are considered – *IBM;*
- that (arguably) affordability for the scheme and the employer is considered; and
- that the employer's views are considered – *Edge*[128] and *British Airways*[129]*,* but depending on the relevant power may not be determinative - *British Airways*[130]*.*

5.35 On the purpose of the Scheme or an amendment power, the argument is that this is to provide only the stated benefits (unless employer agrees) – see *British Airways*[131]. A move from RPI

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124 Points considered by the Supreme Court in its hearing (11 June 2018) of the appeal from the Court of Appeal in *Buckinghamshire v Barnardo's* [2016] EWCA Civ 1064.

125 There is a more detailed discussion of some of these issues in Michael Tennet, Emily McKechnie and James McCreath "*RPI, CPI and Beyond*" (2017) Edward Nugee Memorial Lectures 35 at 49 to 57.

126 *Edge v The Pensions Ombudsman* [2000] Ch 602, CA.

127 *Foster Wheeler Ltd v Hanley* [2009] EWCA Civ 651, [2010] ICR 374, [2009] PLR 229 at [36] and [37], a case on the effect of an amendment.

128 *Edge v The Pensions Ombudsman* [2000] Ch 602, CA.

129 *British Airways v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) (Morgan J).

130 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533 overturning the decision of Morgan J in *British Airways v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) on the "proper purpose" challenge to the decision of the trustees to increase pensions in payment to reflect part of the gap between CPI and RPI.

131 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533 per Lewison and Peter Jackson LJJ (Patten LJ dissenting), overturning Morgan J at first instance [2017] EWHC 1191 (Ch) on this "proper purpose" issue.

to CPI may reduce benefits actually paid to the pensioners (the *British Airways* case is concerned with the opposite).

5.36 The purpose of the specific power will depend on its wording and the context. But its primary purpose may well be seen as to give some protection against price inflation/cost of living inflation/wage inflation. Issues on this will be whether:

- CPI or RPI is more "appropriate" or "fair" (see eg *FDA*[132])?
- RPI is not "inappropriate"? – *BT*[133]
- Is the index used as a national statistic? But how relevant is this?
- Is RPI the default and so applicable unless changed?
- Are changes in public sector policy relevant? The recent pensions White Paper[134] rejected any proposal to give employers or trustees an overriding power to change the index.

5.37 If the scheme is in deficit and the effect of any change would be to increase benefits without the agreement of the employer this may not then be using a relevant power for a proper purpose – see the Court of Appeal in *British Airways*[135].

5.38 Impact on scheme funding/contributions as a relevant factor? This involves considering what would be likely to be the impact of the change on:

- Scheme funding (ie security for benefits accrued); and
- Future contributions.

5.39 If there is an increased danger of insolvency resulting for the employer/scheme as a result of not changing the index (financial advice would usually be needed), then it may be easier for a trustee board to justify an index change.

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132 *R (on the application of FDA) v Secretary of State for Work and Pensions* [2012] EWCA Civ 332, [2013] 1 WLR 444, [2012] Pens LR 215.

133 *British Telecommunications plc v BT Pension Scheme Trustees Ltd* [2018] EWHC 69 (Ch) (Zacaroli J).

134 "*Protecting defined benefit pension schemes*" (Cm 9591, March 2018).

135 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533 per Lewison and Peter Jackson LJJ (Patten LJ dissenting), overturning Morgan J at first instance [2017] EWHC 1191 (Ch) on this "proper purpose" issue.

5.40 Is saving money for the employer a relevant factor? Can it be the only factor? Warren J in *Thales* took a restrictive view at [134]:

> "….. the determination of a basis of pension increase under Rule 4.4.4(b)(i) is for the Trustees alone. They are, as under Rule 4.4.1(b)(i), subject to fiduciary obligations when making the determination: it would require exceptional circumstance for them to adopt an alternative index, such as CPI, in order to reduce the costs to the Company if, in so doing (as in current circumstances would be the case), they would be acting to the detriment of the beneficiaries of the Scheme. I accept, of course, that a change in the RPI may result in the Trustees having to choose a new index and that their practical choice may be between one, such as CPI, which saves the Company money and makes the beneficiaries worse off, and one, such as the RPI as altered, which costs the Company money and makes the beneficiaries better off. Their choice must be one which they can properly make in accordance with their fiduciary duties and must be made "having regard to the alteration". It is difficult to see how they could properly adopt an index acting under Rule 4.4.4(b)(i) unless it would also be within their powers under Rule 4.4.1(b)(i)."

5.41 But is Warren J's comment contrary to *Edge*? Contrast Lewison LJ in *Barnardo's*[136] at [35]:

> "Mr Rowley also said that adherence to RPI has, as things turned out, been to the members' benefit, but things could have turned out differently with the result that pensions no longer kept pace with inflation. The implications of that submission, if correct, would be that the trustees had power to impose greater financial obligations on the sponsoring employer without obtaining the employer's consent. That is, in my judgment, an unlikely conclusion."

This was cited by BA to Morgan J in *British Airways*[137] at [377].

5.42 What will happen if the change is not made? Is it possible or likely that the employer may take other actions – eg freeze the scheme/reduce future pay increases? Which members would be affected by such actions? Would such actions in themselves be challengeable?

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136 *Buckinghamshire v Barnardo's* [2016] EWCA Civ 1064.

137 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) (Morgan J).

5.43 What does the employer think? What is fair? In our view in a defined benefit scheme, the employer should be considered as a beneficiary[138]. Morgan J held in *British Airways*[139]:

> "[605] Finally, under this head, I will consider BA's submission that the trustees failed to consider what would be fair to BA. I accept that the trustees had to take account of the interests of BA and of the members and pensioners of the APS. Insofar as those interests conflicted, the trustees had to try to hold the balance between them in a fair way. However, BA's case is that there was only one fair outcome and that was that there should not be an award of a discretionary increase. BA does not say that there was any other way of achieving fairness, for example, by awarding an increase of 0.10% rather than 0.20%. Put that way, BA's case is effectively that its wishes must prevail and the trustees were disabled from making any other decision. I do not think that that is the legal position."

5.44 There should not be a "windfall" gain for members. For example, in *Foster Wheeler Ltd v Hanley*[140] Arden LJ held:

> "By conferring a windfall on members with mixed NRDs, the judge's solution did not satisfy the principles which I have identified. It is unfair to the company and potentially unfair to other members of the scheme. I am reinforced in this view by the fact that Mr Spink's submissions did not give any reasons to justify the windfall element as such of the judge's solution. In my judgment, the windfall element constituted a fatal flaw."

5.45 Ultimately the issue remains very fact and context specific. It is almost impossible to give clear general views in the absence of a specific scheme or circumstance. And, unhelpfully, it is difficult to be sure that the court will agree with any conclusions reached by the decision maker (or its advisers) on purposes or factors.

All relevant factors?

5.46 Does the first limb of the *Braganza*/*Wednesbury* test mean that the decision maker needs to consider all relevant factors? Or is it perhaps limited to the material ones? James Walmsley discussed this issue in his talk on *Braganza* to the Chancery Bar Association (March 2018), pointing out that in *Braganza*, Lady Hale at [29] referred to "obviously relevant" considerations:

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138 See *Edge* and *MNRPF* (*Merchant Navy Ratings Pension Fund Trustees v Stena Line* [2015] EWHC 448 (Ch), [2015] PLR 239, Asplin J). See Pollard *'The Law of Pension Trusts'* (2013, OUP) at Chapter 10 'Trustees' duties to employers'.

139 *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) (Morgan J).

140 *Foster Wheeler Ltd v Hanley* [2009] EWCA Civ 651, [2010] ICR 374 [2009] PLR 229 at [36].

"take into account those considerations which are obviously relevant"

But in *Wednesbury*[141] itself, the reference is to the decision maker having "neglected to take into account matters which they ought to take into account".

5.47 At least three Court of Appeal decisions have referred to the positive part of the first limb of the *Braganza* test as a requirement to take into account "all relevant matters": *Hills v Niksun*[142]; *Evangelou v McNicol*[143]; and *IBM*[144].

5.48 But, as James Walmsley pointed out, that must be a shorthand, leading to the question of what does this requirement really mean? Two possible approaches are suggested by *Braganza*:

- Look to the public law cases[145];
- A test of:
  - "obviously relevant considerations" (per Lady Hale at [29], picked up in *IBM* at [38]); or, perhaps,
  - "material points" (*Watchfinder*[146] at [102], *BHL v Leumi ABL Ltd*[147] at [40], *Shurbanova v Forex*[148] at [81]); or, perhaps
  - "important relevant factors" (*BHL v Leumi*[149] at [88]).

This probably leads on to the issue of causation and the potential to ignore "minor" factors.

6. <u>Trustees and relevant factors: *Pitt v Holt* compared with *Braganza*?</u>

6.1 There is a clear line of caselaw, culminating in the 2013 Supreme Court decision in *Pitt v Holt*[150] that makes it clear that a decision by trustees (or other fiduciaries) cannot be overturned (or avoided) merely because of "inadequate deliberation" by a trustee board, for example that they did not take account of all the right facts. There must also have been a breach of duty by the trustees

141 *Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1948] 1 KB 223, CA per Lord Greene MR at p234.
142 [2016] EWCA Civ 115 at [19].
143 [2016] EWCA Civ 817 at [47].
144 *IBM v Dalgleish* [2017] EWCA Civ 1212 at [57].
145 Per Lady Hale at [30], Lord Hodge at [53], Lord Neuberger at [103].
146 *Watson v Watchfinder.co.uk Ltd* [2017] EWHC 1275 (Comm) (Judge Waksman QC).
147 [2017] EWHC 1871 (QB), [2018] 1 All ER (Comm) 965 (Judge Waksman QC).
148 *Shurbanova v Forex Capital Markets Ltd* [2017] EWHC 2133 (QB) (Judge Waksman QC).
149 [2017] EWHC 1871 (QB), [2018] 1 All ER (Comm) 965 (Judge Waksman QC).
150 [2013] UKSC 26, [2013] 2 AC 108.

and it seems that there may not be such a breach if trustees take "apparently competent" advice and reasonably rely on it.

6.2 As discussed above, the decision on this area in *Pitt v Holt* was a deliberate policy to restrict the availability of the use by trustees of the so called "Rule in Hastings-Bass", which had been interpreted to allow trustees to avoid their decisions if they had not taken into account all relevant factors (for example had not properly understood the tax effects of their decision).

6.3 In *Pitt v Holt* in the Supreme Court Lord Walker (giving the only judgment, with which the other six Supreme Court Justices agreed) at [73] and [80]:

> "73. In my view Lightman J was right to hold that for the rule to apply the inadequate deliberation on the part of the trustees must be sufficiently serious as to amount to a breach of fiduciary duty. Breach of duty is essential (in the full sense of that word) because it is only a breach of duty on the part of the trustees that entitles the court to intervene ….. It is not enough to show that the trustees' deliberations have fallen short of the highest possible standards, or that the court would, on a surrender of discretion by the trustees, have acted in a different way. Apart from exceptional circumstances (such as an impasse reached by honest and reasonable trustees) only breach of fiduciary duty justifies judicial intervention."
>
> ……
>
> "80. …. Trustees may be liable, even if they have obtained apparently competent professional advice, if they act outside the scope of their powers (excessive execution), or contrary to the general law (for example, in the Australian case, the law regulating entitlement on intestacy). That can be seen as a form of strict liability in that it is imposed regardless of personal fault. Trustees may also be in breach of duty in failing to give proper consideration to the exercise of their discretionary powers, and a failure to take professional advice may amount to, or contribute to, a flawed decision-making process. But it would be contrary to principle and authority to impose a form of strict liability on trustees who conscientiously obtain and follow, in making a decision which is within the scope of their powers, apparently competent professional advice which turns out to be wrong."

Two stage approach for trustees

6.4 In *Pitt v Holt* Lord Walker had previously (at [40]) approved as a "correct statement of the law" Lightman J's finding about breach of duty in *Abacus v Barr*[151]:

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[151] *Abacus Trust Co (Isle of Man) v Barr* [2003] Ch 409 (Lightman J) at [23].

'What has to be established is that the trustee in making his decision has, in the language of Warner J in *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587, 1625, failed to consider what he was under a duty to consider. If the trustee has in accordance with his duty identified the relevant considerations and used all proper care and diligence in obtaining the relevant information and advice relating to those considerations, the trustee can be in no breach of duty and its decision cannot be impugned merely because in fact that information turns out to be partial or incorrect."

6.5 These findings by Lord Walker in relation to the "duty to give proper consideration to the exercise of their discretionary powers" clearly involves looking at the duty of care or proper deliberation[152] or consideration owed by trustees[153].

6.6 Lightman J's formulation (as approved by Lord Walker) seems to involve two stages. To slightly paraphrase, a trustee board will not be in breach of duty if:

(a) in accordance with its duty, it identifies the relevant considerations; and

(b) it uses all proper care and diligence in obtaining the relevant information and advice relating to those considerations.

6.7 So it would seem in *Pitt v Holt* (where the relevant fiduciary decisions were not overturned on this due consideration ground) that the relevant fiduciaries concerned had complied with this two stage approach and so were not in breach of trust (or at least not in breach of fiduciary duty). They had:

- identified the relevant considerations (including the tax impact on the beneficiaries) – so complying with the *Abacus* stage (a); and
- taken "apparently competent professional advice" in relation to those factors – so complying with the *Abacus* stage (b).

Stage (a): Identifying relevant factors

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152 The description given by Lord Walker in a later lecture – see '*When will the court grant relief for Trustees' mistakes?: Pitt v Holt and Futter v Futter*' (2014) 44 HKLJ 759. On the duty, see Mark Studer '*Modern trustee decision-making: unpacking the duty of proper consideration*' (2016) 22 Trusts & Trustees 991.

153 Similarly for directors, see Rosemary Teele Langford '*Directors' duties: principles and application*' (Federation Press, 2014) at 9.7: "Overlap between the duties".

6.8 The formulation of this stage in *Abacus* and *Pitt v Holt* for trustees does not refer to the trustee decision maker being able to rely on any relevant advice as to what is (or is not) a relevant factor.

6.9 Instead it can be argued that it is perhaps an absolute test – not what the trustees reasonably considered to be the relevant factors, but instead they need to get it right (in a way similar to getting the legal scope of the relevant power right – to avoid 'excessive execution" in the terminology used by Lord Walker in *Pitt v Holt* at [78] and [80] cited above).

6.10 If this is right, it is not made very clear by the judgments in *Pitt v Holt*. Lord Walker can be seen as indicating that professional advice may be a protection perhaps for both stages, commenting (at [82]) that Warner J in *Mettoy*[154]:

> 'was wrong in disregarding the 'amount or quality' of professional advice obtained by trustees, when the question relates to a decision within the scope of the trustees' powers.'

Limb (b): Trustees duty of care

6.11 For trustees of a trust in England and Wales, s1(1), Trustee Act 2000 sets out a statutory duty of care:

> **1 The duty of care**
>
> (1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular—
>
> (a) to any special knowledge or experience that he has or holds himself out as having, and
>
> (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

[154] *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 (Warner J) at 556.

6.12 Does this duty of proper deliberation mean that trustees (and other fiduciaries) when making decisions:

(a) are obliged to reach the right answer as to which factors should be considered (eg in *Braganza*, BP had a full report seeking to discover the cause of death but was still held to have not considered a relevant factor, namely that Mr Braganza was a roman catholic)?; or

(b) can rely on professional advice (as in *Pitt v Holt* where the relevant decision maker took tax advice, but this turned out to be incomplete)?

6.13 The question arises as to whether the trustees are entitled to rely on the legal and other advice they may receive as to the nature and extent of the factors they should consider (or not consider). If they do so, are they acting reasonably and so not in breach of trust? Does this "adviser protection" only extend to an avoidance claim (as was the claim in *Pitt v Holt*) and not (say) to a damages (or equitable compensation) claim (as was the claim against the employer in *Braganza*? A damages claim is also more likely to be subject to an exoneration provision in the relevant trust instrument (eg covering trustee liability unless there is actual fraud or wilful default[155]).

Pitt v Holt* compared with *Braganza

6.14 It is difficult to see how *Pitt v Holt* and *Braganza*, the two recent Supreme Court decisions on review of the exercise of discretions in a private law context, link with each other. Both involve a review by the court of a decision made by a decision maker under the powers given under the relevant instrument. In the case of *Pitt v Holt* this was a decision by fiduciaries (trustees and a receiver) and, in the decision, two years later, in *Braganza* this was a factual decision by the employer.

6.15 Unhelpfully, despite both cases dealing with a review of the exercise of a private law discretion, *Braganza* does not refer to the decision in *Pitt v Holt* (nor does it appear that the decision in *Pitt v Holt* was cited in argument).

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155 See *Trustee indemnities and exonerations*, ch14 in Pollard '*The Law of Pension Trusts*' (2013, OUP).

6.16 To contrast the judgments in *Pitt v Holt* and *Braganza*:

	***Pitt v Holt* (2013)**	***Braganza* (2015)**
Court	Supreme Court	Supreme Court
Majority	7-0	5-0 (Law) 3-2 (Application to facts)
Judges in common	Lord Neuberger and Lady Hale in majority	Lady Hale in majority, Lord Neuberger dissenting
Nature of claim	Claim to avoid decision	Money claim
Type of arrangement	Trust	Contract
Family or commercial?	Family trust (Not a pension trust)	Employment contract: Death benefit on death of employee
Type of discretion or decision	Wide discretion	Factual decision
Original court	Chancery Division	Queen's Bench Division
Case decided on:	Relevant factors test	Relevant factors limb
Real defendant?	HMRC	Not a tax issue
Applying public law test?	Similarities were "superficial" and "analogy cannot … be pressed too far"	Public law *Wednesbury* test is appropriate

Trustees: What was the decision in Pitt v Holt?

6.17 In *Pitt v Holt*[156] at [73] (see above) Lord Walker clearly held two matters:

(a) a decision by the fiduciaries in those cases could not be overturned on the basis of a failure to carry out proper consideration (ie the so-called *Hastings-Bass* basis, corresponding with the first limb in *Wednesbury*/*Braganza)*, unless there was a breach of fiduciary duty by the trustees – see [73]; and

(b) in the cases concerned, the trustees had taken apparently competent professional advice and so they were not in breach of a relevant duty – see [80] and so the decisions would not be overturned (at least on this basis[157]).

6.18 This can be quite tricky to analyse. But it seems to lead to three questions when considering *Pitt v Holt* on this point (and how it interacts with the later decision in *Braganza*):

(a) First that there is potentially a different test for trustees (or other fiduciaries) than on others (eg employers);

(b) Second that the requirements in *Pitt v Holt* for a breach of "fiduciary duty" (i) only apply where a decision is being sought to be overturned (rather than, say, where damages are being sought); and (ii) are using the term "fiduciary duty" in a wide sense (not the narrow or "full" sense envisaged by Millett LJ in *Mothew*[158]); and

(c) Third that the *Hastings-Bass*/*Wednesbury*/*Braganza* duty as applied to trustees to "consider all relevant factors" is modified by a reasonableness component to be in reality a duty to take reasonable care to consider all relevant factors – so forming part of the trustee's duty of care or "proper deliberation". This would mean that if the trustee obtains "apparently competent professional advice" then this means that either:

    (i) the trustee is not in breach of this modified duty at all; or alternatively

    (ii) the trustee could still be in breach of the general duty of care or proper deliberation, but, given the advice and that the trustee has in some sense acted reasonably, this is not enough to amount to a sufficiently serious breach or a breach of fiduciary duty

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156 [2013] UKSC 26, [2013] 2 AC 108 at [88].

157 In one of the two cases in *Pitt v Holt*, the decision was overturned on the basis of "mistake". This is not considered further in this paper.

158 *Bristol and West Building Society v Mothew* [1998] Ch 1, CA per Millett LJ at 17.

so as to mean that the decision would be overturned by the court. There are echoes of this analysis in the judgments in the liquidator case, *Top Brands*[159] and the director case, *Carlyle*[160], discussed below.

6.19 This paper now briefly looks at these three points in turn.

1. Trustees and employers are different?

6.20 There are clearly a number of distinctions between the two cases, *Braganza* and *Pitt v Holt*. It seems that the *Braganza* test should apply to trustees as well. The distinctions between *Braganza* and *Pitt v Holt* are not great enough so that *Braganza* should be seen (say) as not applying to trustees at all. In our view the *Braganza* test is not restricted to contracts or non-fiduciaries (eg the decision makers in *IBM*).

6.21 In our view it would be very odd to impose a standard of decision making on non-fiduciaries that is greater than that on trustees (and other fiduciaries). In our view:

(a) the *Braganza* test will apply to trustees of pension and other commercial trusts (indeed it has already been applied to the trustee of a commercial trust in New Zealand in *Wellington Council*[161] - see above).

(b) The *Braganza* test probably applies to help fix the level of "proper deliberation" for other trustees as well. It could perhaps be argued that it imposes too great a burden on trustees of non-commercial trusts, but this seems to me ultimately to be unlikely to succeed as a criticism. The *Braganza* tests are still fairly stiff, involving irrationality (more clearly seen in the second limb).

2. Need for a breach of "fiduciary duty"?

6.22 The judgments in *Pitt v Holt* are clear about the need for a breach of "fiduciary duty" in order for a trustee (or other fiduciary) decision to be overturned[162]. Conversely, of course, in *Braganza* there is no suggestion of any need for a breach of duty or fiduciary duty.

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159 *Top Brands Ltd v Sharma* [2014] EWHC 2753 (Ch), [2015] 2 All ER 581 (HHJ Barker).

160 *Carlyle Capital Corporation Ltd v Roberts* (2017) 4 September, Guernsey Judgment 38/2017 (Hazel Marshall QC, Lieutenant Bailiff).

161 *Wellington City Council v Local Government Mutual Funds Trustee Ltd* [2017] NZHC 2901 (Collins J).

162 *Pitt v Holt* [2013] UKSC 26 at [73]. The need for a breach of "fiduciary duty" is repeated in the Privy Council's summary of the principles in *Pitt v Holt* in *Gany Holdings (PTC) SA v Khan* [2018] UKPC 21 per Lord Briggs at [54].

6.23 The limit on overturning a decision was imposed in *Pitt v Holt* to reduce the scope of the "get out of jail free"[163] aspect of the decision in *Re Hastings-Bass*[164] – namely that trustees were able to reverse their decision.

6.24 It may be that, in context, this requirement in *Pitt v Holt* for a breach of fiduciary duty:

(a) only applies where a decision is being sought to be overturned (rather than, say, where damages or compensation are being sought); or

(b) is using the term "fiduciary duty" in a wide sense (not the narrow or "peculiarly fiduciary" sense envisaged by Millett LJ in *Mothew*[165]).

This is not at all clear from the judgments in *Pitt v Holt*.

6.25 On (a), whether the *Pitt v Holt* principles only apply to a claim to overturn the relevant decision, the context of the claims in *Pitt v Holt* was just such a claim. They were not claims against the trustees for damages (or equitable compensation) for breach of duty (or for an account). And the language of the judgments in *Pitt v Holt* is often clear that the judges concerned are looking at the position on an overturning of a decision.

(i) It could well be that the references in *Pitt v Holt* to a need for a breach of fiduciary duty are doing nothing more that emphasising that overturning a decision needs to be on the basis of a material (and not minor) breach of a relevant duty (or test) by the trustees concerned.

(ii) It can perhaps be seen as similar to the test in contract law allowing a contract to be terminated for breach only if there is a substantial breach (ie a breach of a condition), leaving damages claims available for lesser breaches (eg a breach of warranty).

6.26 On (b) above, the nature of the fiduciary duty involved, the term "fiduciary duty" is giving rise to many problems, owing to a difficulty in working out what is a fiduciary duty and what is not. The Law Commission commented in 2014[166]:

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163 See Richard Nolan '*Controlling Fiduciary Power*' [1993] CLJ 293 at 307.
164 [1975] Ch 25, CA.
165 *Bristol and West Building Society v Mothew* [1998] Ch 1, CA per Millett LJ at 17.
166 *Fiduciary duties of investment intermediaries* (Law Com No 350) at 3.11.

"… the term "fiduciary duty" means different things to lawyers and non-lawyers. Even lawyers use the term in different ways. In part, this reflects changes in judicial thinking about what the term means.[167]"

6.27 In *Mothew*[168]*,* Millett LJ famously held that fiduciaries will owe both fiduciary duties and non-fiduciary duties and that only those duties that are peculiar to fiduciaries are properly termed fiduciary duties. It follows that not every breach of duty by a fiduciary is a breach of fiduciary duty. Millett LJ noted (at p16):

'This branch of the law has been bedevilled by unthinking resort to verbal formulae. It is therefore necessary to begin by defining one's terms. The expression "fiduciary duty" is properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties. Unless the expression is so limited it is lacking in practical utility.'

6.28 The due consideration of the relevant factors rule does not look to be "peculiarly fiduciary" under this test[169]. But the duty of due consideration was itself described as fiduciary by the Court of Appeal in *Pitt v Holt*[170]. The Law Commission commented[171] in 2014 on this point in *Pitt v Holt*:

"In this context, however, the term is being used broadly and encompasses duties other than those which are "peculiarly fiduciary", such as the rules prohibiting unauthorised conflicts of duty and interest and the rule prohibiting unauthorised profits. Here the term means "the duties incumbent on a fiduciary to perform his office": R Nolan and A Cloherty, "The rule in Pitt v Holt?" (2011) 127 Law Quarterly Review 499 at 501."

6.29 Later commentators (including Lord Walker himself[172]) have taken a similar view that a breach of the full "peculiarly" fiduciary duty (as defined in *Mothew*) is not needed[173].

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167 *Aequitas v AEFC* [2001] NSWSC 14 at [283]

168 *Bristol and West Building Society v Mothew* [1998] Ch 1, CA per Millett LJ at 16. See Sarah Worthington '*Four Fiduciary Duties*' (2018) 32 TLI 22 at 28 to 32 and Peter Birks '*The Content of Fiduciary Obligation*' (2002) 16 TLI 34 at 35.

169 Before *Pitt v Holt*, see Richard Nolan '*Controlling fiduciary power*' [2009] CLJ 293 at 309, citing *Permanent Building Society v Wheeler* (1994) 14 ACSR 109 (Ipp J) at 157-158; *Colin Gwyer & Associates Ltd v London Wharf* [2002] EWHC 2748 (Ch) (Leslie Kosmin QC) at [83] and *Extrasure Travel v Scattergood* [2002] EWHC 3093 (Ch) (Jonathan Crow QC) at [87] – [90].

170 *Pitt v Holt* [2011] EWCA Civ 197 at [127].

171 *Fiduciary duties of investment intermediaries* (Law Com No 350) at 3.64, fn127.

172 Lord Walker '*The Changing face of Trust Law*' (2017) 31 TLI 19 at 25; Lord Walker '*When will the Court grant relief for Trustee's Mistakes?*' (2014) 44 HKLJ 760 at 765.

173 See eg Dyson Heydon '*Modern fiduciary liability: the sick man of equity?*' (2014) 20 Trusts & Trustees 1006; Kelvin Low '*Fiduciary duties: the case for prescription*' (2016) 30 TLI 3, Newey J (extra judicially) in *Constraints on the exercise of trustees' powers*, chapter 2 in '*Equity and Administration'* (P G Turner ed, 2016, CUP) at p55 (note that

(a) It is unclear what the term "fiduciary duty" means in the context of powers of a trustee board. Sometimes the courts categorise duties as being fiduciary, but the Court of Appeal in *Mothew*[174] made the point that not all powers owed by a fiduciary (such as a trustee) are fiduciary powers.

(b) It presumably includes acting where there is a conflict of interest, but it is not clear if it includes (say) acting without due care. In some categorisations a duty of skill and care (including a duty of due consideration) would not be considered to be a fiduciary duty in the full "peculiarly" fiduciary sense.

(c) But it seems likely that *Pitt v Holt*[175] allows a trustee decision to be overturned even if it is not a full "peculiarly" fiduciary duty that has been breached[176].

(d) It may be relevant that the claim in *Pitt v Holt* was for reversal of the decision, and not for another remedy (eg damages). The logic here would be that overturning a decision involves a higher hurdle to be reached (so that the references in *Pitt v Holt* to the need for a breach of fiduciary duty[177] should be read with this in mind). This is not a point that is expressly made in the judgments in *Pitt v Holt*, but the whole context[178] of the case is a claim to reverse the relevant decision.

3. Professional advice safe harbour for trustees?

6.30 In *Pitt v Holt*[179] Lord Walker discussed the argument that trustees have a duty to rely only on correct advice (otherwise they would not be properly considering a relevant factor). He dismissed this forthrightly as being a "last-ditch argument" involving "taking the principle of strict liability for

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the Supreme Court decision in *Braganza* was given after this chapter was written) and Michael Ashdown '*Trustee Decision Making*' (OUP, 2015) at ch4 'The nature of the *Hastings-Bass* duty'.

For a discussion of the fiduciary duty concept in relation to making third parties liable, see P S Davies '*Accessory Liability*' (2015, Hart Publishing) at p99 and J Heydon, M Leeming and P Turner, *Meagher, Gummow and Lehane's Equity: Doctrines & Remedies* (5th ed, 2014, LexisNexis) at [5-355] to [5-430] (discussing in particular *Bell Group v Westpac (No 9)* (2012) 270 FLR 1).

174 *Bristol & West Building Society v Mothew* [1998] Ch 1, per Millett LJ at 16, 18.

175 [2013] UKSC 26, [2013] 2 AC 108.

176 Lord Walker, '*The changing face of trust law*' (2017) 31 TLI 19, the annual lecture given in November 2016 to ACTAPS (the Association of Contentious Trust and Probate Specialists).

177 See eg the discussion in Michael Ashdown '*Trustee Decision Making: The rule in Re Hastings-Bass*' (2015, OUP) at 4.04 and by Newey J (extra judicially) in chapter 2 '*Constraints on the exercise of trustees' powers*', at p54, in the book 'Equity and Administration' (P G Turner ed, 2016, CUP).

178 On context being important, see Lord Steyn in *R v Secretary of State for the Home Office, ex p Daly* [2011] UKSC 42 at [59] "In law, context is everything" and Lord Walker in *Bridge Trustees v Houldsworth* [2011] UKSC 26 at [32] "…. apparently wide propositions may have to be read in the context of the particular facts of the case to which they related".

179 [2013] UKSC 26, [2013] 2 AC 108 at [88].

ultra vires acts out of context" and requiring "trustees to show infallibility of judgment" which is "quite unrealistic":

> "[88] Finally, on this part of the case, there is the submission that the trustees' duty to take account of relevant considerations is to be interpreted as a duty to act on advice only if it is correct—in effect, a duty to come to the right conclusion in every case. I have left this submission until the end because it is to my mind truly a last-ditch argument. It involves taking the principle of strict liability for ultra vires acts (see [81] to [84], above) out of context and applying it in a different area, so as to require trustees to show infallibility of judgment. Such a requirement is quite unrealistic. It would tip the balance much too far in making beneficiaries a special favoured class, at the expense of both legal certainty and fairness. It is contrary to the well-known saying of Lord Truro LC in *Re Beloved Wilkes's Charity* (1851) 3 Mac & G 440 at 448, (1851) 42 ER 330 at 333:
>
> > '… that in such cases as I have mentioned it is to the discretion of the trustees that the execution of the trust is confided, that discretion being exercised with an entire absence of indirect motive, with honesty of intention, and with a fair consideration of the subject. The duty of supervision on the part of this court will thus be confined to the question of the honesty, integrity, and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at, except in particular cases.'
>
> The trustees' duty does not extend to being right ('the accuracy of the conclusion arrived at') on every occasion. The 'particular cases' that the Lord Chancellor had in mind may have included cases concerned with the maintenance of minor beneficiaries. They may also have included cases (such as *Kerr v British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071) in which the trustees have to make a particular factual judgment, rather than exercise a wide discretion."

6.31 But unfortunately, having held that a breach of duty was needed before a decision could be reversed (see [73]), Lord Walker did not explain why the relevant fiduciaries were not in fact in breach of duty by not considering a relevant factor. The previous caselaw on proper consideration had merely referred to a need to consider the relevant factors, without qualifying this by reference to taking reasonable care. But at [88] in the passage cited above, Lord Walker seems to be holding that any relevant duty is so qualified.

6.32 Accordingly, it seems from *Pitt v Holt* that trustees (at least) can rely on "apparently competent" professional advice at least in relation to:

(a) Claims in private family trusts for avoidance of a decision and where they have taken advice on the issue or factor[180] (in *Pitt v Holt*, this was tax).

(b) But they probably cannot seek to rely on such advice to uphold their action if they did not actually take advice (eg the Isle of Man decision, *AB v CD*[181]) or if they did not give proper instructions or use proper care and diligence in gaining information: *Top Brands Ltd v Sharma*[182] and *Power Adhesives Ltd v Sweeney*[183];

6.33 It is unclear from *Pitt v Holt* (because the case of course turned on the facts of the two trusts before the court and did not involve these situations) if this professional advice "safe harbour" protects decision makers if:

(a) the advice is itself about whether a factor is relevant or not (as opposed to the weight to be given to it) – in *Pitt v Holt*, the fiduciaries had considered tax, but not all relevant aspects of tax; or

(b) the claim is for breach of the second limb of the *Braganza* test – ie that no reasonable decision maker would have so decided; or

(c) the decision maker is a non-fiduciary (eg the employer in *Braganza* – who seems to have had a full report); or

(d) the decision was about a factual matter as opposed to a full general discretion – this was a point mentioned by Lord Walker in *Pitt v Holt* (at [75]) (for example *Braganza* was a factual judgment case); or

(e) as mentioned earlier, is it relevant if the claim is not for reversal of the decision, but rather for another remedy (eg damages). The logic here would be that overturning a decision involves a higher hurdle to be reached (so that the references in *Pitt v Holt* to the need for a

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180 In the context of court approval of momentous trustee decisions, see the references to advice in *Cotton & Moore v Brudenell-Bruce* [2014] EWCA Civ 1312 per Vos LJ at [10] and [72] (trustees are not obliged to "second guess the professional view of the experts they had instructed"). Cited in *MNRPF* [2015] EWHC 448 (Ch) (Asplin J) at [17].
Contrast the tax cases (on tax surcharges for unauthorised payments) which can be discharged if "it would not be just and reasonable in all the circumstances for [taxpayer] to be liable to the unauthorised payments surcharges". The tribunals have held that "the fact that taxpayer has taken legal, accounting or tax advice is not sufficient of itself to make it unjust or unreasonable for the charge to remain": *O'Mara v HMRC* [2017] UKFTT 91 (TC) and that the taxpayer "should have considered the basis for any advice received and whether it made sense": *A Anderson* [2016] UKFTT 335 (TC), *Bella Figura Limited v HMRC* [2018] UKFTT 412 (TC).

181 *AB v CD* (2016) 19 ITELR 316 (Deemster Doyle) at [89].

182 [2014] EWHC 2753 (Ch), [2015] 2 All ER 581 (HHJ Barker) at [33].

183 [2017] EWHC 676 (Ch) (Chief Master Marsh).

breach of fiduciary duty[184] should be read with this in mind). This is not a point that is expressly made in the judgments in *Pitt v Holt*, but the whole context[185] of the case is a claim to reverse the relevant decision.

6.34 The professional advice aspect of the decision in *Pitt v Holt* has been criticised – see Robert Ham '*The rule in Hastings-Bass after Pitt v Holt and Futter v Futter*'[186]. Robert Ham queried how this decision in *Pitt v Holt* ties in with the judgment on costs in

> '*Re Beddoe* [1893] 1 Ch 547, which though not mentioned in the Appeal Cases was cited to the Supreme Court. That was a case where trustees had followed apparently competent professional advice, yet were not permitted to resort to the trust property for costs.'

6.35 Robert Ham also pointed out that, in its December 2011 Consultation Paper[187] on '*Defects in the Exercise of Fiduciary Powers*', the Scottish Law Commission (*SLC*) was critical of the reasoning of Lloyd LJ in the Court of Appeal in *Pitt v Holt*:

> "17. We have some difficulty with this reasoning. If the trustees obtain ex facie proper professional advice there is clearly no breach of their fiduciary duty to obtain proper professional advice, but if that advice is wrong, with the result that the trustees take account of an irrelevant consideration (or fail to take account of a relevant consideration), it can be said that they are in breach of the separate fiduciary duty to take account of relevant considerations but not irrelevant considerations. In other words, two separate fiduciary duties appear to be involved here, and the fact that there is no breach of one duty does not mean that there is no breach of the other. In this respect, we are of opinion that the faults of the professional advisers must be imputed to the trustees; the simple fact is that when they exercised the discretion the trustees were in error as to the considerations that they should take into account, whatever the source of that error. Moreover, in other areas of the law where the issue of relevant and irrelevant considerations is material, the fact that such a consideration is ignored (where relevant) or taken into account (where irrelevant) as a result of professional advice does not matter; the decision-taker is still wrong in what it has or has not taken into account. That would apply, for example, to judicial review of a public

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184 See above.

185 On context being important, see Lord Steyn in *R v Secretary of State for the Home Office, ex p Daly* [2011] UKSC 42 at [59] "In law, context is everything" and Lord Walker in *Bridge Trustees v Houldsworth* [2011] UKSC 26 at [32] "…. apparently wide propositions may have to be read in the context of the particular facts of the case to which they related".

186 (2016) 22 Trusts & Trustees 971 at p973. See also the Isle of Man decision in *AB v CD* (2016) 19 ITELR 316 (Deemster Doyle) at [52].

187 On the SLC website: https://www.scotlawcom.gov.uk/files/1013/2342/1382/defects_fiduciary__powers.pdf.

authority's actions. Likewise in areas of the law where error is relevant, for example contracts and unilateral deeds, an error induced by defective professional advice is still an error."

6.36 In its final Report[188] the SLC did not pursue that criticism, saying (at [19.1]) that it was:

> "very clear" that the decisions in *Pitt v Holt* and *Futter v Futter* related to "extremely technical aspects of English law which we have no desire to incorporate into Scots law".

Ultimately the SLC preferred to put forward (chapter 19) a specific statutory review provision based on the decision of the House of Lords in the Scottish case, *Dundee General Hospitals v Bell's Trustees*. The SLC referred to the *Wednesbury* public law standard as part of its discussion.

6.37 There is some discussion in the recent cases on judicial approval of a trustee's proposed actions about being able to rely on an expert's clear view, at least where there is no evidence that this is defective – see *Cotton & Moore v Brudenell-Bruce, Earl of Cardigan*[189] and also *MNRPF*[190].

6.38 The advice issue is also discussed by Paul S Davies and Simon Douglas in an article, '*Tax mistakes Post Pitt v Holt*'[191], noting that "the tight shackles imposed by the Supreme Court may be somewhat loosened by the lower courts". They point out that in *Pitt v Holt*, Lord Walker had held that the professional advice must be obtained 'conscientiously', be 'apparently competent' and reasonably followed[192].

6.39 See also Judge Matthews in *Devon Commercial Property Ltd v Barnett*[193], a case on LPA receivers selling property. The mortgagor claimed that the receivers had breached their duty to sell at a proper price. Judge Matthews commented:

> "263 There is also criticism of the methodology adopted by Edward Symmons. I accept that the defendants cannot escape liability by retaining an apparently competent professional adviser. Their duty extends to ensuring reasonable care was taken by that adviser: see *Raja*

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188 Report on Trust Law (SLC Report 239, August 2014).

189 [2014] EWCA Civ 1312 per Vos LJ at [10], [72] and [77].

190 [2015] EWHC 448 (Ch), [2015] Pens LR 239 (Asplin J) at [18] and [161]. See also *Re LB Holdings Intermediate 2 Ltd* [2017] EWHC 2032 (Ch) (Hildyard J) approving proposals from an administrator, at [54]: "it is apparent that considerable thought has been put into developing the Proposed Settlement over a period of several months by professional administrators with the benefit of professional legal advice. The presentation of the matter left me in no doubt as to the care with which the proposals have been developed.'

191 (2018) 32 TLI 3 at 7.

192 [2013] UKSC 26 at [80].

193 [2019] EWHC 700 (Ch) (HHJ Matthews).

v Austin Gray [2003] BPIR 725, CA, [29]-[36], following *Cuckmere Brick Co v Mutual Finance Ltd* [1971] Ch 949, 973A-F, per Cross LJ.'

On the facts Judge Matthews held that the adviser had taken reasonable care (see [264]).

6.40 The professional advice issue is discussed in depth by Michael Ashdown in his recent chapter, '*Professional advice*', in the book '*Defences in Equity*'[194]. He refers to an exchange between counsel and the judge in the course of the trial in the *BA case*[195] (which did not ultimately find its way into the judgment in that case as the finding was that the relevant factors had been properly considered and so there was no issue involved of looking at the professional advice received[196]).

6.41 Michael Ashdown puts forward (at p141) a possible three fold distinction in the type of advice a trustee might take in relation to a relevant matter in a *Wednesbury*/*Braganza* type case[197]. He calls these type 1, type 2 and type 3 advice:

Type 1: advice as to the identity of the relevant considerations;

Type 2: advice as to content of a particular consideration;

Type 3: advice as to how trustees should weigh competing considerations.

6.42 Michael Ashdown gives the example of trustees considering the exercise of a power of appointment who take advice on the exercise. They might be advised that they should take account of the inheritance tax consequences (type 1), what the inheritance tax consequences would be (type 2) and whether to prioritise the other benefits of the exercise over the inheritance tax liability that may be incurred as a result (type 3).

6.43 Michael Ashdown then goes on to discuss the potential implications of the "professional advice" defence in *Pitt v Holt*, commenting that Type 1 advice may well not be seen as a defence (despite the apparently wide wording of the judgment in *Pitt v Holt*) on the basis that it might be argued that the trustees need to get the law right.

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194 P Davies, S Douglas and J Goudkamp (eds), '*Defences in Equity*' (Hart Publishing, 2018). On advice (but before the Supreme Court in *Pitt v Holt*), see Geraint Thomas '*Thomas on Powers'* (2nd ed, 2012, OUP) at [10.96].

195 *British Airways plc v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) (Morgan J). Morgan J's decision was later overturned on appeal, on the proper purposes test. The "relevant factors" point was not the subject of the appeal.

196 Morgan J at [635].

197 The chapter does not however refer to those cases as such.

6.44 In our view, this is perhaps similar to the point that if trustees act outside their powers, their decision will not (seemingly) be saved by the fact that they took legal advice on the question of the extent of their power. But ultimately Michael Ashdown's view was that type 1 advice should protect a trustee as well as type 2 (and type 3 is within the general management role of the decision maker anyway). But this, of course, does not explain why the decision maker in *Braganza* (an employer) could not rely on the advice given (the full report on the circumstances of Mr Braganza's death).

Adviser cases after *Pitt v Holt*

6.45 These works refer to two cases in England and Wales after *Pitt v Holt*, namely *Top Brands Ltd v Sharma*[198] where a liquidator was liable for a breach of duty even though she had taken legal advice and to *Power Adhesives Ltd v Sweeney*[199] where directors had taken tax advice, but this was held to have been insufficient and so their decision was a breach of duty and so overturned.

Both cases refer to *Pitt v Holt*. *Top Brands* was decided in 2014 before the Supreme Court decision in *Braganza. Power Adhesives* was decided in 2017 (ie after *Braganza*), but does not refer to *Braganza*.

Top Brands

6.46 In *Top Brands*, Judge Simon Barker QC held that a liquidator was in breach of duty in not taking reasonable care in dealing with an asset. She had taken advice from a solicitor but had not properly instructed the solicitor.

6.47 Judge Barker referred to *McPherson's Law of Company Liquidation* (3rd edn, 2013) to a footnote under para 8–037 stating:

> "A liquidator who exercises powers in good faith after taking proper advice is not open to challenge: *Re Burnells Pty Ltd (in liq), ex p Brown and Burns* (1979) 4 ACLR 213."

Judge Barker noted that *Pitt v Holt*[200] had endorsed the decision of Lightman J in *Abacus v Barr*[201]:

> "What has to be established is that the trustee in making his decision has, in the language of Warner J in *Mettoy Pension Trustees Ltd v Evans* failed to consider what he was under a duty to consider. If the trustee has in accordance with his duty identified the relevant

198 [2014] EWHC 2753 (Ch), [2015] 2 All ER 581 (HHJ Barker) at [33]. Not considered on appeal: [2015] EWCA Civ 1140.

199 [2017] EWHC 676 (Ch) (Chief Master Marsh).

200 *Pitt v Holt, Futter v Futter* [2013] UKSC 26, [2013] 2 AC 108, per Lord Walker at [40].

201 *Abacus Trust Co (Isle of Man) v Barr* [2003] EWHC 114 (Ch), [2003] Ch 409 (Lightman J) at [23].

considerations and used all proper care and diligence in obtaining the relevant information and advice relating to those considerations, the trustee can be in no breach of duty and its decision cannot be impugned merely because in fact that information turns out to be partial or incorrect."

6.48 Judge Barker continued[202]:

> "[33] Applying the above proposition from *Pitt v Holt* to the footnote in McPherson citing *Burnell's Pty (in liq)*, a liquidator will not have taken proper advice where the instructions to the adviser were flawed (partial or incorrect) by reason of a failure on the part of the liquidator to identify relevant considerations, or a failure to use all proper care and diligence in obtaining information relevant to the instructions given, or a failure to use all proper care and diligence in obtaining information relevant to the advice obtained."

Power Adhesives

6.49 In *Power Adhesives Ltd v Sweeney*[203] directors had decided to convert a debt into shares. They had taken tax advice*,* but this was held to have been insufficient and so their decision was a breach of duty and so overturned.

Davey v Money

6.50 In *Davey v Money*[204] Snowden J dismissed a claim against administrators alleging that they had relied on defective advice and sold property at an undervalue. Snowden rejected an argument that *Pitt v Holt* meant that an administrator could be liable, even if they were following professional advice if their decision, judged objectively was unreasonable. Snowden J rejected an analogy for administrators with the position of receivers and mortgagees, who can be liable if their agent was negligent. He noted that if any relevant agent employed by the administrator were negligent the claim against the agent would be an asset of the company (unlike the position of a receiver or mortgagee). Accordingly he held that the administrators could not be liable in negligence to the company if they reasonably relied on professional advice that appeared to be competent.

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202 This paragraph is cited in the preliminary decision in *British Airways Plc v Spencer* [2015] EWHC 2477 (Ch), [2015] Pens LR 519 (Warren J) discussing the need for expert evidence in what became *British Airways Plc v Airways Pension Scheme Trustee Ltd*.

203 [2017] EWHC 676 (Ch) (Chief Master Marsh).

204 [2018] EWHC 766 (Ch) (Snowden J) at [444].

Daniel v Tee

6.51 Interestingly in 2016 in the private trust case *Daniel v Tee*[205] the judgment does not refer to *Pitt v Holt*, despite the claim by the beneficiaries against the trustees relating to whether the trustees had exercised their investment power properly and including a discussion of how far professional trustees could be held "to have acted imprudently by relying on the advice of independent financial advisers which transpires to be incorrect"[206].

Negligence claims against advisers?

6.52 It could be said that if trustees take professional advice then they should be able to rely on it. If the advice is wrong or misleading or leads to the trustees making the wrong decision, the remedy is a claim by them against their advisers for negligence. Indeed many of the *Hastings-Bass* line of cases were probably attempts to reverse the relevant mistake rather than claim on the advisers (the advisers, or their insurers, perhaps funding the litigation as a pre-cursor to defending a negligence claim).

6.53 However, as the Scottish Law Commission pointed out[207], claims against advisers may well be problematic or difficult to prove (did the scope of their advice cover the point raised, were they given proper instructions, are there any limitation provisions). In addition, in the case of trustees, the legal nature of the claim against advisers, there can be conceptual difficulties if loss has been suffered by the beneficiaries rather than the trustees personally (eg because the loss is a tax payable by the beneficiary and not the trustees)[208].

6.54 The SLC commented:

> "19.13 …. in many cases where powers are exercised defectively the reason will be incorrect legal advice. We noted that it was true that in such cases there might well be a right of action against the professional advisors for their negligence, but we thought that this was not a complete answer. In a typical trust situation, proceedings for professional negligence are far from straightforward. Establishing negligence may not be easy in cases where, for example,

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205 [2016] EWHC 1538 (Ch), [2016] 4 WLR 115, [2016] PNLR 33 (Richard Spearman QC). The judge followed at [44] Neuberger J's decision at first instance in *Wight v Olswang (No.2)* [2000] Lloyd's Rep PN 662, [2000] WTLR 783, (2000) 2 ITELR 689 that a negligence claim against trustees for failing to sell shares could only succeed if it could be shown that no reasonable trustee would have made the same decision. There is no express mention in *Daniel v Tee* or *Wight v Olswang* of the first limb *Braganza* / *Wednesbury* "relevant factor test".

206 At [1].

207 *Report on Trust Law* (Scot Law Com No 239, August 2014), Chapter 19 '*Defects in the exercise of trustees' powers*'.

208 Further on this, see the discussion in T Rosen Peacocke, '*Liability of professionals retained by settlors and trustees following Pitt v Holt/Futter v Futter*' (2011) 25 TLI 125 and in Christopher Nugee '*Suing for losses to a pension scheme - some issues*' (2001) 15 TLI 83.

the relevant tax law is not clear. Furthermore, professional advice will normally be given to the trustees with the result, at least in Scots law, that only the trustees had title and interest to sue for professional negligence. They are not, however, the parties who normally suffer the loss; the loss is likely to be suffered by beneficiaries, who would lack title and interest to sue because they had no contact with the professional advisors. The defence might therefore be mounted that trustees themselves had suffered no loss and so should recover nothing.

19.14 We thought it possible to avoid this problem using a technique, developed in the field of building contracts, whereby one party to a contract can recover for losses suffered by others but subject to an obligation to account for any damages recovered to those others. Nevertheless, the fundamental point remained that proceedings for professional negligence would not be entirely easy. Furthermore, the powers in question would normally be discretionary, and in such a case the beneficiaries have no pre-existing right to any property, and only obtain property through the acts of the trustees. If, therefore, the beneficiaries receive less than they might have hoped for because of a tax liability, can it be said that their position is any worse than it was before the power was exercised? In short, the complexities involved in actions for professional negligence were such that we thought that a more direct remedy, that of reduction of the exercise of the discretionary power, was more satisfactory."

7. Three types of relevant factors: The public law approach

7.1 The two key cases on relevant factors in public law are:

- the House of Lords in *In re Findlay*[209]– applying the New Zealand decision in *CREEDNZ*[210]; and
- the Court of Appeal in *R (Khatun) v Newham LBC*[211].

Three categories of factors: obligatory/impermissible/permissible

7.2 These judicial review cases divide relevant factors into three categories:

(a) Those that are required to be taken into account (the *obligatory considerations*). These are identified, either expressly or impliedly, in the statute that confers the power.

(b) Those that are required not to be taken into account (the *impermissible considerations*).

209 [1985] AC 318, HL at 333-334.
210 *CREEDNZ Inc v Governor-General* [1981] 1 NZLR 172.
211 [2004] EWCA Civ 55 at [34].

(c) The remainder, where the decision-maker may choose for him or herself whether or not to take it into account (the *permissible considerations*).

7.3 In public law this follows from the judgment of Lord Scarman in *Re Findlay*[212] (1985), citing *CREEDNZ*[213] from New Zealand:

> "But this is not the end of the contention. Counsel for the applicants also invoked the 'Wednesbury principle' (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) submitting that no reasonable Home Secretary could have reasonably omitted to consult the board. He prayed in aid some observations of Cooke J in the New Zealand case of *CREEDNZ Inc v Governor-General* [1981] 1 NZLR 172. The facts of that case bear no resemblance to this case. But the judge did consider the question of the proper exercise of an administrative discretion in a situation where a statute permits but does not require consideration of certain matters. The judge said (at 183):
>
>> 'What has to be emphasised is that it is only when the statute expressly or impliedly identifies considerations required to be taken into account by the authority as a matter of legal obligation that the court holds a decision invalid on the ground now invoked. It is not enough that a consideration is one that may properly be taken into account, nor even that it is one which many people, including the court itself, would have taken into account if they had to make the decision.'
>
> These words certainly do not support the submission of counsel for the applicants. But, and it is this on which counsel has to found his argument, the judge in a later passage (at 183) did recognise that in certain circumstances, notwithstanding the silence of the statute—
>
>> 'there will be some matters so obviously material to a decision on a particular project that anything short of direct consideration of them by the Ministers … would not be in accordance with the intention of the Act.'
>
> These two passages are, in my view, a correct statement of principle."

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212 [1985] AC 318 per Lord Scarman at 333-334. This was approved in *R (Hurst) v London Northern District Coroner* [2007] UKHL 13 per Lord Brown at [57].

213 *CREEDNZ Inc v Governor-General* [1981] 1 NZLR 172. For a recent discussion, see Robert Williams '*From CREEDNZ to Cumberlege: A Review of the Law on Material Considerations*' (2017) Journal of Planning and Environment Law 1358.

7.4 Laws LJ in *Khatun*[214] held that in public law *CREEDNZ*[215] supported two points:

1. where a statute giving discretionary power does not expressly state ("provides no lexicon of") the matters to be treated as relevant by the decision-maker, then it is for the decision-maker (and not the court) to conclude what is relevant subject only to *Wednesbury* review; and
2. it is for the decision-maker (and not the court), subject again to *Wednesbury* review, to decide upon the manner and intensity of inquiry to be undertaken into any relevant factor accepted or demonstrated as such.

7.5 Laws LJ held at [35]:

> 35 In my judgment the *CREEDNZ Inc* case (via the decision in *In re Findlay*) does not only support the proposition that where a statute conferring discretionary power provides no lexicon of the matters to be treated as relevant by the decision-maker, then it is for the decision-maker and not the court to conclude what is relevant subject only to *Wednesbury* review. By extension it gives authority also for a different but closely related proposition, namely that it is for the decision-maker and not the court, subject again to *Wednesbury* review, to decide upon the manner and intensity of inquiry to be undertaken into any relevant factor accepted or demonstrated as such.
>
> This view is I think supported by the judgment of Schiemann J in *R v Nottingham City Council, Ex p Costello* (1989) 21 HLR 301…. That case concerned the degree of inquiry which an authority was obliged to undertake into issues of priority need and intentional homelessness. Schiemann J said, at p309:
>
> > "In my view the court should establish what material was before the authority and should only strike down a decision by the authority not to make further inquiries if no reasonable council possessed of that material could suppose that the inquiries they had made were sufficient."
>
> This approach is lent authoritative support by the decision of this court in *R v Kensington and Chelsea Royal London Borough Council, Ex p Bayani* (1990) 22 HLR 406, which was concerned with the authority's duty of inquiry in a homelessness case. Neill LJ said, at p415:

214 *R (Khatun) v Newham LBC* [2004] EWCA Civ 55, [2005] QB 37 per Laws LJ at [34].

215 *CREEDNZ Inc v Governor-General* [1981] 1 NZLR 172, NZ CA.

"The court should not intervene merely because it considers that further inquiries would have been sensible or desirable. It should intervene only if no reasonable housing authority could have been satisfied on the basis of the inquiries made."

Applying this three way split to private law

7.6 This three way divide between obligatory, permissible and impermissible factors used in public law, seems to us to be highly suitable for use in the private law *Braganza* tests as well. There is no clear case law on this point in the private law sphere, but in our view there is no reason why the courts should not follow public law in this area, despite the warnings of caution from Lord Walker in *Pitt v Holt*[216] about the use of public law (see above). This is supported by the fact that the caselaw on private law decisions on the weight to be given to the relevant factors has already followed public law (see below).

7.7 There are indications that such a three way categorisation is appropriate in private law cases as well. Some of the case law dealing with trustees indicates that the relevant duty of due consideration is subject to a reasonableness limit (which will depend on the circumstances).

8. <u>Limits on enquiries</u>

8.1 Trustees when considering exercising a power of distribution need to consider the size and composition of the relevant class, but this does not mean that they "must worry their heads to survey the world from China to Peru", in the colourful phrase used by Harman J[217] (echoing Dr Johnson) if it is clear who are the prime candidates for the exercise of the trustees' discretion.

8.2 Similarly in Australia, in *Alcoa of Australia Retirement Plan Pty Ltd v Frost*[218] Nettle JA in the Victorian Court of Appeal held:

"Superannuation fund trustees are bound to give properly informed consideration to applications for entitlements and, if that necessitates further inquiries, then they must make them.[16]

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216 [2013] UKSC 26, [2013] 2 AC 108 at [11].

217 *In re Gestetner Settlement* [1953] Ch 672 (Harman J) at 688-689. See also *Re Baden's Deed Trusts (No 1)* [1969] Ch 388 and Lord Walker in *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26, [2003] 2 AC 709 at [41]. Mark Studer noted in '*Modern trustee decision-making: unpacking the duty of proper consideration*' (2016) 22 Trusts & Trustees 991 at 994, fn26 that the reference is to the opening lines of Dr Johnson's '*The Vanity of Human Wishes, The Tenth Satire of Juvenal Imitated*' (1749).

218 [2012] VSCA 238, 36 VR 618 per Nettle JA at [59] and [60].

[16] *Kerr v British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071, 1079 (Fox LJ); *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27 [1991], 1992 WL 895102, 7; *Vidovic v Email Superannuation Pty Ltd* (Unreported, NSWSC, 3 March 1995, BC9504297, Bryson J, 15–20); *Uncle v Parker* (1994) 55 IR 120, 123 (Santow J); *Sayseng v Kellogg Superannuation Pty Ltd* [2003] NSWSC 945, [59]–[60] (Bryson J); *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593, 601–2 (Waddell CJ in Eq); cf *Tuftevski v Total Risk Management Pty Ltd* [2009] NSWSC 315, [128] (Smart J); and see Campbell JC, *Exercise by superannuation trustees of discretionary powers* (2009) 83 ALJ 159, 167.

[60]. So to say does not mean that a trustee is required to do the impossible. Nor is it to suggest that a trustee is expected to go on endlessly in pursuit of perfect information in order to make a perfect decision. The reality of finite resources and the trustee's responsibility to preserve the fund for the benefit of all beneficiaries according to the terms of the deed means that there must be a limit. Like the judge below, I accept that a trustee is not expected to go on endlessly in pursuit of perfect information in order to make a perfect decision. The reality of finite resources and the trustee's responsibility to preserve the fund for the benefit of all beneficiaries according to the terms of the deed means that there must be a limit. . . . I accept that a trustee is not under an obligation to go on endlessly seeking more and more information".

8.3 Such limits on the extent of due consideration point to the relevant decision makers (here trustees) being able in some cases to limit their enquiries and so choose some of the relevant factors.

Esso Australia

8.4 The Australian case *Esso Australia Ltd v Australian Petroleum Agents' & Distributors' Association*[219] concerned the exercise of a discretion conferred upon the trustee of an industry fidelity fund. Hayne J held that a trustee is not under an obligation to take every possible matter into account, so long as all necessary matters are considered[220].

8.5 It had been submitted that the public administrative law test should apply (in Australia that under *Avon Downs v Federal Commissioner of Taxation*[221]), looking very similar to the *Wednesbury* test:

219 [1999] 3 VR 642 (Hayne J) at 652.
220 MW Bryan and VJ Vann '*Equity & Trusts in Australia*' (2012, CUP) at [17.51].
221 (1949) 78 CLR 353.

> "[38] It was submitted on behalf of Esso that a court asked to review the decision of trustees exercising a discretion should apply the same principles as have been developed in the judicial review of discretionary conclusions reached by administrative decision-makers and reference was made to the well-known statements of Dixon J. in *Avon Downs Pty. Ltd. v Federal Commissioner of Taxation* (1949) 78 C.L.R. 353 at 360 as a convenient statement of the principles to be applied. Thus, to paraphrase what was said in *Avon Downs*, it was submitted that if a trustee does not address himself to the right question, if his conclusion is affected by some mistake of law, if he takes some extraneous reason into consideration or excludes from consideration some factor which should affect his determination, on any of these grounds his conclusion is liable to review."

8.6 Hayne J accepted this, noting (at [39]) that it was consistent with the approach in the private law trust cases, *Re Beloved Wilkes* and *Karger v Paul*. He noted the difficulty in proving a failure to consider a relevant matter in the absence of a statement of reasons:

> "… in the absence of a statement of reasons, it will not usually be possible to conclude that the trustee has taken into account irrelevant matters or has failed to take into account relevant matters. First and foremost, it will not be possible to say from the decision reached by the trustee what it was that the trustee did (or did not) take into account.
>
> [40] Nor is the position any different if it is possible to identify what material was made available to the trustee for consideration. It will not be possible to conclude from the bare fact that a particular piece of information was available for consideration by the trustee that that information was taken into account by the trustee."

8.7 Hayne J went on to categorise that even if some material had been omitted, this would not invalidate the decision. Only if the material was such that the trustee "should" have taken into account, but not if the material "could or might" have affected the outcome. Hayne J held:

> "[41] If the material available to the trustee for consideration is examined, it may be said that there was other material that the trustee might have taken into account and that it is possible to infer that the trustee did not take this matter into account. But the omission of reference to some such matters in the material made available to the trustee does not mean that the conclusion reached by the trustee is shown to be ill founded. In *Avon Downs* Dixon J. spoke of the exclusion of some factor which *should* affect the decision, not of the exclusion of some factor which *could* or *might* affect the decision. The omission of material laid before a trustee would be significant only if the trustee should have taken it into account and the very premise from which the consideration of the present kind of problem proceeds is that

the trustee is not called upon to make a judgment reached by following one of a limited series of paths of reasoning: the trustee is to exercise a discretion."

Hayne J continued:

"The bare fact that there was material that was not placed before the trustee and which the trustee *might* have taken into account is not to say that the trustee should have considered it. Thus proof that there was material not considered by the trustee and which was material that the trustee might have taken into account does not show that the decision is ill founded."

8.8 This looks very similar to the public law three way categorisation of relevant factors described in *Re Khatun* and *CREEDNZ* discussed above. The permissible factors are ones which the trustee "could or might" have taken into account.

9. Weight given to factors

9.1 The weight that the decision maker gives to the relevant factors seems to be a matter for the decision maker to decide (subject itself to *Wednesbury* irrationality – presumably the full irrationality 2nd limb of no reasonable decision maker). This seems right in principle on the basis that the relevant instrument confers the decision on the decision maker (not the court) and so it is a judgement call for them.

Case law on weight

9.2 This is supported by the cases:

(a) **Employer/ Principal Company**: *IBM* at [238] and [247]:

"238. Mr Simmonds [counsel for IBM] also submitted first that, consistently with the essence of the rationality test, whether there had been a significant change in financial and economic circumstances was a matter for the decision-maker to consider, not an objective question for the court to decide, and secondly that the judge never dealt with that question, on whatever basis, as a matter of decision.

….

247. There is a good deal of force in Mr Simmonds' submission that, if [the judge] had asked himself the question, he must have found that there had been a relevant significant change, or, properly, that IBM could rationally have concluded that there had been such a

change. Whether or not that is so, it seems to us that the burden of proof on the RBs required them to prove that the Reasonable Expectations did outlast the 2008 crisis, and in the absence of a finding that there had not been a significant change in financial or economic circumstances, or that IBM could not rationally have considered that there had been such a change, in 2008, their case must fail for lack of proof."

(b) **Trustee:** *Edge v Pensions Ombudsman*[222] per Chadwick LJ at p626:

> "The essential requirement is that the trustees address themselves to the question what is fair and equitable in all the circumstances. The weight to be given to one factor as against another is for them."

9.3 Earlier in *Edge*, Chadwick LJ had ruled against any approach, to decisions by the Pensions Ombudsman, that asked whether the trustees had put sufficient weight on a particular factor to justify a decision. Chadwick LJ held (at p619):

> "He had asked himself whether, in the light of those matters, he thought the decision was "fair". The correct approach was to ask whether the matters were irrelevant; so that the trustees could be said to have acted irrationally or improperly in taking them into account. If the trustees were entitled to take these matters into account, then it was for the trustees – and not for the ombudsman – to decide what weight these matters should be given. In particular, it was for the trustees to decide whether the fact that pensioners were already adequately provided for by past increases in benefits and by index-linking was a sufficient ground~~s~~ for excluding them from further benefits. The fact that the pensioners were already adequately provided for (which was not challenged) could not be dismissed as irrelevant. The trustees' decision to give weight to that fact could not be categorised as irrational or improper. Further, the trustees were bound to have regard to the fact that the employers' consent had to be obtained. But it was for them to decide how far the employers could be pressed in negotiation. It was not for the ombudsman to substitute his own judgment for that of the trustees on a matter of this kind."

9.4 A similar position applies in Ireland. In *Greene v Coady*[223] Charleton J referred to the public law principles[224] and then to Chadwick LJ in *Edge* and ultimately held (at 4.2):

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222 [2000] Ch 602, CA.

223 [2014] IEHC 38 (Charleton J) at 4.0 to 4.2.

224 Citing *Kildare County Council v An Bord Pleanála* [2006] IEHC 173 (McMenamin J), which itself cited Lord Keith and Lord Hoffmann in *Tesco Stores Ltd v Secretary of State for the Environment* [1995] 1 WLR 759.

> "Therefore, once a factor can be taken into account, unless the weight attached to that factor can be analysed as being outside the range of what any reasonable body of trustees would give to it, the decision of the trustees must stand."

9.5 A similar position applies in Australia: *Mandie v Memart Nominees Pty Ltd*[225] and *Re Marsella; Marsella v Wareham (No 2)*[226].

Similar to public law

9.6 This again looks to be very similar to the test in public law; for example in *Khatun*[227] Laws LJ held (in a passage already cited above):

> "…. it is for the decision-maker and not the court, subject again to *Wednesbury* review, to decide upon the manner and intensity of inquiry to be undertaken into any relevant factor accepted or demonstrated as such."

Wednesbury irrationality limits on weight

9.7 It seems to us to be over-complicating matters if this 'weight' principle can be reviewed by the courts, save on the ultimate "no reasonable decision-maker" ground – ie the second limb of *Braganza* and *Wednesbury* and not the first.

9.8 It seems to us unlikely that decision maker's views on the weight to be given could itself be reviewed if the decision maker failed to consider all relevant factors in that decision. The various references to "irrationality" in this area seem to be referring just to the second limb (and not the first) of *Wednesbury* irrationality.

10. What is the second limb of the *Braganza* test?

10.1 Part of the mechanism by which the court seeks to ensure that the relevant contractual decision-making powers are not exercised irrationally is to apply the second limb of the so-called *Wednesbury* irrationality test; in so doing, the court asks whether the decision made is so unreasonable that no reasonable decision-maker could have come to it:

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225 [2018] VSC 719 (Ginnane J) at [154].

226 [2019] VSC 65 (McMillan J) at [36].

227 *R (Khatun) v Newham LBC* [2004] EWCA Civ 55, [2005] QB 37 per Laws LJ at [34]. See also *Tesco Stores Ltd v Secretary of State for the Environment* [1995] 1 WLR 759, HL per Lord Keith and Lord Hoffmann and *City of Edinburgh Council v. Secretary of State for Scotland* [1997] UKHL 38, [1998] 1 All ER 174, HL per Lord Clyde at p185.

> "The court is entitled to investigate the action of the local authority with a view to seeing whether they have taken into account matters which they ought not to take into account, or conversely, have refused to take into account or neglected to take into account matters which they ought to take into account. Once that question is answered in favour of the local authority, it may still be possible to say that, although the local authority have kept within the four corners of the matters which they ought to consider, they have nevertheless come to a conclusion so unreasonable that no reasonable authority could ever have come to it"

per Lord Greene MR in *Associated Provincial Pictures Houses Ltd v Wednesbury Corporation*[228].

10.2 Although this test is couched in terms of 'reasonableness', it is well established that the meaning of the term is different to that used when speaking, for example, of the duty to take reasonable care. The latter implies a far higher objective standard and accordingly more invasive role by the court. The difference was encapsulated by Lord Sumption in *Hayes v Willoughby*[229] as follows:

> "Rationality is not the same as reasonableness. Reasonableness is an external, objective standard applied to the <u>outcome</u> of a person's thoughts or intentions…A test of rationality, by comparison, applies a minimum objective standard to the relevant person's <u>mental processes</u>".

10.3 The difference in outcome resulting from this so-called minimum objective standard is that a decision pursuant to the *Wednesbury* rationality test purportedly remains that of the decision-maker, whereas on an application of the objective reasonableness test the decision-maker becomes the court itself (see Rix LJ in *Socimer International Bank Ltd v Standard Bank London Ltd*[230]*)*.

What does irrationality mean?

10.4 The question then arises as to what rationality or irrationality means in this context. Multiple terms have been adopted by the court by way of reference to the concept, perhaps demonstrating that while one might instinctively feel that one would recognise an irrational decision as such, it is less than straightforward to define irrationality in the abstract.

10.5 One reason for this is that, inevitably, any assessment of what is rational is highly fact specific; while it may be irrational to dismiss a red haired teacher on the basis of the colour of her

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228 [1948] 1 KB 223 at [233], approved by Lady Hale in *Braganza v BP Shipping Ltd* [2015] UKSC 17 at [24].
229 [2013] UKSC 17 at [14].
230 [2008] EWCA Civ 116 at [66].

hair, it will not be irrational to make a decision based on hair colour in the context of a trust established for the benefit of red-heads.[231]

10.6 Similarly in *Re Manisty's Settlement*[232] Templeman J cited, as an example of capricious decision making by trustees, the choosing of an object for distribution according to height, complexion or by reference to the irrelevant fact that he was a resident of Greater London. However, this was later qualified by Megarry V-C in *Re Hay's Settlement Trusts* [1982] 1 WLR 202 where he suggested that where the settlor was, for example, a former chairman of the Greater London Council, the residency of a discretionary object may well be relevant and a rational factor to consider.

10.7 Rationality has been referred to as "*an absence of arbitrariness, of capriciousness or of reasoning so outrageous in its defiance of logic as to be perverse"* (per Lord Sumption in *Hayes v Willoughby* at [14], echoing Rix LJ in *Socimer International Bank Ltd* at [66]).

10.8 However, what do words such as "arbitrary", "capriciousness' or "perversity" actually mean? Manifesting the somewhat unhelpful circularity with which these terms tend to be defined by the Court, a perverse decision has been categorised as "*a decision to which no reasonable body of trustees could arrive"*[233].

10.9 Similarly it has been said that "caprice or capriciousness" are good examples of perversity[234], that perversity will be manifest where "no reasonable employer would have exercised his discretion in this way"[235], and that "capriciously" means acting for reasons which are irrational or perverse.[236]

10.10 In *Braganza* itself the Supreme Court endorsed the interpretation of rationality as being a lack of arbitrariness, capriciousness or perversity.[237] However, yet again this goes no further in identifying the substance of what makes a decision arbitrary, which in any event may not be the same as the rationality test, as transpires from the Court of Appeal decision in *IBM v Dalgleish*[238]:

> "The correct[239] approach is to apply a rationality test equivalent to that in Wednesbury…Both limbs of the test can apply, but it was not argued in the present case that any irrelevant matter had been taken in to account, or any relevant matter left out of account. Therefore the question

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231 See David Pollard "*Braganza: the new Donoghue v Stevenson*" at 19.8, and Lord Greene MR in *Wednesbury* at 229.
232 [1974] Ch 17, 26.
233 *Harris v Lord Shuttleworth* [1995] OPLR 79 per Glidewell LJ.
234 Burton J in *Clark v Nomura International Plc* [2000] IRLR 766 at [40].
235 Ibid.
236 *Re Manisty's Settlement* per Templeman J at [26C].
237 Lady Hale at [23] and Lord Neuberger at [103].
238 [2017] EWCA Civ 1212.
239 At [232].

was whether the decision taken was one which no rational decision-maker could have reached. Although the judge directed himself that the test to be applied was one of capriciousness, perversity or arbitrariness, which is close to the rationality test, he accorded an overriding substantive significance to the Reasonable Expectations such that they could only lawfully be disappointed in a case of necessity, which is not compatible with the correct approach".

10.11 Unfortunately, the Court of Appeal resisted the temptation to further clarify the substance of the rationality test, although the prolific mention of the word "perverse" in its judgment suggests that the distinction drawn by the court may not be overly significant in practical terms.

10.12 Lord Diplock has gone further than most in articulating the test of irrationality, in particular by way of reference to the outrageousness of a decision:

"By 'irrationality' I mean what can by now be succinctly referred to as 'Wednesbury unreasonableness'…It applies to a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it".[240]

10.13 That formulation was adopted both by Lord Sumption who, in setting out the test of rationality, referred to the "absence of arbitrariness, of capriciousness or of reasoning so outrageous in its defiance of logic as to be perverse"[241] and by Lady Hale in *Braganza* at [23]:

"The first limb focusses on the decision-making process – whether the right matters have been taken into account in reaching the decision. The second focusses upon its outcome – whether even though the right things have been taken into account, the result is so outrageous that no reasonable decision-maker could have reached it. The latter is often used as a shorthand for the Wednesbury principle, but without necessarily excluding the former".

10.14 The Court of Appeal in *IBM v Dalgleish* at [228], quoting all three of Lord Diplock, Lord Sumption and Lady Hale, likewise concluded that the question as to whether an employer had acted rationally needed to be tested:

"…by reference to one or both of these formulations: was the decision by Holdings or by UKL so outrageous in its defiance of logic or accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it, or is it completely lacking

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240 *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374 at [410].
241 *Hayes v Willoughby.*

in any logical connection between the relevant circumstances and the ostensible reasons for the decision?".

10.15 Despite the courts' efforts to clarify the nature of the rationality test, it is fair to say that its precise substance remains elusive. As a result, the safest way to characterise the test may well be as a somewhat nebulous common-sense check on a relevant decision.

What is the threshold/hurdle?

10.16 It seems that the intensity of judicial scrutiny under the second limb may well depend on the context of the decision in question, so that a decision taken in the context of a commercial contract, for example, may be subject to lighter judicial scrutiny than one taken in an employment context; Lord Hodge in *Braganza* commented that:

> "The personal relationship which employment involves may justify a more intense scrutiny of the employer's decision-making process than would be appropriate in some commercial contracts.
>
> The scope for such scrutiny differs according to the nature of the decision which an employer makes… In cases such as *Clark v Nomura International Plc, Keen v Commerzbank AG*, and *Horkulak v Cantor Fitzgerald International* [2005] ICR 402 the courts have reviewed contractual decisions on the grant of performance-related bonuses where there were no specific criteria of performance or established formulae for calculating a bonus. In such cases the employee is entitled to a bona fide and rational exercise by the employer of its discretion. The courts are charged with enforcing that entitlement but there is little scope for intensive scrutiny of the decision-making process. The courts are in a much better position to review the good faith and rationality of the decision-making process where the issue is whether or not a state of fact existed.. "[242]

10.17 Further, the rationality test is framed in terms of a decision that "no sensible person",[243] "no reasonable decision-maker",[244] "no rational decision-maker"[245] etc. would have made. That is to say, it would appear to be sufficient merely to show that one reasonable person would have come to the same decision in order to successfully defend an allegation of irrationality. This seems to have been the conclusion of Etherton C in *Arbuthnott v Berryman*[246]:

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[242] At [55]-[57].
[243] *IBM v Dalgleish, Council of Civil Service Unions* at [410].
[244] *Braganza.*
[245] *IBM v Dalgleish.*
[246] [2015] EWCA Civ 536 at [108].

"The test is not whether all reasonable people would have agreed that the amendment was in the best interests of the company. It is sufficient that a reasonable person could have thought it was in the company's best interests."

10.18 It is suggested that such an interpretation must be correct, reflecting as it does the many guises of what can be deemed reasonable, as well as the importance highlighted in *IBM v Dalgleish* that in cases involving the exercise of an employer's discretionary powers "the court does not and must not substitute its own decision for that of the decision-maker".[247]

10.19 In practical terms, the result is that the burden of establishing that a decision was irrational under the second limb (which falls on the challenger), is a heavy one and has accordingly been described variously as a "very high one" requiring an "overwhelming case"[248] and a "severe" test.[249]

10.20 This is reflected in the fact that the weight to be afforded to relevant factors, in line with the decision in *Edge v Pensions Ombudsman*[250], appears to be a matter for the relevant decision maker save that it too must be subject to the second limb of the *Wednesbury* irrationality test:

"If the trustees were entitled to take those matters into account, then it was for the trustees - and not for the ombudsman - to decide what weight those matters should be given…The trustees' decision to give weight to that fact could not be categorised as irrational or improper."

10.21 In terms of the background against which irrationality is to be assessed, the relevant circumstances are those that existed at the time the decision was made and in light of the information that could reasonably have been available to the decision maker at that time. So in *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*[251], Browne-Wilkinson V-C held:

"In my judgment the obligation of good faith resting on the company as employer requires that it should consider each proposal for amendment under clause 36 put forward by the committee at the time it is put forward in the light of the circumstances that then exist".

10.22 This was cited with approval in *IBM v Dalgleish* at [336]:

"It is clear from the *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589 at 599B, that the employer must take into account all the circumstances existing at the date of its decision. It follows that all circumstances of the case must be taken into account in

247 At [45].
248 *Keen v Commerzbank AG* [2006] EWCA Civ 1536, [2007] ICR 623.
249 *Prudential Staff Pensions Ltd v The Prudential Assurance Co Ltd* [2011] EWHC 960 (Ch), [2011] Pens LR 239.
250 [2000] Ch 602.
251 [1991] 1 WLR 589 at 599B.

> determining rationality. So, to revert to the example we have already given, it would be relevant to take into account adverse trading conditions to which the employer was subject".

10.23 Irrationality is therefore not to be assessed with the benefit of hindsight or by reference to facts that were not available to the decision-maker at the time, subject to any duty on the decision maker to inform himself prior to making a decision.

How can you protect yourself from attack on grounds of irrationality?

10.24 The key question that arises is: how can one protect a decision from attack on ground of irrationality under the second limb?

10.25 Most importantly, it is suggested that the circumstances in which a decision can be declared irrational where all the relevant and irrelevant factors have been identified, considered and/or disregarded as the case may be, will be limited. If that is right, the most effective way to insulate a decision from attack will be to focus on the first limb of the *Braganza* test and seek advice as to the factors that ought to be considered. As Lord Hodge in *Braganza* commented:

> "I think that it is difficult to treat as rational the product of a process of reasoning if that process is flawed by the taking into consideration of an irrelevant matter or the failure to consider a relevant matter".[252]

10.26 In *Edge v Pensions Ombudsman*[253], the focus was similarly on the taking into account of irrelevant factors, together with the weight afforded to each factor, as a ground for irrationality:

> "The Vice-Chancellor then turned to the ombudsman's criticisms of the matters which the trustees had said that they had taken into account in reaching their decision. He pointed out that the true question, in relation to those matters, was not whether the ombudsman thought they were sufficient to justify the decision; but whether they were matters to which the trustees were entitled to have regard at all. The ombudsman had applied the wrong test. He had asked himself whether, in the light of those matters, he thought that the decision was "fair". The correct approach was to ask whether the matters were irrelevant; so that the trustees could be said to have acted irrationally or improperly in taking them into account".

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252 At [53].
253 [2000] Ch 602.

10.27 Equally importantly, one should have regard to the rationality test and its potential as a ground of challenge prospectively, when considering the future terms of a potential contractual discretion; it has been said that where the discretion is wide, the burden on a challenger is “a very high one”,[254] a factor which may be well worth keeping in mind at the drafting stage to reduce the likelihood of a successful challenge on the ground of irrationality further down the line.

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[254] *Keen v Commerzbank AG* at [39].

Lining up for landing: Lessons from the British Airways case

James Walmsley, James McCreath and Michael Ashdown

Introduction

1. British Airways' long-running dispute with the trustees of the Airways Pension Scheme has over the past six years given rise to a plethora of novel and interesting questions. Now that it is on the verge of settlement – heading off a planned trip to the Supreme Court in July 2019 – we propose to take the opportunity to look back at the changes this case has wrought to pensions law, and to reflect on the questions it leaves unanswered.

2. The history of the dispute will be well known to most pensions lawyers, and so is set out here only in abbreviated form. A fuller account can be found in the judgments of Morgan J after trial,[255] and Patten LJ in the Court of Appeal.[256]

The Airways Pension Scheme

3. The Airways Pension Scheme ("APS") is a defined benefit balance-of-cost scheme established in 1948 for employees of three state-owned airlines, the British Overseas Airways Corporation, the British European Airways Corporation and the British South American Airways Corporation. Although established by deed and rules in the ordinary way, those governing documents had to be brought into force by the Minister of Civil Aviation, who promulgated for that purpose the Airways Corporations (General Staff Pensions) Regulations 1948. The deed remains in effect, though repeatedly amended over the last seven decades. The original rules have been supplemented by further sets of rules for different "parts" of the scheme, and the recent proceedings have primarily concerned what is known as Part VI, the rules of which were introduced by amendment in 1973. APS closed to new members in 1984.

4. The Part VI rules provide for pensions in deferment to be increased in accordance with the Pension Increase (Review) Orders ("PIROs") made annually by the Treasury. For many years these PIROs were made to reflect the change in the Retail Prices Index ("RPI") over the past year. On 22 June 2010 the Chancellor of the Exchequer announced that henceforth public sector pensions

[255] *British Airways plc v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch), [2017] Pens LR 16 at [15]-[121].
[256] *British Airways plc v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533, [2018] Pens LR 19 at [1]-[36].

would receive increases calculated by reference to the Consumer Price Index ("CPI") rather than RPI increases. From 2011, PIROs have been set by reference to CPI rather than RPI.

5. The trustees of APS in 2010 comprised 6 employer nominated trustees ("ENTs") appointed by BA, and six member nominated trustees ("MNTs) elected by the members and pensioners of APS.[257] After the change from RPI to CPI increases was announced, a member-led campaign to "reinstate" RPI increases began, and the Trustees considered what steps (if any) they ought to take in response. They were advised that under clause 18 of the APS deed, they could amend the deed or rules by a two-thirds majority of the trustees, without the approval of BA. Although some MNTs were keen to use this power to hard-wire RPI into the Part VI rules, this did not command two-thirds support.

6. The Trustees eventually decided to introduce a discretionary increase power: they used the power of amendment in clause 18 to confer on themselves the power to grant, by a vote requiring a two-thirds majority, discretionary pension increases in excess of those provided automatically by the Part VI rules ("the DI Power"). Trustee votes in 2011 and 2012 did not garner sufficient support to award any increase. But in November 2013 the Trustees finally voted 8-4 in favour of a 0.2% increase for 2013, reflecting half the 0.4% difference between RPI and CPI in that year.

The litigation

7. BA had consistently objected to the Trustees' proposals to award increases above CPI, and in December 2013 BA issued proceedings alleging that the Trustees' decisions (i) in 2011 to amend the Part VI Rules to confer the DI Power on themselves, and (ii) in 2013 to exercise the DI Power and grant a 0.2% increase, were invalid on a wide variety of grounds. In particular, BA alleged that the Trustees' decisions were invalid because:

    (1) They were outside the true scope of the power of amendment, which was limited by the prohibitions in the scheme on (i) making benevolent and compassionate payments, and (ii) amending the scheme so as to change its purpose.

[257] In 2016 the 12 individual trustees became directors of the Airways Pension Scheme Trustee Ltd, which replaced them as sole trustee of APS. But nothing turns on this, and for convenience both the earlier individual trustees and then the corporate trustee are referred to as "the Trustees".

(2) The Trustees exercised their powers for an improper purpose, namely giving themselves the power to augment pensions, which is not properly part of the Trustees' function.

(3) The MNTs had pre-determined the result they intended, namely to return to RPI increases, or as near to that as they could manage, and so failed to give genuine consideration to the exercise of their powers.

(4) The Trustees failed to take account of all relevant and no irrelevant considerations, including failing to take account of BA's wishes and interests.

8. The Trustees sought *Beddoe* relief, to obtain the Court's permission to fund their defence from APS assets. This was granted by the Chancellor, who directed the Trustee to defend BA's claim until completion of disclosure. BA subsequently admitted the Trustee's counterclaim for an indemnity in respect of the costs of the proceedings pursuant to the provisions of the APS deed and rules, and pursuant to a consent order made by Birss J subsequently met both parties' costs down to trial.

9. At trial before Morgan J, BA's claim was rejected and the Trustees' decisions were upheld (at [635]). On the facts, Morgan J decided (at [574]-[578]) that whilst some criticisms could be made of the conduct of some MNTs' in 2010 and 2011, by the time they exercised the DI power in 2013 their attitudes had changed: they took proper account of the professional (legal, actuarial, covenant) advice they received, and genuinely considered the exercise of the DI power. Morgan J also held (at [579]-[629]) that the trustees had not, on the facts as he found them, failed to take account of all relevant and no irrelevant considerations.

10. On the law, Morgan J rejected BA's case on both scope and proper purpose. In relation to the scope of the power of amendment and the DI power, Morgan J found (at [478]) that the discretionary increases were not benevolent or compassionate because they were made to all pensioners irrespective of personal circumstances. A payment could only be benevolent or compassionate if it was awarded to an individual, based on their personal circumstances, and not to an entire class.

11. In relation to proper purpose, Morgan J rejected (at [423]) BA's case that the fundamental purpose of an occupational pension scheme is to deliver part of an overall remuneration package set by an employer to encourage and reward the staff who work for them and who obtain deferred remuneration through the scheme, and that exercising the power of amendment with the purpose of enabling the trustees to themselves set the benefits members would receive was

therefore an exercise for an improper purpose. Instead Morgan J considered that there was no purpose restriction which prevented the power of amendment being used to create the discretionary increase power, because the purpose of the scheme was simply to deliver pension benefits "*as defined from time to time*". The Trustees had validly amended those benefits.

BA's appeal to the Court of Appeal

12. With permission given by Morgan J, BA appealed on these two points of law only: that the Trustees' exercise of the power of amendment, and (if validly introduced) of the DI power was invalid as done for an improper purpose or outside the true scope of the power. There was no appeal from Morgan J's findings of fact, or his rejection of BA's factual arguments. By consent, the earlier order of Birss J concerning costs was extended to encompass the costs of the appeal, such that both parties' costs were (as at trial) met by BA.

13. After a two-day hearing in the Court of Appeal in May 2018, BA's appeal was allowed by a 2-1 majority (Lewison and Peter Jackson LJ; Patten LJ dissenting).

14. BA's appeal in relation to scope was dismissed unanimously. However, although Patten LJ and Peter Jackson LJ agreed with Morgan J's decision, they declined to follow his reasoning. Patten LJ considered the evidence as to why clause 2 of the APS deed – prohibiting benevolent or compassionate payments – was drafted as it is, and thought that it was fairly inconclusive, showing little more than that clause 2 was inserted to ensure that the Scheme obtained Revenue approval. However, he took from this that the draftsman would have "*wanted to emphasise that the scheme was one which provided only pension benefits to members entitled to them and did not make benevolent or compassionate payments*" (at [81]). Patten LJ therefore considered that the relevant distinction was between "*pension benefits on retirement in accordance with the provisions of the scheme and purely gratuitous payments of a benevolent or compassionate kind which are not pension payments*" (at [82]). This was quite different from Morgan J's concern with whether a benefit was payable to an individual or to a class. But both Patten LJ and Peter Jackson LJ shared Morgan J's focus on the nature of the benefit paid, rather than on the reason why it was paid, with Patten LJ saying expressly that the "*fact that the motivation for a general increase in the pensions payable may include an element of generosity does not make the payment a benevolent one*" (at [82]).

15. BA's appeal in relation to proper purpose was successful. Lewison LJ accepted that the proper purpose doctrine was applicable here, and that it involves a much wider enquiry than simply construing the trust deed and rules, and quoting Lord Sumption in *Eclairs Group Ltd v JKX Oil and Gas plc* [2015] UKSC 71 at [15]:

> "*The important point for present purposes is that the proper purpose rule is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication. It is concerned with abuse of power, by doing acts which are within its scope but done for an improper reason.*"

16. Lewison LJ noted (at [101]) that clause 4(a) of the trust deed provides that the Trustees "*shall manage and administer the Scheme*", and considered this to accord with his understanding of the function of pension scheme trustees, being "*to manage and administer the scheme; not to design it.*" This was supported by other provisions of the trust deed, such as clause 11 which deals with surplus, and provides for the employer to get a contribution holiday. Lewison LJ considered (at [94]) that if the trustees were right that they could use the amendment power to redesign benefits, there would be nothing to stop them from abolishing the contribution holiday and augmenting benefits instead. Finally, Lewison LJ agreed with BA that although various first-instance decisions appear to permit trustees to make changes to benefit structure without employer agreement, these were all cases where either (i) the increased benefits were to be paid for out of surplus, or (ii) the trustee was proposing to increase contributions in order to fund benefits already promised.

17. Peter Jackson LJ agreed with Lewison LJ, adding (at [121]) that he thought the Trustees had impermissibly "*added the role of paymaster to their existing responsibilities as managers and administrators*". Peter Jackson LJ also rejected the Trustees' argument that the proper purpose restriction sought by BA was unnecessary, because BA was already adequately protected by its ability to appoint the six ENTs, the need for a two-thirds majority for any amendment or exercise of the DI power (i.e. including at least two ENTs), and its ability to challenge a decision if irrational or perverse, or failing to take account of all relevant and no irrelevant considerations. Peter Jackson LJ considered (at [122]) that "*These are brakes on the power of amendment, but the question here is not whether the brakes are working but whether the journey itself is permitted.*"

18. Patten LJ dissented, and would have dismissed BA's appeal on proper purpose. In Patten LJ's view (at [68]-[70]), the overall object and purpose of APS is expressly identified in its objects clause as the provision of pension benefits on retirement. The proper purpose doctrine could have no application unless it was clear that the Trustees intended to use the powers they were granted to achieve something which could be characterised as improper, namely something which did not amount to the provision of pension benefits on retirement. Understood in that narrow way, there would be no infringement of the proper purpose rule in this case.

Trustees' appeal to the Supreme Court, and settlement

19. The Trustees sought and were given the Court of Appeal's permission to appeal to the Supreme Court, on the single ground that the majority of the Court of Appeal was wrong in law to find that the Trustees exercised the amendment power for an improper purpose, and that the introduction of the DI Power was therefore invalid. The appeal was due to be heard in July 2019.

20. BA was not willing to fund the costs of a further appeal in the proceedings, and therefore in order to be able to pay for the appeal from APS funds, the Trustees returned to the High Court in December 2018 to seek *Beddoe* relief. This was granted by Arnold J, save that the Trustees' indemnity from APS was capped at £1.034m.

21. On 8 April 2019, the Trustees announced[258] that they had agreed terms with BA to settle these proceedings, including the Supreme Court appeal, on terms which would permit discretionary increases so that APS pensions would be increased up to the annual change in RPI from 2021, subject to affordability tests, and BA ceasing to pay deficit repair and other contributions in excess of it ongoing liability for the few remaining active members. This compromise is subject to approval by the High Court, with a hearing listed for early July 2019.

***Beddoe* relief for a Supreme Court appeal**

22. In circumstances where one of the most interesting pensions decisions of recent years had been the subject of a controversial split Court of Appeal decision, and was on its way to the Supreme Court, it is perhaps not terribly surprising that the Trustees' application for *Beddoe* relief in late 2018 did not attract a great deal of attention.

23. However Arnold J's decision[259] is a startling and potentially far-reaching one for all future pensions litigation, as it very substantially widens the circumstances in which it will be permissible to fund appeals out of scheme assets.

Beddoe relief and appeals

24. It is well known to both trusts and pensions lawyers that trustees have to be careful about paying for litigation from trust assets. In particular, where trustees are unsuccessful in bringing or defending a claim, they are at risk of it being said that the sums they have expended are not

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[258] https://www.mybapension.com/aps/news/other-news.
[259] *Airways Pension Scheme Trustee Ltd v Fielder* [2019] EWHC 29 (Ch) [2019] 4 WLR 9.

"*expenses properly incurred*"[260] and that they must therefore meet them from their own resources and not the scheme's. It is for this reason that *Beddoe* relief is sought, especially in the context of occupational pension schemes where the sums involved may be substantial and the proposed litigation (as in BA's case) both complex and expensive.

25. Where *Beddoe* relief is given, it is because the Court takes the view that it is in the members' interests that the proposed claim be brought or defended by the Trustees, rather than either not pursuing the claim or defence at all, or leaving it to someone else – such as an individual member or class of members – to do so at their own expense.

26. The outcome of *Beddoe* hearings can be difficult to predict, as the Court weighs a number of competing and sometimes finely-balanced considerations, including the prospects of a successful claim or defence, the cost and other consequences of failure, the scheme's ability to meet such costs, and the interests of different classes of members, which may not be aligned e.g. where proposed litigation is for the benefit of, say, pensioners, but not active or deferred members, but any adverse costs will impact the whole scheme.

27. That has not, however, been the case in the past in relation to appeals, as the law has been crystal-clear: "*A trustee who appeals from an order made in proceedings concerning the construction of the trust and similar proceedings does so at his own risk as to costs*", because "*the order made at first instance operates to protect and indemnify the trustee and there is no need for him to appeal*": Lewin on Trusts (19th edn) at 27-153.

28. The leading case is the decision of the Court of Appeal in *Re Londonderry's Settlement*.[261] The trustees had sought the Court's directions as to whether they were bound to disclose certain trust documents at the request of a beneficiary. Plowman J decided that they were, and the trustees appealed. Harman LJ (with whom Danckwerts LJ agreed[262]) held that this was "*an irregularity*", because *"[t]rustees seeking the protection of the court are protected by the court's order and it is not for them to appeal. That should be done by a beneficiary…"*.[263] Although the Court did proceed to determine the appeal, Harman LJ considered that the Court was "*in some embarrassment*", and that it did so only "*in mercy to the parties, and having heard argument over more than two days*".[264]

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[260] Trustee Act 2000, s 31.
[261] *Re Londonderry's Settlement* [1965] Ch 918.
[262] At 934.
[263] At 930.
[264] At 931.

29. Although the Court of Appeal did not refer explicitly to the costs implications of an appeal by trustees, it is clear that it did not consider that trustees should be entitled to appeal at the expense of the trust fund, since it did not consider that the trustees should appeal at all. If, as the Court of Appeal suggested, an appeal should properly be for a beneficiary, that beneficiary would appeal at his or her own risk as to costs.

30. That is plainly right: where there is a dispute as to a point of law concerning construction of the trust deed or the function of the trustees, the beneficiaries and others should fight it out on the basis that the loser pays the winner's costs, as in any other litigation. The trustees should remain neutral, and are entitled to meet the cost of doing so from the fund.

The Trustees' application

31. It was against this rather unpromising backdrop that the Trustees' asked Arnold J to permit them to spend £1.24 million of APS funds pursuing their appeal to the Supreme Court, in what Arnold J accurately described as "*unprecedented circumstances*".[265]

32. The Trustees' overarching case (supported by Mr Fielder, the representative beneficiary) was that there is no "*inflexible rule*" but rather that trustees' should be entitled to appeal at the trust's expense (and risk of adverse costs orders) whenever such an appeal would be in the interests of the trust (i.e. the scheme) as a whole, praying in aid the decision of the Guernsey Court of Appeal in *Re R & RA Trusts*[266] to adopt that approach.

33. They relied, in particular, on (i) the fact that the Court of Appeal had divided 2-1 in allowing BA's appeal, but had unanimously and unusually given permission to appeal to the Supreme Court, and (ii) that Patten LJ had given as a reason for his dissent that in his view adopting Peter Jackson LJ's approach to the purpose of the amendment power would "*place the Trustees in a position of complete uncertainty about the scope of their powers*".[267]

Arnold J's judgment

34. Arnold J held that the Trustees were right to submit that there is "*no inflexible rule*" in English law that Trustees may not pay for appeals out of trust funds, and that "*the true principle … is that a trustee is entitled to be indemnified from the assets of the trust if, in the specific*

[265] At [1].
[266] *Re R & RA Trusts* (Unreported, 20 May 2014).
[267] *British Airways plc v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533, [2018] Pens LR 19 at [74].

circumstances of the particular case, the trustee would be acting in the interests of the trust as a whole by appealing".[268]

35. He rejected[269] the submissions (i) that this would only be the case where the decision under appeal created significant uncertainty as to the interpretation or operation of the trust, and (ii) that an appeal would not be in the interests of the trust as a whole for these purposes where it would benefit a majority but not all of the beneficiaries. In relation to the latter point, Arnold J noted[270] that in the first *Beddoe* proceedings in 2014, the Chancellor had permitted the Trustees to defend BA's claim because it would be in the interests of the "*overwhelming majority*" of members – but not of all of them.

36. Having decided that it was open to him to grant *Beddoe* relief if convinced that an appeal to the Supreme Court would be in the interests of APS members, Arnold J then considered whether he should do so. Relevant factors included (i) that the overwhelming majority of members entitled to substantial benefits[271] would benefit from a successful appeal (ii) the appeal had (it was said) a good prospect of success (iii) the supposed uncertainty for the Trustees arising from the majority decisions in the Court of Appeal (iv) that the Trustees are the only party who can realistically pursue an appeal, as members and pensioners would not be able to meet the expense involved.

37. Arnold J decided that these and other factors pointed to the desirability of *Beddoe* relief, which was duly granted. The judge did, however, consider the Trustees' proposed costs of £1.24m for a 1.5 day hearing in the Supreme Court on a single point of law to be "*deeply alarming*", and capped them at £1.034m, to match BA's proposed costs.[272]

Wider ramifications of Arnold J's decision

38. Looked at narrowly, Arnold J's decision could be seen as nothing more that the exercise of the Court's inherent supervisory jurisdiction over the Trustees of APS in a very fact-specific context. Looked at more broadly, though, this decision reflects a radical reshaping of the Court's *Beddoe* jurisdiction in relation to pension schemes. Three points are of particular note.

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[268] At [71].
[269] At [73]-[75].
[270] At [75].
[271] APS has a large number of members entitled to "equivalent pension benefits" only. Although over 22,000 in number, they amount to less than 0.1% of the scheme's liabilities.
[272] At [92]-[95].

39. First, and perhaps most importantly, Arnold J appears to have abrogated what was widely understood to be the binding effect of the Court of Appeal's decision in *Re Londonderry's Settlement* and so brought *Beddoe* applications in respect of appeals into the discretionary mainstream of such applications. There is no suggestion in Arnold J's judgment that he is articulating special principles applicable only to Supreme Court appeals: he appears to be addressing all appeals by trustees.

40. The immediate effect is obvious: scheme trustees who are unsuccessful at first instance can seek permission to appeal, then rush to the High Court on a *Beddoe* application to get permission to fund it from the scheme. In view of Arnold J's decision it seems very unlikely that the costs of the *Beddoe* application would be disallowed even if unsuccessful (unless the application is obviously hopeless), and the trustees would have some prospect of actually getting *Beddoe* relief, especially if they already have permission to appeal (on which see further below). The result is the inevitable prolonging of litigation which would otherwise have been brought to an end, at an inevitable financial cost to schemes.

41. There is no certainty in the regime Arnold J has now introduced. Whereas before it was clear that trustees who had been given the answer they required at first instance (e.g. as to the true construction of the deed or rules) could not properly fund an appeal from the scheme, now the position is that they might be able to, but only if the Court agrees with their assessment of where the interests of members lie (Arnold J having accepted that he was entitled to form his own view of this, and not merely to decide whether the Trustees' view was a reasonable one[273]). This too will increase the cost, and indeed likelihood, of further or more prolonged litigation.

42. Second, it is notable that Arnold J appeared to give significant weight to his view that the Trustees' appeal had "*a good prospect of success*", even though success could not be "*assured*". If the judge meant only that the Trustees had a real prospect of succeeding on the appeal, then that much was unsurprisingly accepted by BA (in circumstances where the Court of Appeal had reversed the trial judge, split 2-1, and had itself given permission to appeal to the Supreme Court). But given that permission to appeal would not usually be given where there is no real prospect of success,[274] that would be to say no more than that *Beddoe* relief would not be

[273] At [45].
[274] In the case of appeals to the Supreme Court, there must be "*an arguable point of law of general public importance which ought to be considered by the Supreme Court…*" (Supreme Court Practice Direction 3 at 3.3.3). In relation to appeals to the High Court and the Court of Appeal, the usual test is whether there is "*real prospect of success*" (CPR 52.6).

uselessly granted where the prospective appellant would not in any event obtain permission to appeal.

43. The tenor of Arnold J's judgment, however, goes further than that, and suggests that Arnold J may have been rather more impressed with Patten LJ's dissent than with the majority judgments of Lewison and Peter Jackson LJJ. Arnold J's reference to the Trustees' victory in the Supreme Court not being "*assured*" certainly sounds like a suggestion that victory is all but assured.

44. Arnold J also relied on the uncertainty he considered the majority judgments in the Court of Appeal to engender, holding that "*the judgments of the majority do not make it clear what the limits on the Trustee's power of amendment are*" and that "*[e]ven if the appeal is unsuccessful, I consider that it is reasonable to anticipate that the Supreme Court will provide greater clarity in this respect."*[275]

45. If Arnold J did intend to engage with the merits of the appeal beyond merely establishing that it had some real prospect of succeeding, then, with respect, there is real difficulty. Here Arnold J was being asked to review the judgments of two judges of the Court of Appeal – his superiors in the hierarchical system of precedent – and was encouraged to find them wanting. It is difficult to see how a judge of the High Court could really be expected to form a clear view of the likelihood of a Supreme Court appeal succeeding, beyond noting that permission to appeal had already been given. There is plainly a real risk in such cases of the judge at the *Beddoe* hearing simply granting relief in cases where he or she would not have made the decision under appeal and believes it should be reversed, and not in cases where the judge happens to agree with the original decision. If this really is the question the *Beddoe* court has to grapple with, then the outcome of such applications will necessarily be very uncertain.

46. <u>Third</u>, Arnold J's judgment gives weight[276] to the fact that it would not be financially realistic to expect the members and pensioners of APS to take over – and pay for – the Trustees' appeal to the Supreme Court, and accepted that the leading campaign group supporting the award of discretionary increases, the Association of British Airways' Pensioners, was not in a position to do so. The Trustees, funded by APS, were the only realistic appellants.

47. The difficulty for pension schemes, and particularly their sponsoring employers who will ultimately have to fund whatever appeal trustees are permitted to pursue, is that this will almost always be the case. Members and pensioners of an occupational pension scheme will rarely be

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[275] At [83].
[276] At [85]-[87].

sufficiently wealthy to fight High Court litigation and subsequent appeals at their own expense, even if the litigation or appeal is for their own private benefit.

48. Arnold J's approach is therefore likely to lead to trustees being permitted to pursue claims at the scheme's expense which are in truth claims for the benefit of particular beneficiaries or classes of beneficiaries, which those individuals ought to pursue. That litigation is both expensive and risky is unfortunate, but that is the reality faced by all other private litigants who wish to vindicate their rights. It is hard to see why pension scheme members should automatically be in a more privileged position.

Is Arnold J's decision the last word?

49. At present it is too early to say whether Arnold J's decision will be widely followed. BA did not appeal from Arnold J's decision, which will therefore stand as the leading modern case on when trustees can properly appeal at the trust's expense. It does however seem likely that other judges will be attracted to this discretionary approach to trustee's appeals which brings them within the mainstream of *Beddoe* relief.

50. However, Arnold J's decision is plainly open to criticism. Various practical difficulties with giving effect to the principles it articulates have already been set out above. But another judge might also simply consider that Arnold J was wrong in law in treating earlier cases as imposing no hard and fast rule. That was certainly not the understanding of the majority in *Re Londonderry's Settlement*.

51. In particular, Arnold J's judgment opens the door to scheme funds being spent on appeals which do not benefit all members even if they succeed – and benefit none if they lose – in circumstances where the trustees are perfectly capable of carrying out their trusts in accordance with the existing decision of the Court. It might be asked why a minority of members should have to meet the cost not only of appealing for the benefit of the majority, but of paying the respondent's costs if they lose. If some members wish to pursue litigation for their own benefit, why should they not pay the costs and take the costs risks like any other litigant?

52. Trustees are in a privileged position in relation to the costs of litigation because, at least with *Beddoe* relief and a sizeable scheme or trust fund behind them, they can litigate without costs risk: they only ever spend, or put at risk, someone else's money. But they are put in that position because they could not otherwise do their job: no trustees would seek the court's directions on a construction question, or defend a claim adverse to the trust, if they were at real risk of having to pay for the proceedings themselves. Whereas the Trustees in this case were perfectly able to

carry out the trusts of the APS without a further appeal to the Supreme Court, but – admittedly for reasons which appeared sufficient both to them and to Arnold J – did not wish to do so.

What the majority's proper purpose principle requires of trustees, where it applies

The allegations of uncertainty

53. The purpose of this section is to explore the uncertainties to which the judgments of the majority in the Court of Appeal are said to give rise, as to the true effect of the principle, where it applies, that Trustees are not permitted, subject to certain qualifications, to engage in scheme benefit design. The section that follows after this one is concerned with the related but different question as to the circumstances in which the principle applies (or does not apply) in the first place.

54. We have already referred briefly to the alleged uncertainty, as it played a part in Arnold J's reasoning in the costs judgment. More fully, this is what has been said to date about this uncertainty:

    a. In his dissenting speech, at [74], Patten LJ said this:

        "*I… agree with Mr Rowley's submissions [for the Trustees] that the various qualifications which BA has accepted in its formulation of this principle, in particular its non-application when the scheme is in surplus,*[277] *are likely to make it difficult in practice for the Trustees to know with any certainty what are the precise limits to the exercise of the power.*"

    b. His Lordship went on to say this:

        "*With respect to Peter Jackson LJ, the formulation of the purpose of clause 18 suggested at [126] would in my view place the Trustees in a position of complete uncertainty about the scope of their powers.*"

    c. In the costs judgment at [83], Arnold J said this:

        "*… counsel for the Trustees and for Mr Fielder submitted that the differences between the reasoning of Lewison and Peter Jackson LJJ, and in particular the test propounded by Peter Jackson LJ at para 126, made it very uncertain in what circumstances the Trustees could*

[277] As we come on to later, this description of the surplus related qualification needs to be read in the context of what is said earlier in the judgment at [58]-[59].

exercise the power of amendment conferred by clause 18 without BA's consent. In support of this, they relied in particular upon the passage from the judgment of Patten LJ at para 74… They also relied upon the fact that the Scheme may now be in surplus. Against this, counsel for BA submitted that the decision of the majority gave the Trustee sufficient certainty. In my respectful opinion, the judgments of the majority do not make it clear what the limits on the Trustee's power of amendment are. Even if the appeal is unsuccessful, I consider that it is reasonable to anticipate that the Supreme Court will provide greater clarity in this respect."

55. In their Notice of Appeal to the Supreme Court, relevant paragraphs of which are fully set out in the costs judgment of Arnold J at [34], the Trustees set out ten reasons why, in their submission, the decision of the Court of Appeal was wrong. Their ninth ground also refers to uncertainty, as follows:

"*Ninth, in their 2008 iteration, rules 4, 8, 8A, 9, 10, 12, 12, 13, 13A, 13B, 14, 15, 16, 19, 20, 20A, 20B, 20C and 22 all have as their subject matter the pecuniary benefits to which members or persons claiming through them are entitled under the Scheme, yet the effect of the majority's judgment is that the Power of Amendment cannot be used by the Trustee so as to amend any of the same unless either (i) the Scheme is in surplus (<u>on a bases or to be determined in a manner which is neither prescribed by the Scheme's governing documentation nor explained in the judgment of the majority and which, as Patten LJ concluded, would produce practical uncertainty for the Trustee</u>) or (ii) BA consents to the same."*

The reasoning of the majority

56. Before discussing the various sources of alleged uncertainty, we summarise the reasoning of the majority.
57. Lewison LJ's judgment is at [84] to [111], and all of it is devoted to the "proper purpose" point.
    a. [87] to [92] survey various cases where an exercise of a power of amendment by trustees either to augment benefits or increase contributions has been upheld. It was noted that the deficit cases (namely *PNPF v Taylor* [2010] EWHC 1573 (Ch) (the "Pilots" case); *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees* [2010] EWHC 1805) (Ch) and the related subsequent *Merchant Navy Ratings Pension Fund, Re* [2015] EWHC 448 (Ch)) were concerned with seeking additional contributions in order to fund the benefits payable under the scheme in question (i.e. to cure a funding gap). The other cases (*Edge v Pensions Ombudsman* [2000] Ch 602; *Law Debenture Trust Corp Plc v Lonrho Africa Trade & Finance*

Ltd [2002] EWHC 2732 (Ch)) were analysed as surplus cases where the trustees "*are doing no more than managing assets that have already been entrusted to them*".

b. [93] to [94] identified that clause 11 of the deed in this case dealt with what is to happen in the case of a deficit and in the case of a surplus, and noted that if the Trustees were right in their position, the Trustees could, by exercising the power of amendment, delete various rights available to the employer under those provisions.

c. At [95] the Judge introduced the question of whether the proviso to rule 15 introduced by the amendment under challenge went beyond the proper purpose of the power of amendment.

d. In a crucial passage at [101]-[103] Lewison LJ focused on the question of "*the constitutional functions*" ([101]) and the "domain" ([103]) of the Trustees. Lewison LJ relied on clause 4(a) (which provided that "*The Management Trustees shall manage and administer the Scheme and shall have power to perform all acts incidental or conducive to such management and administration*") as defining the function and domain of the Trustees. The design of the benefit structure was said to fall outside the purpose of that general power under clause 4(a). In addition, however, Lewison LJ did not just rely on Clause 4(a); he also relied on his understanding of the "*business context*", and the general observations made by Park J in *Smithson v Hamilton* [2007] EWHC 2900 (Ch).

e. At [104]-[107] Lewison LJ drew on cases concerned with company directors (*Howard Smith v Ampol Petroleum* [1974] AC 821 and *Eclairs* [2015] UKSC 71). It is apparent that those cases are relied on because they illustrate the significance of examination of the function/role of a power holder, in the context of the overall relevant constitution, when considering whether their exercise of power can be properly upheld.

f. At [108]-[109] Lewison LJ emphasised the breadth of the power conferred on the Trustees by the disputed proviso, noting in particular as follows:
"*It is true that the trustees are required to take actuarial advice. But there is no restriction on the nature of the advice. The actuary may, for example, advise the trustees that if they wish to augment benefits they must require additional contributions from the employer. The rules would then require the employer to pay them.*"

g. Then, at [110] Lewison LJ summarised his reasoning and reached his conclusion:
    i. He accepted that the Trustees were entitled to deal (if necessary by amendment) with assets which already form part of the scheme (i.e. where there is a surplus);
    ii. He accepted that the Trustees were entitled to require (if necessary by amendment) additional contributions to be made in order to secure the benefits promised under the rules.

iii. But he identified as "*the fundamental point*" that in this case the Trustees were "*arrogating to themselves the responsibility for designing as opposed to managing and administering the scheme, in circumstances in which (a) the fund is in deficit and (b) the employer would be required to make additional contributions … for funding additional benefits decided upon by the trustees*."

iv. He repeated that that was "*not the trustees' constitutional function under the trust deed*", and concluded that the amendment therefore goes beyond the purpose of the power of amendment contained in clause 18.

58. Peter Jackson LJ's judgment is at [112] to [127]. The Judge addressed the proper purpose point from [114] onwards. He concludes by stating that he is in full agreement with "*the reasoning much better expressed*" by Lewison LJ. However, [114]-[126] provide reasons of his own:

a. From the outset of his discussion, Peter Jackson LJ addressed the matter through the lens of consideration of the "*responsibility and competence of the parties*" ([115]).

b. At [116], the Judge rejected the idea that the purpose of the scheme is to be identified by reference to the end that the scheme is intended to produce. Rather, the purpose is a wider (in the sense, presumably of richer) concept covering not only the intended result but also the means by which it is to be produced. "*The purpose of the scheme is… not simply to provide pensions, but also to provide the machinery whereby pensions are provided*."

c. At [117], the Judge identified the question as to how detailed the analysis is to be in identifying the aspects of the machinery that form part of the purpose of the scheme.

d. At [119]-[125] he then identified various matters that he took into account, namely:

i. First, at [119]-[120], he identified the rules and clauses dealing with circumstances in which the employer may be required to pay more, or may exercise a discretionary power to increase benefits, and identified that there was no express provision for unilateral discretionary increases by the Trustees.

ii. At [121], the Judge relied on clause 4 of the Deed as defining the trustee's "*role*". He then noted that the challenged amendment involved a change in that role because it added, to the Trustee's existing role, the role of "*paymaster*". This meant that it involved a remodelling of the balance of powers. And there was nothing to suggest that the power of amendment was intended to give the trustees the power to remodel the balance of powers.

iii. At [122] he rejected the contention that the usual safeguards as to trustee conduct and decision making gave the Trustees any answer to the above considerations.

iv. At [123] he rejected the contention that the historical removal of the ministerial veto had any bearing on the analysis that he had to carry out.

v. At [124] he drew nothing from the fact that the application of the proper purpose principle that BA were inviting the Court to accept was "*unprecedented*". In the course of this paragraph he emphasised that he regarded an increase to the employer liability for a scheme already in very substantial deficit as "*conceptually different*" from actions in taking steps to dispose of a surplus.

vi. At [125] he made clear that he regarded his analysis as not necessarily relating to all occupational pension schemes, but that the "*purpose of a scheme is to be ascertained from the contents of the instrument, an analysis of their effect and an understanding of their business context*".

vii. He then concluded at [126] that the power of amendment was limited so as to enable changes "*which may be required by the exigencies of commercial life"; that the amending power in this case was never intended to permit them to impose discretionary increases upon BA; and that the amendment was "for purposes contrary to the instrument*".

59. Here we explore three different sources of uncertainty as to the operation of the principle:

a. First there is the general source of uncertainty arising out of the introduction of the question that must be asked on the majority's analysis, as to whether a given exercise of power involves the trustees' stepping outside their role.

b. Second, there is the specific source of uncertainty arising out of BA's acceptance of the qualification that if the employer agreed to an amendment then an amendment that would otherwise be objectionable would not be.

c. Third, there is the specific source of uncertainty arising out of BA's acceptance of the qualification that if the scheme was in surplus then the Trustees could engage in benefit design to the extent that that in substance involved dealing with that surplus.

The general source of uncertainty: the trustees' role

60. As noted above Patten LJ expressed the view that the formulation of principle by Peter Jackson LJ at [126] to the effect that the amendment power was limited to those changes "*which may be required by the exigencies of commercial life*" left the scope of the Trustees' powers of amendment completely uncertain.

61. However, it is only fair to read that paragraph of Peter Jackson LJ's judgment in the context of what had preceded it and the agreement with Lewison LJ's reasons that followed it.

62. In particular it is important to note that both Peter Jackson LJ and Lewison LJ put particular emphasis on the concept of the trustees' role/function/domain. If the reason why the challenged amendment in this case was objectionable is that it involved the Trustees stepping outside their proper constitutional function, does that realistically provide sufficient certainty, in answer to the last sentence of Patten LJ's [74]?

63. A potential difficulty here is that it is apparent from the reasoning of the majority that not <u>all</u> changes that might perhaps be considered to involve "*benefit design*" by the Trustees, even where the Scheme is in deficit and the employer does not consent, need necessarily involve a violation of the Trustee's function. In other words, there remains a real question as to what counts as "*benefit design*", or illegitimate "*benefit design*", for these purposes.

64. Thus:
    a. Both Lewison LJ and Peter Jackson LJ emphasise that the course of action under challenge in this case involved more generous benefits being (or possibly being) introduced at a time when the Scheme was in deficit. It is unclear, therefore, whether the Trustees would be prohibited under this principle, without employer consent and where the scheme is in deficit, from making changes to the benefit design for future accrual that were <u>less</u> generous (and that therefore would not increase employer liability). On the one hand, such conduct would seem to be "*benefit design*" and therefore not for the trustee; on the other hand, the majority does focus on the fact that the Scheme was in deficit.
    b. Both Lewison LJ and Peter Jackson LJ emphasise that the course of action under challenge in this case involved a remodelling of the balance of powers. But it would be hard to suggest that every change to benefit rules need necessarily be properly characterised in that way. What about apparently minor amendments intended to assist in making the rules more workable in relation to ill-health benefits, for instance, or to deal with changes in legislation? The Trustees' ninth ground of appeal to the Supreme Court (quoted above) appears to be premised on the position that the majority's reasoning necessarily involves <u>any</u> changes to rules that have as their subject matter the pecuniary benefits could not be amended by the Trustees unless there was either a surplus or employer consent. However, it is suggested that it is not clear that the majority's reasoning gives rise to that conclusion. It may be that on the majority's approach, a fact sensitive question will arise as to whether a particular amendment to benefit provisions is properly characterised as having the purpose of ensuring, in substance, the effective delivery of the employer's chosen pension benefits, or whether it attempts something more. Indeed, one notes the language of what was "*never*

intended" in Peter Jackson LJ's [126], which might suggest that, on the majority's reasoning, a multi-factorial *Hole v Garnsey* type test of reasonable contemplation is really in play.

65. There is a further, and broader point, to be made here. The emphasis of the majority on Trustees' proper role strongly suggests that trustees should at all times when exercising their powers ask themselves whether what they are doing is properly something for them, having regard to their place in the constitutional structure, even where they have the unilateral power under the pension scheme in question to do it. This is striking because, where the only power by which something can be done is conferred on the trustees alone, it might be argued that that fact in itself answers the question whether it is for the trustees to make the decisions as to how that power is to be exercised (while of course taking into account all relevant and no irrelevant considerations). Put another way, it might be thought to be a somewhat oblique way to give the employer the role of scheme designer to say that though the trustees have the unilateral power of scheme amendment, the consent of the employer will in certain circumstances be a necessary precursor to valid exercise of that power. In the context of other schemes, without a statutory history such as that of the BA scheme, where the Minister originally had a role in amendments which had to be confirmed by statutory instrument, it may be that the unilateral power residing with the trustees will be a stronger indication that it is part of their role, under the given scheme's constitution, to decide how the relevant power is to be exercised.

66. The shift in the analysis from the focus on "purpose" to the focus on "role" might also suggest that there is scope for the analysis of the majority to evolve through further cases so that the violation of principle here is not so much a violation of proper purpose as a failure to take into account the key consideration of what the trustees' function is (and indeed failure to take into account the only reasonable conclusion one could reach having taken into account that function).

67. Having said all of that, it is quite understandable why the Court of Appeal's analysis did shift the focus from "purpose" to "role". For that is the only way in which the analysis can sensibly cater for an appropriate role for the position of the employer, to which we now turn.

Uncertainties arising out of BA's qualification as to employer consent

68. It is common ground that if BA consented, then even changes to benefit design that increase employer liability in the context of scheme deficit may be permitted.

69. Analysing the power of amendment purely through the prism of purpose might be argued to make the place of BA consent in the conceptual scheme quite difficult to understand. If a change to benefit is outwith the purpose of the power of amendment (eg because it remodels the balance of powers) it is on one view quite difficult to see how employer agreement can bring the change within the purpose of the power.

70. The introduction of the idea of role, as focused on by the majority, offers a way round this. One then tests whether the Trustees are acting for a proper purpose by reference to whether they are properly acting within their role and/or are avoiding making changes that alter their role. One then asks whether the Trustees are properly respecting their role, and, crucially, the Trustees will not be acting outside the proper scope of their role – even if what they are doing involves a change of the balance of powers – if the employer agrees to the changes.

71. However, further questions then arise by reference to the employer consent qualification:

    (1) In multi-employer schemes, who are "the employer" for these purposes? Just the Principal Employer? Or do all employers need to consent? And what about industry-wide schemes?

    (2) If benefit design is not for the Trustees, is it open to them, to make proposals to the employers in relation to benefit design, or is expenditure in relation to that not part of their function? Put another way, is it apt to frame the qualification in terms simply of employer "consent"?

    (3) How are Trustees to respond when the employer itself puts forward a benefit design change? Are the Trustees confined to making points about workability and the like? If, to the contrary, it is open to the Trustees to refuse to introduce a change that would reduce benefits on grounds that, for instance, the change goes further than secure funding for the scheme demands, and/or it is open to the Trustees to refuse to introduce a change that would improve benefits on grounds that, for instance, it would put too much of the employer's resources towards funding ongoing benefits, what is the substantial and logical basis for distinguishing the nature of the Trustees role in the context of an employer proposing that there be an amendment vs the context of an employer proposing that there be no amendment? It is not obvious that the answer lies in a distinction between the scope to challenge trustee exercises of power and the scope of challenge non-exercises of power, for often scheme related decisions involve the consideration and crystallisation of options, and the decision might come down to a straight choice between "Make this change" or "Do

nothing"; it seems very odd that the potential for a trustee to argue for the contrary position to that of the employer depends on which of those two options the employer is promoting.

72. It is not suggested here that these present problems in themselves undermine the BA analysis. However, they are questions that call out for clarification in subsequent cases.

Uncertainties arising out of BA's qualification as to surplus

73. The BA qualification recorded by Patten LJ at [74] was that BA accepted that the preclusion of the trustees amending benefits so that they are more generous, without employer agreement, did not apply where the Scheme is in surplus.

74. The Trustees note in their Notice of Appeal to the Supreme Court that it is unclear what funding basis is to be used to determine whether the Scheme is in surplus for these purposes, and unclear what if any process for the determination of whether there is a surplus is required. And that gives rise to the question whether there is an important lack of clarity here.

75. One can well see that there could be serious difficulties if the options open to the trustees were dependent on whether there was in fact a surplus in the scheme.

    a. What is the measure of liabilities for this purpose?
    b. What if the scheme is in fact in surplus but has not been determined to be as such?
    c. One could find oneself drawn into a debate not dissimilar to the one encountered in the insolvency context, and which has now been going on for decades, in respect of the stage at which the obligation to take into account the duties of creditors kicks in. That difficult topic was recently discussed at great length by the Court of Appeal in *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112.
    d. There would also be a real question of principle that would arise: given that liability valuations go up and down, why should there be a fundamental switch in what the trustee can do and/or consider by reference to one particular valuation threshold, that may or may not be a significant threshold so far as employer risk appetite is concerned.

76. However, Patten LJ's comment at [74] is to be read in the context of what he had said at [58]-[59]:

> *"58. It is important to note at this stage that BA does not contend that clause 18 can never be used so as to increase benefits. Mr Tennet accepts that it would be open to the Trustees,*

for example, to increase benefits in order to remove an actual or potential surplus from the Scheme. The employer's obligation to make contributions is limited to what is necessary to meet the liabilities under the Scheme: nothing more. The identification of a surplus by the actuary could lead to a contributions holiday for BA as part of a scheme under clause 11(d) of the Trust Deed which expressly provides for that event. But Mr Tennet accepts that it would also be open to the Trustees to use the power of amendment to increase benefits so as to eliminate what is referred to as a "trapped" surplus even though that is not catered for under clause 11. Such exercise would not be conditional on the consent of BA unlike a scheme under clause 11 which requires the employer's consent: see clause 11(b). The only limitation on the use of clause 18 to remove a surplus is the bar (in clause 18(ii)) on the return of contributions to the employer.

59. This limited concession is consistent with the position taken by all counsel on the last occasion when the APS was considered by the Court. In Stevens v Bell [2001] Pens LR 99 Lloyd J was asked to consider the scope of clause 11 and its relationship with clause 18 in connection with a surplus which then existed in the scheme. Most of the questions raised in the proceedings are not relevant to this appeal but it is interesting to note that all counsel were agreed that if and so far as the clause 11(d) power was not wide enough to dispose entirely of the surplus, it would be possible for it to be amended and expanded under clause 18. The Court of Appeal (see [2002] Pens LR 247) affirmed the view of the judge that clause 11(b) of the Trust Deed operated independently of clause 18 but rejected the submission that clause 11(b) contained an implied power of amendment. It was not therefore possible to devise a scheme providing for the return of contributions to BA except by amendment under clause 18 but that was prohibited by clause 18(ii).”

77. Understood with that passage in mind, the qualification to which Patten LJ refers is a qualification concerned with the position where there is “trapped surplus”, in the sense of disposable surplus that cannot be disposed of through the operation of Clause 11 as it stands.

78. That, it would seem, offers a good answer to the concern that there is a lack of clarity about where the surplus-related ability for the Trustee to amend the Scheme so as to dispose of surplus kicks in – it kicks in where the machinery already there in Clause 11 is insufficient to enable disposable surplus to be disposed of. There is no standalone qualification to the principle that the trustees cannot engage in scheme design without employer consent referable to the question of whether the scheme is, in some abstract sense, in surplus.

79. It is submitted that, on a fair reading, the above analysis is consistent with the majority's decision. It is true that Lewison LJ at [110] said this:

"I would readily accept that managing and administering ***the scheme entitles the trustees to deal (if necessary by amendment) with assets which already form part of the scheme (i.e. where there is a surplus);*** *or to require (if necessary by amendment) additional contributions to be made in order to secure the benefits promised under the rules. As I have said, clause 11 in fact makes provision for these eventualities."*

80. But this must be read in the context of the thrust of [93]-[94]:

"93. Clause 11 of the deed in our case deals with what is to happen in the event of a deficit. The trustees must make a scheme for making good the deficiency; and that scheme must provide for the employer to make additional contributions. There is provision for employer's consent and for any dispute to be referred to an actuary. The scheme will come into force subject to any amendments directed by the actuary. If the trustees are right, they could, by exercising the power of amendment, delete the dispute resolution procedure.

94. Again, clause 11 of the deed deals with what is to happen in the event of a surplus. In essence, the employer gets a contribution holiday for up to 30 years. If the trustees are right, they could, by exercising the power of amendment, deprive the employer of that contribution holiday, and augment benefits instead."

81. Given that Lewison LJ went on to reject the Trustees' position it would seem that Lewison LJ rejects the contention that the trustees could, by exercising the power of amendment, interfere with the contribution holiday provided for by clause 11. It must, it seems, follow from that that his comments at [110] are concerned with trapped surplus. Or, to put it another way, the "if necessary" in his "if necessary by amendment" there caters for the fact that amendments should only be made to deal with surplus if the existing machinery is not sufficient to do so, without amendment.

82. Though this is an answer to the bigger picture points that appear to have been contemplated in the Trustees' ninth ground of appeal, there does remain uncertainty on a point of detail. Clause 11 of the Airways Scheme deed, as discussed in the preceding case of *Stevens v Bell* [2001] PLR 99, imposes under Clause 11(b) a freestanding obligation for the Trustees to put in place a "scheme" for dealing with a disposable surplus where one arises. But such a scheme, under the terms of Clause 11(b), will be subject to agreement with the relevant employer or in default of

such agreement a direction from an independent actuary. It appears to be suggested from Patten LJ's dissent at [58] that what is contemplated is that the Trustees might exercise their power of amendment not merely so as to put into effect a scheme pursuant to Clause 11(b), but also to circumvent the requirement under Clause 11(b) for employer consent or independent actuary direction in relation to a scheme for the disposal of an identified disposable surplus. If the surplus related qualification to the majority's rule goes that far, one might question what the point of principled distinction is that means that:

a. it can be appropriate for the trustees to override via amendment the mechanism for consent or independent actuarial determination under Clause 11(b) where the mandatory steps under Clause 11(d) are insufficient themselves to dispose of the disposable surplus; but
b. it is not possible for the trustees to override the mandatory requirements under Clause 11(d) themselves.

Where does the restriction in *BA* on the purposes for which Trustees may exercise their powers extend?

83. The uncertainties as to what the principle requires of Trustees are compounded, and to an extent intertwined with, the uncertainties as to when that principle itself applied. While BA of course is a case about a power of amendment, the proper purposes principle is applicable to all powers. And the shift in the analysis from "purpose" to "role" might on one view be regarded as expanding the scope of the decision, as the "role" of trustees is, at some level of generality, the same in any pension scheme.

84. Those observations give superficial support for a somewhat extreme view that *any* exercise of a power by trustees undertaken with a purpose to alter the benefit design of the scheme (save where the employer consents) is vulnerable to challenge. The implications of that view in practice would be startling, and one imagines that the Court of Appeal did not intend so extreme a conclusion, but the reasoning does not straightforwardly rule it out. In this section, we consider what limitations there may, or may not be, on the scope of the principle. The absence of authoritative guidance from the Supreme Court means that it will be left to subsequent cases to test the limits of the principle.

85. Two points merit making at the outset. First, it should be stressed however that difficulties in these areas would have existed however the Court of Appeal had decided the case, as they reflect the inherent nebulousness of the "proper purposes" doctrine.

86. Second, perhaps somewhat ironically, the broader and apparently more unconstrained the power as a matter of literal construction, the greater the scope for the role of the "proper purposes" principle. To put the point the other way, where the power is on its express terms narrow and constrained, the less need or justification there is for identifying further constraints in the doctrine of proper purposes.

The role of Trustees?

87. As we have explained, the crucial step in the Court of Appeal's reasoning was to derive the purpose of the power from the role of the party in whom it vested. That solution was perhaps particularly attractive in the case in front of it, because clause 4(a) spelt out, so the Court held, the domain of the Trustees, limiting it to management and administration, which the Court distinguished from benefit design.

88. On that basis, the decision could be read as having a relatively narrow scope. The majority's reliance on the terms of clause 4(a) is an example of the uncontroversial principle that the roles of the parties to a scheme are determined in the final analysis by the terms of the scheme's governing documentation. BA, on that basis, is a decision limited to its particular facts, where the terms of the scheme itself precluded the Trustees from a role in benefit design. In other cases, the answer will depend on what the Scheme rules say.

89. But there are at least two problems with that. The first is what the Court said. The second is where that analysis leaves us in other cases.

90. As to the first, while it is true that the majority placed reliance on the terms of clause 4(a), it appears that it regarded that as consistent with what it would expect the position to be in any event:

    a. Lewison LJ at [102] thought that his conclusion was consistent with how Chadwick LJ had described the purpose of a pension scheme in *Edge*, and with what Park J had said in para [87] of *Smithson*, in which he considered that it was the employer, not the trustees, who *"takes the lead in formulating the design of the scheme."*
    b. Jackson LJ thought that the description of the Trustees' role in clause 4 was *"unsurprising"* (para [121]). He described Park J's observations in *Smithson* as *"persuasive."*

91. The second reason is more conceptual. If the purpose of a power is to be determined by reference to the proper role of the person exercising it, it needs to be possible to identify that

role. That will be easy if, as in BA, the governing provisions address the question (although defining the limits of the role thus identified is another matter). Likewise, it would be easy in the other direction if the scheme rules expressly provided for the trustees to have a role in benefit design.

92. But in many cases, the scheme's rules will be silent on the role of the trustees. It may be possible to divine clues from different provisions and different powers as to their intended role, but as the purpose of ascertaining their role is to understand the true scope of those very powers, such an exercise risks becoming circular. If the proper purpose of powers is to be derived from the proper role of the trustees in whom they are vested, on the face of things one requires a general understanding of what the proper role of trustees is. Such an understanding could no doubt be displaced in any particular case by contrary provision in the rules, but its application does not require express provision such as clause 4(a).

93. On this basis, it is respectfully suggested that the majority's approach to the role of the Trustees is of broader application, and should apply absent clear contrary wording in the rules of any particular scheme.

Bilateral powers

94. BA was relatively unusual in that the Trustees had a unilateral power of amendment. More normally, trustees have powers of amendment vested in them jointly with the employer, or subject to the employer's consent. In such cases, intuitively one might feel that there is less need for the restriction in BA to apply: the involvement of the employer itself can act as a check on the trustees. Their "role" can be more easily regarded as inherently antagonistic to the employer.

95. That intuition has some support in authority. In *Arcadia Group Ltd v Arcadia Group Pension Trust Ltd* [2014] EWHC 2683 (Ch), Newey J had to decide whether a power to change index that he had determined existed was exercisable by the trustee, the employer, or the two jointly. He chose the last of these possibilities. As well as relying on the fact that no other power in the scheme was vested in the employer alone, he also said the following, at para [38]:

"It might also be said that the trustees of the AGSEPS and AGPS can be seen as natural spokesmen for the schemes. That, perhaps, tends to suggest that they were intended to be involved in any exercise of the power of selection."

96. That intuition however is difficult to sustain in the light of the reasoning of the majority in BA. The limits on the apparently limitless unilateral power in that case derived from an understanding of the Trustees' overall role in the scheme. That role precluded them from impinging on matters of benefit design. Where there is a bilateral power, it does not seem sustainable to suggest that the fact that the rule on its face grants the trustees a lesser role means that in substance their role is in fact greater, and allows them to interfere with the employer's intended benefit design. The position which Newey J was considering in *Arcadia* was materially different: as we expand on below, the choice of index for increasing accrued benefits is easier to see as part of the "administration" or "management" of the scheme than more substantive amendments to the underlying benefit basis of the scheme.

97. Such a conclusion of course does not render the trustees' involvement in amendments merely formal. They would plainly be entitled to object to an amendment because, for example, it was administratively unworkable. They ought also be able to refuse to consent because they consider that the amendment is unlawful, whether through insufficient consultation or for some substantive reason. On the face of things, it would be consistent with their role as custodian of accrued benefits to question benefit improvements which put greater funding strains on the scheme, and hence potentially risked accrued benefits.

98. Where does that leave benefit reductions, in respect of future accrual? On the face of the logic in BA, as this is a matter of benefit design, it is a matter for the employer. It follows that the trustees ought not to refuse to join in with or consent to an amendment reducing benefits to be accrued in the future on the basis that they consider such benefits to be insufficiently generous.[278]

99. In practice, however, many trustees will use their ability to veto a proposed benefit reduction as commercial leverage. Thus they may initially oppose or withhold consent for a proposed amendment not because they object to it in principle, or regard it as their place to object to it in principle, but because they recognise an opportunity to use their veto to extract something beneficial to accrued benefits, often in the form of extra funding.

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[278] One could perhaps imagine a situation where the trustees were concerned that a benefit reduction in respect of future service would have a sufficiently serious impact on staff morale that it counter-intuitively would put the funding of accrued rights at risk by imperilling the company's future. That is not necessarily an outlandish scenario – this is a justification not infrequently encountered, for example, for maintaining accrual, often on a relatively generous basis, for senior managers. Here, depending on the facts, the trustees may even in their role as custodians of accrued rights have reason to question the employer's remuneration strategy.

100. Where does BA leave an approach such as that? On the one hand, it may be said that it remains permissible. Provided that the trustees' purpose is merely to obtain some advantage in relation to accrued benefits, using their consent to a proposed amendment as the means to do so does not involve them acting outside of their role. The limits on their role in benefit design should not be regarded as a fetter on their leverage to pursue their proper role.

101. But we respectfully suggest that that analysis risks appearing too bullish. The kind of strategy we have outlined depends on the trustees maintaining that they will ultimately veto the proposed benefit reduction. If it is right that BA prevents them from doing this, absent some implications for accrued benefits or the administration of the scheme, that is ultimately a threat to do something unlawful. There is plainly an argument that it cannot be proper for trustees to seek to gain a collateral advantage by threatening an impermissible exercise of their powers.

Powers to change indexation

102. Another area in which the trustees are frequently given a power relates to indexation, either the decision to move away from the current index in use (RPI normally), or the choice of the index which is to replace it once that prior decision has been made. As a glut of recent case law, BA included, has reminded us, increases are a valuable part of any scheme's benefit structure, and the effect of moving to a less valuable index when compounded over the course of a retirement can be considerable.

103. On that basis, can it be said that the BA approach applies to the trustees' role in such matters? They can comment on new indices from the perspective of administration and management – is it workable etc – but they cannot refuse to consent to a change which the employer desires simply because they regard it as giving an insufficiently generous benefit.

104. We would suggest that such an analysis would be too simplistic. Increases are indeed benefits, but they are parasitic rather than free-standing. Their primary purpose is to protect the purchasing power of the underlying benefits against inflation. Choosing the "right" index to protect those underlying benefits from inflation appears to be more a question of managing or administering the existing benefit structure – ensuring it is not undermined by inflation – than of designing the benefit structure in the first place. The purpose of powers to change indices is normally to allow the scheme to cope with changing circumstances relating to indices or inflation over many years, such as the index ceasing to exist or a better index coming into existence, rather

than to provide a free-standing way to increase or reduce benefits. As such, these are matters on which the trustees may legitimately intervene.

105. In the present climate, these issues tend to arise in the context of an employer wanting to switch from a relatively generous index, normally RPI, to a relatively less generous index, normally CPI. The trustees' role is normally reactive. But it is possible that in future that may change. In particular, the Office of National Statistics is currently developing new 'household cost indices', including pensioner-specific indices. While those are still at an early stage of development, it is possible that they may produce a higher inflation rate than CPI, and it is likely that as measures intended, potentially, to measure the price increases faced by pensioners in particular, there will be an argument that they are more appropriate to use than CPI.

106. Trustees in schemes using CPI may therefore find themselves in the position, where the power permits it, of proposing to the employer that a switch to a more expensive index should occur, and advocating that approach. If they have a unilateral power to change the index, they might seek to use it for that purpose. Would that involve illegitimate scheme design? On the face of things, even though it would involve increasing the cost to the employer, on the analysis above that would be a legitimate approach for the trustees, provided the purpose underlying it was to better protect the underlying benefit structure from inflation.

107. What may be regarded as striking about that example is its similarity with the facts of BA, where the trustees' purpose was to compensate for what they regarded as the enforced switch to an inferior measure of inflation. The crucial difference lies in the nature of the power being exercised, and again reflects the fact that the wider the power, the greater the scope for it to be curtailed by the proper purposes doctrine.

108. Thus in the former case, part and parcel of the underlying benefit structure is the power which is conferred on some combination of the trustees and employer to alter the index. Given that the purpose of that power must be to ensure that the scheme continues to protect against inflation in an appropriate way, the exercise of that power is not an illegitimate exercise in benefit design, but a working out of the benefit structure which the employer designed in the first place.

109. In practice, proposals to move index are often made as part of a broader package of what employers may describe as "cost moderation." There can be a tendency for trustees in those circumstances to baulk at the prospect of a move to CPI not out of principle as such, but because that makes the overall package appear unduly harsh on members. But there is a good argument

that that would be an illegitimate approach for trustees to take to the request that they join in with or consent to the exercise of a power to change index. That is a matter which requires to be judged separately by reference to whether or not the proposed new index is an appropriate way to protect accrued benefits.[279]

Discretionary powers of augmentation

110. It is obviously the case that trustees who have a discretionary power of augmentation under the scheme (at least one that has not been introduced by them by way of amendment as in BA) are capable of using it in order to increase benefits. That is not to exercise the power for an improper purpose, but to exercise it for the very purpose for which it was given.

111. What is more complicated is ascertaining the limits to that power. There is an uneasy tension between the conclusion that the proper role of the trustees is to administer and manage the benefit structure, not design it, and the existence of a discretionary power of augmentation. That tension however is not satisfactorily resolved by concluding that the mere existence of such a power is sufficient to indicate a wider role for the trustees, as that simply restates the problem of identifying the limits of that wider role. To suppose from the existence of such a free-standing power that the trustees may properly act as a 'paymaster' more generally appears to be a jump too far.

112. It may be that how one resolves this tension is a question incapable of a general answer: in any particular case it will depend on the precise terms of the power and the way in which it is proposed to exercise it. But if the analysis we have given above of the proper role of the trustees as it emerges from BA is correct, it is a tension which may require resolution at some stage.

[279] Of course, what is sauce for the goose is sauce for the gander, and the employer is likely to struggle to justify a change in index simply because the new proposed index is cheaper. However, (i) a savvy employer is unlikely to do so, but will seek to justify the move to CPI by reference to the well-publicised alleged deficiencies of RPI, and (ii) cost to the employer can be a relevant factor in the choice of index, which involves some trade off between protecting members without incurring disproportionate cost. Annual increases of RPI plus 5% would be an effective way of ensuring that all members were protected from inflation, whatever their personal circumstances, but the cost of such luxury protection renders it obviously inappropriate in the ordinary case.

Conclusion

113. The fact that the Court of Appeal in BA took the highly unusual step of themselves granting permission to appeal to the Supreme Court suggests that they were well aware of the tensions inherent in the analysis the majority adopted, and the force of Patten LJ's dissent. The task of lower Courts seeking to confront those difficulties in future cases is compounded by the fact that that analysis is binding on them. But precisely what that analysis actually is, and how it applies, remains very much up for grabs.

Time limits for underpaid DB benefits

Robert Ham QC, Simon Atkinson and Daniel Scott

1. From time to time members of defined benefit occupational pension schemes receive payments which are higher or lower than the benefits to which they are entitled. This paper is concerned with underpayments, and the steps that can and should be taken by trustees in particular once an underpayment or series of underpayments has been discovered.

2. Where members have been underpaid, the question arises what bars or restrictions they might face in seeking or insisting on back payments of the arrears. That question has recently been considered in Morgan J's first-instance judgment in *Lloyds Banking Group Pensions Trustees Ltd v Lloyds Bank Plc and others* [2018] EWHC 2839 (Ch). Following *Lloyds*, the position is that there is no statutory limitation period on the recovery of back payments. The equitable defences of laches and acquiescence will rarely apply, because, in general, they require (a) knowledge of a claimant's true rights and (b) detrimental reliance on the part of the defendant or some other change of circumstances making it inequitable for an underpaid member to claim back payments. We do not propose to say anything more about laches. Unless the scheme in question has a rule or power that allows for benefits to be forfeited when they have gone unclaimed after a specified period (known as a "forfeiture clause"), members will therefore usually be able to recover back payments in full.

3. This paper will consider the following topics:
   (a) The elements of Morgan J's judgment in the *Lloyds* litigation which relate to back payments and the forfeiture of benefits;
   (b) The practical implications of the judgment;
   (c) The problems created by the judgment;
   (d) Discretionary forfeiture clauses;
   (e) Attempts to amend schemes; and
   (f) Points of which advisors and practitioners must now be aware.

The *Lloyds* litigation – back payments and time limits

4. The *Lloyds* judgment was the first to grapple definitively with the question of whether GMP benefits should be equalised. It was in this context that Morgan J addressed the question of back payment of arrears and the time limits for claiming such arrears.

5. But the treatment of back payments in the *Lloyds* litigation is equally applicable to *all* kinds of underpayments, and not just limited to those relating to GMP equalisation. Although the current focus of most scheme sponsors or trustees is likely to be on historically underpaid unequalised GMP benefits, it is important not to narrow the scope of application of the judgment. To take an obvious example it will extend to underpayments attributable to other failures to equalise benefits. The judgment is a key starting point for any consideration of underpayments of any kind in defined benefit schemes.

6. The issues which the Court had to decide in the *Lloyds* case in relation to underpaid benefits (insofar as they are relevant to us) are as follows:

   (a) Was the trustee obliged to make back payments to members where there had been an underpayment?

   (b) If so, should back payments be made (i) going back 6 years (and if so, 6 years before what date), (ii) going back to 17 May 1990, or (iii) going back to some other date?

The trustee's obligation to make back payments

7. In *Lloyds* everyone agreed that the trustee was obliged to make payments to members where there had been an underpayment. The trustee's basic duty is to observe the provisions which govern the scheme. This means that trustees are under a duty to pay the correct benefits to members as required by a scheme's governing documentation as varied by overriding provisions of the general law, such as the obligation to provide equal pay for men and women.

8. Accordingly, the starting point is that where there has been an underpayment of benefits to members, the trustees must remedy that by making a back payment in full.

What time limit, if any, applies to a claim for back payments?

9. The parties in the *Lloyds* litigation did not agree on this point.

10. Leaving aside laches, there are two ways in which a time limit can be imposed on a claim for back payments. First, the scheme rules can impose a limit, as long as those rules comply with section 92(5) of the Pensions Act 1995 (**"PA 1995"**). Secondly, a time limit can be imposed by a statute of limitations.

11. The employer banks contended that there was a statutory limitation period on a member's right to recover back payments imposed by section 134 of the Equality Act 2010[280]. They further argued that, in any event, some of the relevant schemes' rules included express provisions that precluded the trustee from paying any arrears that stretched back further than six years into the past.

12. An example of such a rule is rule 62.9 of the Lloyds Bank Pension Scheme No.2 Rules dated 21 December 1995[281]:

> *"62.9 Failure to claim benefit*
>
> *No beneficiary shall be entitled to claim any instalment of pension or other benefit to which he is entitled under the Scheme more than 6 years after that instalment has fallen due for payment."*

13. The employer banks said that this rule (and several others with materially similar wording) was consistent with section 92(5) of PA 1995. Section 92 provides (so far as relevant) as follows:

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[280] The wording and operation of this section is not relevant for current purposes. In case it is of interest, it is discussed in detail in the judgment in Part VII.

[281] The majority of these rules are mandatory in nature. However, one rule in the *Lloyds* litigation gave the trustees a discretion to forfeit. The treatment of discretionary forfeiture rules is considered in detail later in this paper.

"92.- Forfeiture, etc.

(1) Subject to the provisions of this section and section 93, an entitlement to a pension under an occupational pension scheme or a right to a future pension under such a scheme cannot be forfeited.

…

(5) Subsection (1) does not prevent forfeiture by reference to a failure by any person to make a claim for pension-

(a) where the forfeiture is in reliance on any enactment relating to the limitation of actions, or

(b) ***where the claim is not made within six years of the date on which the pension becomes due.***

…

(7) In this section and section 93, references to forfeiture include any manner of deprivation or suspension." (emphasis added)

14. According to the banks, the schemes' rules were thus consistent with a legislative intention that back payments extending beyond six years should not be paid.

15. The representative beneficiaries contended that the trustee was obliged to make good any underpayments of pension during the period that a member had been entitled to receive a pension and there was no limitation period at all in relation to a claim for back payments.

16. Further, the forfeiture rules in the schemes were of no application here because:

    (a) They dealt with circumstances where no pension had been claimed (for example where a member had lost touch with the schemes). They did not apply where benefits that had been claimed and paid were not properly calculated; and/or

    (b) Where those forfeiture rules were discretionary, the trustee should not exercise its discretion against the relevant members in these circumstances.

17. The representative beneficiaries went on to say that section 92(5)(b) of PA 1995 was not satisfied where a member had made a claim for, and been paid, a pension but the trustee has failed to calculate that pension properly. The member claims a pension and relies upon the trustee to calculate it properly, therefore it cannot be said that there has been any failure by the member to *"make a claim for [any part of[282]] a pension".*

18. The representative beneficiaries also said that, even if the member's claim is time-barred, that does not prevent the trustee from properly administering the trust and paying the sums which should have been paid but were not.

19. Morgan J found as follows:

    (a) On the correct construction of the relevant forfeiture rules, members were not allowed to claim arrears more than six years after the date when they were due, even in a case such as the present where the trustees have made payments in relation to pension entitlement but have underpaid the beneficiary because they have miscalculated the pension. As the members are not entitled to those arrears, the trustees are not bound to pay them, and any such payment would be voluntary.

    (b) The forfeiture rules would not be effective unless they came within section 92(5) of PA 1995. The rules in question were valid within that section. Section 92(5) refers to a *"claim for pension"* but *"pension"* is defined by section 94(2) to include any part of a pension or any payment by way of pension. Accordingly, where a member's payments are wrongly calculated and he is underpaid, and the member does not make a claim in relation to the underpayments, that is a case where the member has not made a claim for a payment by way of pension and a rule which provides for forfeiture after 6 years on this basis is therefore a valid rule for the purposes of section 92.

    (c) Where the trustee is given a discretion to pay or withhold a back payment in relation to a period which is more than 6 years before the back payment was claimed, the general rule as to the exercise of a trustee's discretion apply. A trustee must have regard to all relevant considerations and no irrelevant considerations and must make a decision which is rational and not perverse.

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[282] See the definition of pension in section 94(2) PA 1995.

(d) The claim for back payments of arrears was not subject to any statutory limitation period. Such a claim was a claim to recover trust property from the trustee by a beneficiary and was therefore governed by section 21(1)(b) of the Limitation Act 1980, meaning it was not subject to a limitation period. Morgan J rejected the argument of the banks that the claim was merely a claim for breach of trust under section 21(3) and was therefore subject to a 6-year limitation period. The limitation period under section 134 of the Equality Act 2010 was disapplied because it offended the European law principle of equivalence.

20. The result of the above findings was that the position in relation to back payments was governed by the rules of the schemes but there was no limitation period in respect of claims to back payments under either the Limitation Act 1980 or the Equality Act 2010.

Practical implications of the judgment

21. Morgan J's judgment brings the scheme rules to the forefront. Practitioners will need to check carefully whether the scheme in question contains a forfeiture rule, and whether that forfeiture rule is compliant with section 92(5) of PA 1995 (i.e. whether it prevents recovery where a claim has not been made within six years of the pension or benefit becoming payable).

22. Where the scheme rules contain no forfeiture rule however, there will be no time limit on making a claim for the recovery of arrears. Accordingly, the cost to the scheme in question where there have been historic underpayments may be very high indeed. Moreover, (as is discussed further below), we consider that it will likely be difficult to amend schemes to introduce forfeiture rules where there are none. Accordingly, as has been the case with the recent spate of RPI/CPI litigation, the position in which schemes now find themselves is likely to be governed by the quality of the drafting of their trust deed and rules. It is another case for the small print lottery.

23. Accordingly, on the one hand, a key consequence of the *Lloyds* litigation has been to expose the assets of schemes to considerable risk where there is no forfeiture rule and underpayments have occurred. On the other hand, however, where there is a compliant mandatory forfeiture rule, that rule will operate to bar recovery by members even where the member has never been aware of the benefits to which he was entitled because they have been miscalculated.

The problems created by the judgment

24. The question of back payments was very much ancillary to the main dispute concerning equalisation and was dealt with relatively briefly in submissions and in judgment. Perhaps because of this, there has been some criticism of the law for lacking clarity and for appearing to deal unduly harshly with scheme members. It has also been remarked by some that this is an area of the judgment which was susceptible to appeal though Morgan J refused permission to appeal on this point and permission was not sought from the Court of Appeal.

25. Perhaps the most obvious criticism of the judgment is that it seems unfair that members are barred from claiming arrears after 6 years in circumstances where they did not know that they were entitled to those benefits. As the representative beneficiaries argued, it can be said with force that scheme forfeiture rules and section 92 of PA 1995 are aimed at members who have 'gone away' and have not claimed their pension at any time. In this scenario, it makes good sense to forfeit the benefits and apply them for other purposes which are in the interests of the scheme and its members – indeed, many forfeiture rules which we have seen give the trustee the power to apply the forfeited benefits in such a way.

26. The situation is materially different, however, where the member *has* claimed his pension but that pension has been miscalculated. It is more difficult to see why scheme rules or the legislation should bar recovery in these circumstances. Trustees have a duty to administer the scheme and to pay the correct benefits, and surely the member is entitled to rely on the trustees to do so. The effect of Morgan J's judgment is to put the member on risk if the trustees make a mistake. If the scheme has a mandatory forfeiture rule, benefits are automatically forfeited after 6 years which effectively absolves the trustees from their duty of administering the scheme and deprives the member of having a reasonable opportunity to claim the benefits of which he was unaware through no fault of his own. The implication is that a member will have to supervise the trustees' administration of the scheme in order to ensure that if a mistake in calculation in made, he is able to claim for any underpayment within 6 years.

27. While that might seem unfair, a contrary view might be advanced as follows. The effect of Morgan J's judgment is not to put the member *entirely* on risk; rather, it balances the rights of members to recover underpayments against the certainty trustees require in order to administer the scheme. If historic underpayments can be recovered without any time limit, what certainty can trustees have as to the value of the assets and liabilities of the scheme? What certainty can

scheme sponsors have as to the extent of their funding obligations? The additional prudence potentially required for trustees in their valuation of the scheme's liabilities could make defined benefit pension schemes yet more unaffordable. In a time of (near) historic funding deficit, should courts really be adopting approaches which result in ever more prudent valuations the deficits resulting from which are ever more expensive for hard pressed employers to fund? Furthermore, if the scheme rules have an inbuilt forfeiture rule, it can hardly be said that members are ignorant of that fact at the time they join as members. The law as it currently stands does make it administratively efficient for schemes to deal with historic underpayments. The *Lloyds* judgment is thus, so the argument concludes, pragmatic and provides schemes with a cost-efficient way to approach GMP equalisation.

28. In reply, it might be said that the aspect of the judgment dealing specifically with forfeiture does not sit easily with the treatment of forfeiture clauses in trusts law more generally and that this may suggest that the law has taken a wrong turn:

    (a) In general, forfeiture clauses are strictly construed. For example. where a testator bequeathed an annuity to be paid to his son monthly *"unless he attempts … to become bankrupt"*, the Court held that the words, read in their strict grammatical sense, did not apply to a bankruptcy made against an unwilling party, and therefore no forfeiture of the beneficiary's interest had arisen upon a receiving order being made against the son on a creditor's petition: *Re Evans* [1920] 2 Ch 304, CA. Conversely, the construction of the forfeiture clauses in the *Lloyds* litigation preferred by Morgan J was a broad one; he rejected the narrower reading offered by the representative beneficiaries and preferred the wider construction offered by the banks. Accordingly, this may prove to be a fruitful line of attack in future on the law as it now stands.

    (b) Particular types of forfeiture clauses, such as "no contest" clauses in wills, have been held to be subject to a number of limitations in their enforceability. Such a clause will fail for repugnancy where the termination of an interest is dependent upon the exercise of rights attached to the interest, as where the clause purports to terminate the interest of a beneficiary who seeks to vindicate his interest by the commencement of proceedings against the trustees, irrespective of the merits of the beneficiary's claim or the outcome. A "no contest" clause which purported to act in such an extreme way would fail not just for repugnancy, but also for ousting the jurisdiction of the court. If the effect of the clause were that no beneficiary could enforce his interest because he

would lose it if he sought to do so, then the trust would become unenforceable by the beneficiaries. Of course, a distinction can be drawn between "no contest" clauses on one hand and limitation provisions on the other in the context of pension schemes. A principal objection to a "no contest" clause is that it ousts the jurisdiction of a court and discourages beneficiaries, who have benefitted from a settlor's largesse, from litigating matters in courts. A time-bar forfeiture clause on the other hand does not oust the jurisdiction of the court but merely puts a temporal cap on the ability of a member to challenge an historic underpayment. The policy objection to "no contest" clauses is different from the potential objections to a time bar on recovery of underpayments.

29. In addition to the policy considerations flagged above, there are a number of practical uncertainties thrown up by Morgan J's judgment, particularly concerning when time stops running for the purposes of calculating whether the time limit prescribed by the schemes' rules for claiming back payments has elapsed or not.

30. Calculating when time *starts* to run for a member to recover an underpayment should be fairly straightforward. Most forfeiture rules refer to a time when benefits *"became payable"* or have *"fallen due for payment"*. Accordingly, in relation to each instalment of underpaid pension, time will usually start to run against the member from the time at which that pension ought to have been paid.

31. But when does time *stop* running against the member? Per section 92(5) of PA 1995 (and most scheme rules), a member must make a *"claim"*. In *Lloyds*, counsel for the banks accepted that the meaning of *"claim"* for the purpose of the schemes' rules and for the purposes of section 92(5) was not limited to a claim initiated by legal proceedings for the arrears. In other words, the relevant *"claim"* may well occur when a member asks the trustee for the arrears. The Court did not express a view on this and stated that it did not have to decide the date of any claim in the case.

32. Accordingly, it is not clear what steps a member must take in order to claim any arrears in order to stop time running. For example, does time stop running so as to protect a member when he writes to the trustee asking for 'all the pension to which he is presently entitled to'? This would seem to put the burden back onto the trustee to calculate the pension correctly, because the member is presently entitled to all of the pension which should be payable at that time. If this

does *not* stop time running against the member, is it really to be said that a member ought to have to issue a protective claim simply on the off chance that he might be entitled to historic back payments of which he is unaware? Scheme rules where they provide for forfeiture after a certain time period rarely make express provision for the suspension of time limits in the context of latent loss (equivalent to s. 14A of the Limitation Act 1980). Should such forfeiture provisions be read as impliedly containing such suspensive provision where members have no actual or constructive knowledge of underpayments?

33. Another element of the judgment which may be revisited is the finding that a claim for back payments is not subject to any statutory limitation period by virtue of section 21(1)(b) of the Limitation Act 1980. The banks' argument that the claim was merely a claim for breach of trust governed by a 6 year limitation period pursuant to section 21(3) has some force to it, albeit that this element of the judgment is in our view less susceptible to challenge than the other points so far discussed given that pensioners are making a claim to trust property to which, under the scheme rules, they have a present entitlement.

Discretionary forfeiture clauses

34. Not all forfeiture clauses found in pension schemes are mandatory; some give trustees a choice whether to forfeit unclaimed benefits. Indeed, one such clause was cited in the *Lloyds* litigation, and reads as follows:

> *"8.2 Assignment, forfeiture, etc*
>
> *Benefits under the Scheme are subject to restrictions imposed by Sections 91 to 93 of the Pensions Act 1995 (assignment and forfeiture, etc). These restrictions are intended generally to ensure that benefits are paid only to the person entitled under these Rules, rather than to any other person. The restrictions prevent benefits from being assigned, commuted, surrendered, charged, or forfeited, except in specified circumstances.*
>
> *However, there are exceptions to the restrictions imposed by Sections 91 to 93. To the extent permitted by those exceptions:*
>
> *…*

*8.2.5 the Trustee **may** also reduce a person's benefits, or decide that a person's benefits will be forfeited, in any other circumstances allowed by sections 91 and 92 of the Pensions Act 1995."* (emphasis added)

35. As is clear from paragraph 420 of Morgan J's judgment, the general rules which govern the exercise of a trustee's discretion apply when considering the exercise of a discretionary forfeiture rule. Trustees have a duty to take into account relevant considerations and to disregard irrelevant considerations. Provided that they have gone through a rigorous (and well-documented) thought process, the exercise of their discretion will become more difficult to challenge.

36. Identifying the relevant considerations is not straightforward and can of course be fact-specific to the scheme in question and its circumstances. In general, however, we would expect well-advised trustees to consider (as a minimum):

    (a) The financial strength of the scheme sponsor and the impact on it and its other stakeholders;

    (b) The financial impact on the scheme and its funding position if the benefits in question were not forfeited;

    (c) The quality of the data concerning scheme benefits and funding;

    (d) Striking a balance between (i) the entitlement of members to the benefits in question going back further than six years and (ii) the fact that the members have not made a claim for those benefits in the six year time period;

    (e) When and how the member and/or the trustees (or administrator) became aware of the underpayment and/or could have become aware of the underpayment and, in the former case, the alacrity (or otherwise) with which the member acted to bring the matter to the trustees' attention; and

    (f) The circumstances in which the original error arose (e.g. was the error as a result of systemic failings and/or had other similar errors arisen in the past or was the error a one

off and/or minor of which the trustees could not reasonably have been expected to have had actual or constructive knowledge?).

37. Ultimately, trustees will need to very carefully consider the purpose for which the forfeiture rule in their scheme was conferred before deciding whether or not to exercise that power. This is not an issue which was addressed in the *Lloyds* litigation as the discretionary forfeiture rule had not yet been exercised.

38. Further, whilst the *Lloyds* litigation has determined that section 92(5) of PA 1995 permits the forfeiture of historic underpaid benefits in certain situations, including where members were not aware of the underpayment, in accordance with a scheme's rules, that in itself is not an answer to whether each and every forfeiture rule found in pension schemes was conferred for this purpose. This is especially so given that many forfeiture rules were introduced into schemes before PA 1995 came into force on 6 April 1997.

39. Identifying the purpose for which a power is conferred is not straightforward in most cases, because the instrument conferring it will not state the purpose expressly. Accordingly, ascertaining the purpose of the power depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context: *Eclairs Group Ltd v JKX Oil & Gas Plc* [2015] UKSC 71 at [30]. The objects clause in a scheme is a good first port of call but is not decisive as to the purpose of the power in question: *British Airways Plc v Airways Pension Scheme Trustees Ltd* [2018] EWCA Civ 1533.

40. The primary purpose of a pension scheme is generally seen as being to secure the delivery of the benefits specified under the rules of the scheme: *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch). Accordingly, it would seem that some forceful arguments can be made that the exercise of a forfeiture power to forfeit underpaid benefits of which members were not aware is an improper use of that power. Of course, in any given case a detailed analysis of the scheme’s trust deed and rules will need to be undertaken in order to divine its proper purpose. We do note, however, that the use of a power of forfeiture to forfeit historic underpayments sits uneasily with the primary purpose of all occupational pension schemes, which is to provide retirement benefits which have been "earned" as part of each member's employment. On the other hand, it might be said that a forfeiture provision in fact

provides a benefit to the members of the scheme as a whole in that it encourages the proper and efficient administration of a scheme by time limiting claims by members to historic underpayments. We anticipate, however, that this latter argument would face a rather uphill struggle before an appellate court!

41. Members and their advisors wishing to challenge the forfeiture of benefits where there is a discretionary forfeiture power may wish to consider an improper purpose claim against the trustees of the scheme.

Attempts to amend schemes

42. Given that the consequence of Morgan J's judgment is that, in the absence of a valid forfeiture rule, there is no time limit on claims by members for back payments, trustees and/or employers will want to know whether they can validly amend the scheme to introduce such a rule. This could conceivably arise in two circumstances:

    (a) Where there is no forfeiture rule in the scheme and the trustee and/or employer wish to introduce one;

    (b) Where there is a discretionary forfeiture rule and the trustee and/or the employer wish to replace it with a mandatory forfeiture rule.

43. When seeking to amend a scheme, regard must be had to the scheme's amendment power, which may be held by the trustee or employer or be exercisable jointly.

44. In many cases, we think it likely that the introduction of a forfeiture rule where there has not been one previously would contravene the provisos contained in the amendment power. One typically finds restrictions on the exercise of an amendment power which prevent amendments which would *"adversely affect"* or *"substantially prejudice"* the *"rights"* or *"entitlements"* of members. Where members have previously accrued the right to benefits which are not subject to an express forfeiture provision, the introduction of a rule which would forfeit some of those benefits if unclaimed would likely fall foul of the common amendment provisos which protect against prejudicing accrued rights.

45. Even if on its true construction an amendment power does not prevent the introduction of a forfeiture rule, it would be open to the members to argue that the use of an amendment power to introduce such a rule would be an improper use of the power. As discussed above, such an argument will need to rely on a detailed analysis of the purpose for which the amendment power was conferred.

46. However, an amendment to introduce a forfeiture rule will not be a detrimental modification for the purposes of section 67 of PA 1995, and thus voidable at the instance of the Pensions Regulator. For Regulation 3(b) of the Occupational Pension Schemes (Modification of Schemes) Regulations 2006 disapplies section 67 in the case of amendments providing for subsisting rights to be forfeited in a manner that is not prohibited under section 92 of the 1995 Act.

47. It is more difficult to say whether a purported amendment to the scheme rules to change an existing forfeiture rule from a discretionary operation to a mandatory operation would be valid. In respect of both any possible amendment provisos and section 67, the issue is likely to turn on whether it can be said the member has any *"right"* or *"entitlement"* to receive the un-forfeited benefits. If the answer is that those benefits are seen as discretionary rather than as entitlements, then an amendment to introduce a mandatory forfeiture rule would not seem to prejudice accrued rights.

48. Accordingly, it may be possible to validly amend a scheme which already contains a discretionary forfeiture rule, in order to make that rule mandatory. Trustees should act cautiously, and may well think that this is a momentous decision calling for an application to the court for approval of such an amendment.

49. Finally, it is also important to have regard to the past iterations of the scheme Trust Deed and Rules. If a forfeiture rule has not been present in the scheme since its inception, the possibility arises that its introduction was an invalid amendment and/or contravened section 67 if the relevant amendment occurred after 6 April 1997. Trustees will want to review the past versions of the TDR and satisfy themselves that the forfeiture rule has been validly introduced before they purport to forfeit members' benefits.

Points of which advisors and practitioners must now be aware

50. When approached by an employer, trustee or member in relation to an underpayment, the following represents a checklist of points which advisors will want to consider:

    (a) The starting point is always the scheme rules. One must identify if there is a forfeiture rule. Such a rule need not necessarily refer to *"forfeiture"* – section 92(7) of PA 1995 defines forfeiture broadly as something that includes *"any manner of deprivation or suspension"*. Accordingly, it is necessary to consider what the relevant clause does *in substance* in order to determine if it is a forfeiture clause.

    (b) Where there is no forfeiture rule, it is doubtful whether it is possible to amend the scheme to introduce one at least to the extent that the rule adversely affects accrued rights.

    (c) If there is a forfeiture rule, it is necessary to consider whether it complies with section 92(5) of PA 1995. The rule will not be valid if it provides that a benefit can be forfeited if unclaimed for a period shorter than six years. Presumably, however, there is nothing wrong with a forfeiture rule which provides a member with a more generous time period in which to claim.

    (d) Is the rule mandatory or does it afford the trustee a discretion? Where the rule is mandatory, the benefits in question are forfeited as the law stands and the member is likely to be unable to take further steps to challenge that forfeiture. If the rule is discretionary, then the factors discussed above come into play. Trustees and their advisors need to be careful to take into account only relevant considerations when exercising their discretion and to disregard any irrelevant considerations. Members and their advisors, meanwhile, should consider whether the exercise of the discretion can be challenged in any way, or whether the use of the power to forfeit underpaid benefits is contrary to the purpose for which the power was conferred.

    (e) Advisors must analyse all previous iterations of the scheme's Trust Deed and Rules to check whether any forfeiture rule has been invalidly introduced into the scheme.

Conclusion

51. This is a complex and evolving area of law. The *Lloyds* litigation concerning forfeiture and time limits throws up a number of legal uncertainties which will surely be tested in the coming years, both at first instance and on appeal. While it is a shame (at least for those involved in the case) that the *Lloyds* decision is not itself going on appeal, we confidently expect these issues to come before the courts again in the not too distant future.

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