ON THE CASE

Court of Appeal upholds validity of *McCloud* Costs Directions

R (The British Medical Association) v HM Treasury [2024] EWCA Civ 355.

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Introduction

Who should bear the cost of providing the "*McCloud* remedy" to members of public service pension schemes who suffered discrimination as a result of the unlawful transitional protection conferred when the former public sector schemes were replaced by new schemes in 2015? HM Treasury (**HMT**) decided, by Directions made in 2021, that the cost should in effect be borne by members of the new schemes, whether or not they benefited from the remedy.

The 2021 Directions[1] were challenged in judicial review proceedings brought by the British Medical Association (**BMA**) and the Fire Brigades Union (**FBU**), whose members include beneficiaries of two of the new schemes, the NHS Pension Scheme and the Firefighters' Pension Scheme. In *R (British Medical Association) v HM Treasury* [2024] EWCA Civ 355, the Court of Appeal dismissed the judicial review claims, upholding the decision of the Judge below (see here for the case note on the first instance decision).

[1] The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions.

Background

Following the Hutton report, public sector pension schemes were reformed in 2015, pursuant to the Public Service Pensions Act 2013 which introduced new career average schemes (**the new schemes**) and closed the former schemes (**the legacy schemes**).

One of the aims of the 2013 Act was to introduce a degree of cost control into the new schemes. The 2013 Act and the Regulations made under it provided for a cost control mechanism (**the CCM**). The CCM worked by assessing the cost of operating each new scheme as a percentage of pensionable pay. The percentage for each scheme (with a margin either side, initially +/- 2%) then stood as a benchmark against which future changes in the cost of the scheme were assessed. If future costs exceeded the permissible margin, there was a "ceiling breach", with the result that steps would have to be taken to bring the cost back to the target cost, either by cutting benefits or increasing member contributions. If future costs fell below the margin, there was a "floor breach" requiring benefit enhancements or member contribution reductions.

Guidance and policy documents about the CCM suggested that it would only be used if "member costs" had changed. "Member costs" were matters relating to the member profile, such as life expectancy and salary growth. They were distinguished from "employer costs" which related to financial matters such as the discount rate and actuarial method. It was said that the calculation of future service cost would ignore the cost of any transitional protection for members of the legacy schemes (as to which, see below).

The 2016 valuations of the new schemes provisionally established that there would be "floor breaches" because of wage restraint and other demographic factors, creating an expectation among members that there would be benefit increases or member contribution reductions.

In the meantime, it had become apparent that there was a major problem with the public sector pension reforms. Although the Hutton report had cautioned against providing transitional protection to older members of the legacy schemes due to concerns about discrimination, the 2013 Act permitted such protection when those schemes closed on 1 April 2015. Members who, on 1 April 2012, had less than a particular period of service left before Normal Pension Age, were allowed to continue as active members of the legacy schemes. Ultimately it was held that the transitional protection constituted unlawful discrimination against the members who were further away from Normal Pension Age, who were typically younger and were more likely to have other "protected characteristics" under the Equality Act 2010.[2]

To remedy the discrimination, the Government decided that affected members should be given a "deferred choice underpin", whereby members (whether they had had the transitional protection or not) could decide whether to take benefits from the legacy schemes or from the new schemes for the period from 1 April 2015 to 31 March 2022 (**the *McCloud* remedy**). The *McCloud* remedy was subsequently reflected in the provisions of the Public Service Pensions and Judicial Offices Act 2022.

The cost of providing the *McCloud* remedy was estimated at £4 billion. In 2020, HMT decided in principle that the *McCloud* remedy costs should be included as "member costs" within the CCM, so as to be absorbed, in effect, by members of the new schemes rather than the taxpayer. An equality impact assessment considered by HMT in October 2021 explained that including the *McCloud* remedy costs in the CCM would adversely affect some members, because their benefits would be lower than they otherwise would have been, and those adversely affected include members who would not be eligible for the *McCloud* remedy, who

[2] See *Lord Chancellor v McCloud* [2018] EWCA Civ 2844, holding, in essence, that the aim of protecting older members was not, on the evidence, a legitimate one.

were likely to be younger and more likely to be women and/or have other "protected characteristics".

Shortly after that, HMT went ahead and made the 2021 Directions, including the *McCloud* remedy costs as member costs within the CCM. This meant there would be no "floor breach" after all, so benefits were not increased and member contributions were not reduced in the new schemes.

This led to the current judicial review proceedings attacking the 2021 Directions.

The grounds for judicial review

On appeal, the BMA and FBU made the following case for judicial review of the 2021 Directions. The FBU argued that:

- the Directions were made for an improper purpose in the light of the correct construction of the relevant statutory powers, and

- the Directions discriminated unlawfully on grounds of age.

The BMA argued that:

- HMT was under an obligation to consult before making the Directions and had failed in its duty, and

- it was also in breach of the "public sector equality duty" in s 149 of the Equality Act 2010.

Underlying the technical legal submissions was the basic grievance that (as articulated by the BMA during the Government's consultation on the *McCloud* remedy) the remedy cost

was "a direct result of age discrimination imposed by the Government and was not the fault of the scheme members. It is essential therefore that the costs of this remedy are borne directly by the Government and that employee contribution rates, accrual rates and overall pension benefits are not adversely impacted by [the *McCloud* remedy]."

The Court of Appeal's decision

Improper purpose / statutory construction

The CCM derives from s 12 of the Public Service Pensions Act 2013, providing for an "Employer Cost Cap" in relation to "the cost of the scheme". By s 12(4), HMT was empowered to make Directions in relation to matters including "the costs or changes in costs that are to be taken into account … for the purposes of measuring changes in the cost of the scheme against the cap".

The FBU submitted that the relevant statutory purpose was to control the long-term costs of the new schemes, but not to control the value of new benefits not known at the time, and certainly not to enable the Government to pass on to members the costs of its own discrimination. The FBU argued that the references to "costs" in s 12 meant the costs of the new schemes only, whereas the *McCloud* remedy costs were the result of a civil wrong and were costs of the legacy schemes, which could not be passed on to members of the new schemes who could not benefit from the remedy.

The Court of Appeal rejected this argument. It regarded it as significant that the new schemes were unfunded "pay as you go" schemes, where current benefit payments are funded by the contributions of present employees. Thus younger members had always borne the costs of benefit provision for the older members, and the *McCloud* remedy costs were no different from this in principle.

Further, the legislative provisions did not expressly confine the word "costs" to the costs of the new schemes. The factual background meant that the wide general word "costs", which was not otherwise defined, should be given the widest possible meaning. It therefore included both the costs of a new scheme and, where HMT decided it was appropriate, the costs of a connected legacy scheme.

Given the wide meaning of "costs", the fact that the *McCloud* remedy was a remedy for a civil wrong did not mean that the CCM was being used for an improper purpose. The costs of the *McCloud* remedy were also simply the unexpected cost of providing benefits to members to which they were entitled (as a result of the non-discrimination rule implied by the Equality Act 2010).

Discrimination

The FBU argued that the inclusion of the *McCloud* remedy cost in the CCM discriminated indirectly on grounds of age against younger members of the new scheme, who were put at a particular disadvantage compared to older members of the scheme because they would not be able to take advantage of the "deferred choice underpin" remedy. It was argued that the inclusion of the *McCloud* remedy costs in the CCM was the relevant "provision, criterion or practice" (**PCP**) for the indirect discrimination provisions of s 19 of the Equality Act 2010. The PCP caused the younger members to lose the benefit of the "floor breach" and the expected benefit increases or member contribution reductions.

While initially attracted by the argument, the Court of Appeal ultimately rejected it. The effect of the PCP was to negate the beneficial effect of the "floor breach" for all members. It was therefore age-neutral and did not have a disparate impact. While younger members who were too young to benefit from the *McCloud* remedy had suffered a disadvantage, that was a consequence of the structure of the *McCloud* remedy set out in unchallengeable primary legislation, and was not causally linked to the PCP.

The Court of Appeal also rejected the FBU's argument that no legitimate justification for the PCP could be shown. The FBU argued, relying on the ECJ's decision in *De Weerd v Bestuur van de Bedrijfsvereniging* [1994] ECR I-571, that saving cost cannot be a legitimate aim justifying discrimination. However, the Court of Appeal followed *Heskett v Secretary of State for Justice* [2020] EWCA Civ 1487. *Heskett* had held that, while it would be illegitimate if the aim was "no more than a wish to save costs", a legitimate aim could take account of budgetary constraints, and that an employer's need to balance its books can constitute a legitimate aim, particularly in the context of age discrimination given that age is not binary unlike other "protected characteristics". In the present case, the Court of Appeal considered that HMT had sought fairly to allocate costs between members and taxpayers, and as the *McCloud* remedy costs were indeed "member costs" or in the nature of "member costs", the statutory scheme required them to be included in the CCM. The disparate treatment of younger members would therefore have been justified.

Consultation

The BMA argued that the duty to consult arose from a number of contextual factors, including pre-legislative promises, the number of people affected and the fact that the Government was passing on the costs of its own wrongdoing. The BMA claimed that the duty to consult had been breached because the Government's mind "had been made up" before the relevant meetings and discussions took place in 2021.

The Court of Appeal rejected this argument. There was no express statutory duty to consult on the particular point in issue (in contrast to other parts of the legislation which imposed an express duty in relation to different points). The Court agreed with the following summary of the applicable public law principles in *R (Plantagenet Alliance) v Secretary of State for Justice* [2014] EWHC 1662 (QB): there is no general duty to consult at common law, but such a duty may arise (a) if imposed by statute, (b) if there has been a promise to consult, (c) if there is an established practice of doing so, and (d) where, in exceptional circumstances, a failure to consult would lead to conspicuous unfairness. In the present case, there was no

statutory duty or, on the facts, any relevant promises, practice or legitimate expectation of consultation or any conspicuous unfairness.

The public sector equality duty

The public sector equality duty in s 149 of the Equality Act 2010 requires a public authority (such as HMT) in the exercise of its functions to "have due regard" to three listed needs, in summary (a) eliminating discrimination, (b) advancing equality of opportunity and (c) fostering good relations between persons who share a "protected characteristic" and those who do not.

The BMA argued that the s 149 duty was breached because HMT had not looked at the October 2021 equality impact assessment until the last minute and even then with a largely closed mind.

The Judge at first instance had held that HMT had had "due regard" to the listed needs, as it was obvious what impact the 2021 Directions would have on the relevant equality needs and they had been identified earlier in the process. The Court of Appeal was not persuaded that the Judge's evaluation was wrong, and accordingly dismissed the appeal on this ground.

Conclusion

As happened at first instance, all the grounds relied on by the BMA and FBU were rejected. The case is an interesting reminder of the enormous importance of public service pension schemes, in terms of the numbers of members belonging to them and the huge cost of any benefit changes in those schemes. It is also interesting to see how issues that in a private sector scheme might be resolved by trust law principles are resolved in a public sector scheme by public law principles – e.g. the consultation arguments in the present case – whereas so far as discrimination is concerned, the relevant provisions of the Equality Act 2010 (other than s 149) are common to both private and public sector schemes.

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