IN FOCUS

The Pro-rating of Pension Increases

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Introduction

A term in a pension scheme provides for annual increases to pensions in payment on 1 April of each year following the commencement of receipt of pension. A member begins to receive his pension on 1 January 2024. Will he be entitled on 1 April 2024 to a proportion of the increase for the period between his retirement and that date, or is the increase on that date only to be applied to pensions that had been in payment for the full year?

Most well-drafted pension schemes will make express provision for this situation: it is less common for schemes to expressly require a full year of pension payments before the first increase applies; most schemes provide for 1/12th of the increase to be provided for each complete month between retirement and the increase date, so that the member in the above example would receive 4/12ths of the increase.

For pension increases required by s.51 of the Pensions Act 1995, such pro-rating of increases is expressly provided for by s.54(2). However, the statutory increases do not apply to benefits referable to pre-6 April 1997 pensionable service or to schemes which under their rules already provide for increases at least as good as those required under statute:[1] what if in those circumstances the rules of the scheme are silent as to whether increases should apply to part years?

There are two ways in which it can be argued that, notwithstanding the absence of an express provision to that effect, the member who has been in retirement for less than a complete year should be entitled to a pro-rated increase.

[1] Sections 51(1)(b)(i) and (1)(c) of the Pensions Act 1995. There is an interesting question as to whether the assessment of whether the increases provided by the rules are as good as statutory increases itself requires the former increases to be treated as applying to an incomplete first year in retirement: the separate treatment of the rate of increase in s.51 and the timing of the payment in s.54 may suggest that it does not.

Section 2 of the Apportionment Act 1870

The first argument is based on s.2 of the Apportionment Act 1870, which provides as follows:

> *"All rents, annuities, dividends, and other periodical payments in the nature of income (whether reserved or made payable under an instrument in writing or otherwise) shall, like interest on money lent, be considered as accruing from day to day, and shall be apportionable in respect of time accordingly."*

For the purposes of s.2, *"annuities"* is defined to include salaries and pensions: *ibid*, s.5.

Section 2 treats the periodic payments as accruing from day to day, so that, where a payment which would only be payable on the expiry of a stated period, a person will become entitled to a proportion of that payment before that period expires. After some doubt,[2] it is now firmly established in the employment context that s.2 operates to remedy the injustice of the common law position that an employee whose contract is terminated before the end of the period on which their salary becomes due would receive nothing.[3] Whilst there is no corresponding authority in a pensions context, the same principle would seem to apply to enable a pensions increase to be apportioned for the benefit of a member who has been retired for less than a year.

Note that s.2 does not apply where there is an express provision that no apportionment is to take place: *ibid,* s.7: it can therefore only apply where the terms of the scheme are silent as to apportionment.

As to the period of apportionment, the reference in s.2 to the day-to-day accrual of the payments indicates that the payment should be apportioned daily, so that the member in the above example becomes entitled to 1/365^{ths} of the increase for each day of retirement. Thus, in *Hartley v King Edward IV College*,[4] the Supreme Court rejected the argument that the apportioned pay of employees who were required to work on Monday to Friday of each week should be apportioned over the number of those working days, and held that the apportionment was daily because under their annual contracts they were required to work such reasonable additional hours as might be needed to enable them to discharge their duties effectively. The terms of the contract therefore did not displace the prima facie position of daily apportionment. It accordingly appears likely that, subject to the terms of the scheme, annual pension increases will be apportioned on the basis of 1/365^{ths} per day.

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[2] Paul Matthews, '*Salaries' in the Apportionment Act 1870* (1982) 2 Legal Studies 302.

[3] *Item Software (UK) Ltd v Fassihi* [2005] ICR 450 at [116] per Holman J, approved by Lord Clarke of Stone-cum-Ebony JSC in *Harley v King Edward IV College* [2017] 1 WLR 2110 at [10].

[4] *Supra.*

Two final points.

(i) It should be noted that the treatment of pension payments as accruing daily is inconsistent with a scheme which provides for the payment of such pensions monthly, quarterly or annually. The administrative difficulties that this might cause trustees and administrators means that some schemes expressly exclude the application of s.2;[5] and if that exclusion is not limited to the payment of pensions, it may well also apply to exclude the apportionment of pension increases by that means.

(ii) Section 2 does not apply to any trust created or arising on or after 1 October 2013: unless their terms provide otherwise, the entitlement to income under such trusts is to income as it arises and does not accrue from day to day.[6]

The *"rate"* of pension increase

If, for some reason, the Apportionment Act cannot be relied upon to pro-rate pension increases, the same result may be achieved where the increase is specified in the provisions of the scheme in terms of the *"rate"* of increase. Although there is no case directly on point, dicta in two company law cases suggests that provision for a *"rate"* of annual increase imports the concept of pro-rating that increase for a period less than the year in question.

In *Re Central de Kaap Gold Mines*,[7] the articles of a company provided that *"the directors shall be paid out of the funds of the company* [a specified amount] *per annum"*. The executor of a director who had died part way through the relevant year applied to join proceedings brought by the liquidators of the company to determine whether the directors ranked as creditors in respect of those payments. The application was refused on the basis that the payment was not apportionable, so that the deceased director was not entitled to part payment. However, Wright J said that, had the articles provided for payment *"at the rate of"* the specified amount rather than the amount *"per annum"*, he thought that the payment would have been apportionable.[8]

In *Moriarty v Regent's Garage and Engineering Co Ltd*,[9] the plaintiff sold his business to a company, and the sale agreement provided that the plaintiff was to be a director of the company and that his fees for so acting were to be £150 per annum. The articles of the company provided that the remuneration of the directors should be *"at the rate of"* £150 per annum to be divided between the directors as they should agree, or equally in default of agreement. On ceasing to be a director part way through the year in question, the plaintiff sought payment of a proportionate part of the £150.

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[5] For an example of such a blanket exclusion in a public sector context, see reg.166 of the Teachers' Pension Scheme Regulations 2014 (SI 2014/512).

[6] Section 1(1) of the Trusts (Capital and Income) Act 2013.

[7] (1899) 69 LJ Ch 18.

[8] *Ibid,* at 19.

[9] [1921] 2 KB 766.

The Court of Appeal held that the sum was not apportionable under either the agreement or the articles: there was nothing in the agreement that expressly or implicitly provided for apportionment;[10] and there could be no default of the requirement under the articles for the directors to agree the division of the remuneration until the end of the year, which had not elapsed prior to the commencement of the proceedings. However, all 3 members of the Court of Appeal said that, had the articles simply provided for remuneration to be provided to the plaintiff *"at the rate of"* £150 per annum, it would have been apportionable.[11]

Conclusion

It can be seen from the above that it should not be assumed from the absence of an express provision for pro-rating pension increases during the first year of pension payment that such pro-rated increases should not be provided during that period.

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[10] The plaintiff could not rely on the Apportionment Act as it had not been raised in the court below.

[11] See per Lord Sterndale MR at 774 (*"The words 'at the rate of' are in the articles, and therefore if he had been otherwise in a position to recover the fees under the articles, they would have been payable for broken periods, because they are to be payable 'at the rate of'"*); per Scrutton LJ at 779 (*"it seems quite clear that as a matter of practice, the question of apportionment is now usually avoided or dealt with by using the words 'at the rate of' in the articles."*) and per Younger LJ at 781 (*"If, on the other hand, he is claiming under the articles where the words 'at the rate of' do occur, he might, if there were no other objection, be entitled to recover something"*).