

## Amending pension scheme benefits by extrinsic contract

Updated September 2013

Pension briefing

### HIGHLIGHTS

In 2009 the High Court gave judgment in relation to the IMG Pension Plan, in a case concerning amendments intended to change defined benefit (DB) benefits to defined contribution (DC) benefits for both past and future service. The judgment is important because:

- The scheme had a restrictive amendment power – which the court held could not be removed by a subsequent amendment.
- It followed the decision in *Re Courage Group's Pension Schemes* (see box below) and held that the restriction in the amendment power protected final salary linkage, despite argument that *Courage* had been wrongly decided.
- The Court decided that contracts outside the scheme could not be used to get around the restriction in the amendment power. In doing so, it limited the circumstances in which such extrinsic contracts can be relied on – important as extrinsic contracts have become an increasingly popular device to effect benefit changes (following *South West Trains* – see box below). This part of the decision was followed by the High Court in *BBC v Bradbury* in 2012, which confirmed that extrinsic contracts can still be used provided the agreement concerns matters which fall outside the trust deed and rules.



### FACTS

The IMG Pension Plan was established by deed in 1977. The amendment power in the 1977 deed contained a restriction that:

*"no amendment shall have the effect of reducing the value of benefits secured by contributions already made"*

In 1981, IMG adopted rules for the scheme which contained an amendment power allowing the Principal Employer and the Trustee to amend the trust deed and rules provided that the alteration did not prejudice Revenue approval – that is, without the fetter contained in the 1977 amendment power.

In 1992 a deed was executed which purported to convert the Plan from a final salary scheme to a money purchase scheme in respect of both future and past benefits. Following the appointment of an independent trustee, HR Trustees Limited, questions as to the effectiveness of the conversion were raised and the Court was asked to resolve these issues.

Hogan Lovells acted for the independent trustee of the scheme. The trustee was appointed after the disputed amendments took place and was neutral as to the outcome of the proceedings.

### POWERS OF AMENDMENT

The Court was asked to consider several issues in relation to the amendment powers. It held that:

- The 1977 amendment power (containing the fetter by reference to the value of benefits) applied at the time of the 1992 conversion, and not the power in the 1981 rules (which had no such restriction). The 1977 amendment power could not itself have been used to remove the restriction contained in it.
- The restriction in the 1977 amendment power should be construed in line with the similar restriction in the *Courage*

case (see box below). In relation to IMG, the restriction did not prevent the conversion of final salary benefits to money purchase benefits – but it meant that the relevant money purchase benefits were subject to a final salary underpin. To avoid reducing the “value” of the benefits, the underpin had to be calculated by reference to the member’s service to the date of the 1992 amendment and the future final salary of the member when he or she left pensionable service – in other words, a final salary link applied.

- An argument that the deed effecting the 1992 conversion could have retrospective effect should be rejected (the power of amendment was silent on the question of retrospective amendments), because to allow this would be to re-write history, which was not permissible.

### THE COURAGE CASE

*Re Courage Group's Pension Schemes*, decided in 1986, concerned a scheme whose amendment power was subject to a restriction that:

*"no such alteration...shall...vary or effect any benefits already secured by past contributions in respect of any member without his consent in writing".*

The Court was asked to consider the effect of this restriction and held that, in the absence of express definition, there was no reason to exclude from the protected benefits any benefits the member would be prospectively entitled to in respect of future service – put more simply, benefits accrued up to the date of the amendment had to be protected by reference to the member’s final pensionable salary on leaving the scheme.

## EXTRINSIC CONTRACTS

The employers in *IMG* tried to argue that, by virtue of the members having signed application forms to join the new money purchase arrangement, they were contractually bound from claiming anything other than money purchase benefits, relying on the principle in *South West Trains v Wightman* (see box below).

On the facts of the case the Court found there had been no contract made by the employer and members, but that in any event the principle in *South West Trains* could not apply where the contract would override contrary provisions in the trust deed itself – unless the members had consented to that. The Judge made it clear that such consent would have to be fully informed consent and that members would have to have a real choice as to whether to consent.

### SOUTH WEST TRAINS V WIGHTMAN

*South West Trains*, decided in 1998, concerned amendments to train drivers' pension benefits agreed under collective bargaining procedures. The pension benefits under the agreement did not accord with the benefits due under the rules of the scheme. The Court held that there was an implied term under the agreement that the drivers would not claim pensions from the scheme at a higher level than that agreed in the collective bargaining procedure. It followed that the trustee of the pension scheme could and should execute an amending deed to give effect to the contractually-agreed changes.

## THE BRADBURY CASE

The issue of extrinsic contracts was considered in the case of *Bradbury v BBC* in 2012. An active member had been offered a salary increase on the basis that the increase in his pensionable pay for the purposes of his final salary pension would be limited to one per cent per year. The alternative option offered to him was to leave the defined benefit scheme and join a career average section for future service. One of the employer's arguments was that the claimant's individual agreement to the cap on pensionable pay was binding as an extrinsic contract.

The High Court held that, subject to a breach of "implied duties" (see below), an agreement to accept a pay rise on the basis that only part of it would be pensionable would be binding on the member, regardless of the provisions of the deed and rules. The facts fell into the *South West Trains*, rather than the *IMG*, category of case. The enforcement of the extrinsic contract would not have been contrary to the terms of the trust. As in *South West Trains*, the extrinsic contract only affected the salary to which members were to be treated as entitled for the purposes of calculating their pension, which the trustees would have had to look outside the rules for anyway.

## IMPLIED DUTIES

Mr Justice Warren in *Bradbury* went on to say that the employer ought not to be able to rely on a contract agreeing the cap on pensionable salary with a member if the consent given had been undermined by a lack of real choice as to whether or not to accept the changes, since this might give

rise to a breach of the employer's implied duty of trust and confidence or good faith.

The Court in *Bradbury* was unable to consider the implied duties issue as the case was an appeal from a decision of the Pensions Ombudsman and the issue had not been raised before the Pensions Ombudsman; nor had the employer had the opportunity to adduce evidence. However, the member was not precluded from pursuing a separate claim for breach of implied duties.

## ANTI-ALIENATION PROVISIONS AND SETTLEMENT AGREEMENTS WITH MEMBERS

Section 91 of the Pensions Act 1995 provides that (with certain exceptions) any agreement to surrender a member's pension entitlements or rights to a future pension is unenforceable.

In relation to the *IMG* Plan, in some cases the employer and members concerned had entered into agreements with the purported effect of limiting those members' pension entitlements to money purchase benefits.

The High Court in the *IMG* case decided that these settlement agreements were rendered unenforceable by section 91, even though there was a genuine dispute as to the members' entitlement. However, this issue went to the Court of Appeal, who confirmed that, in line with public policy in favour of settling disputes, section 91 is not a bar to compromising disputes over pension rights. Section 91 is limited in scope to "rights and entitlements" to future benefits and does not extend to disputes over whether rights exist.

The High Court in *Bradbury* agreed with the Court of Appeal's conclusion on the section 91 point and held that an agreement between the employer and a member to restrict increases in pensionable pay was not contrary to section 91.

## ONGOING EFFECT OF THE IMG CASE

The *IMG* case offers clear guidance on the important question of whether amendment powers can be amended and when amendments can have retrospective effect (in the absence of express provision). It also affirms the decision in *Courage*, which has been the subject of some criticism, and which it was argued in the *IMG* case had been wrongly decided.

The case also highlights the fact that where there is a restriction in the power of amendment, there are potentially insurmountable obstacles in the way of attempts to get around it.

The *IMG* decision significantly limited the use of the extrinsic contracts approach. The *Bradbury* case has confirmed that the principle in *South West Trains v Wightman* can still be used provided the agreement concerns a matter which is "outside" the trust deed and rules. However, where the issue is one which is not outside the trust deed and rules and the agreement would override contrary provisions, following *IMG* the principle is of limited use and would need both fully informed consent from, and a real choice for, the members.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

#### KEY HOGAN LOVELLS PARTNERS

<b>Jane Samsworth</b>	<b>+44 20 7296 2974</b>	<b>jane.samsworth@hoganlovells.com</b>
<b>Katie Banks</b>	<b>+44 20 7296 2545</b>	<b>katie.banks@hoganlovells.com</b>
<b>Duncan Buchanan</b>	<b>+44 20 7296 2323</b>	<b>duncan.buchanan@hoganlovells.com</b>
<b>Claire Southern</b>	<b>+44 20 7296 5316</b>	<b>claire.southern@hoganlovells.com</b>
<b>Edward Brown</b>	<b>+44 20 7296 5995</b>	<b>edward.brown@hoganlovells.com</b>



### **Pensions360:** the full picture

[www.hoganlovells.com/pensions360](http://www.hoganlovells.com/pensions360)

#### **About Pensions360**

Hogan Lovells' broad cross-practice capability covers the full spectrum of legal advice from lawyers who understand pension clients; advising on issues from scheme investments, corporate restructurings and transactions, to funding solutions and interaction with the Regulator or the courts. The ability to draw on specialists from other practices who are not only experts in their field but have an in-depth understanding of pension issues sets us apart from our competitors.

**[www.hoganlovells.com](http://www.hoganlovells.com)**

"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.

The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members.

For more information about Hogan Lovells, the partners and their qualifications, see [www.hoganlovells.com](http://www.hoganlovells.com). #5006619

Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney Advertising.

© Hogan Lovells 2014. All rights reserved.