THE DYSTOPIA PENSION SCHEME:

An everyday tale of pensions administration

Introduction

In this talk I am intending to explore some of the problems which arise when it turns out that for several years a pension scheme has been administered on the wrong basis. I am sure that is a situation which is familiar to all of us here, even if the cause of the problem is of course nothing to do with us. So let me introduce you to the Dystopia Pension Scheme, a scheme which has perhaps been unfortunate in the number of problems it faces, but whose circumstances are by no means unique.

The Dystopia Pension Scheme

The basics

This imaginary scheme is a contracted out final salary scheme established by an Interim Deed dated 13th December 1978 and a Definitive Deed dated 21st January 1982.

The principal employer is Dystopia Limited.

The long-standing advisers to the trustees and employers are Frank Spencer Plc, a company which, perhaps prophetically, was founded by someone sharing a name with the principal character in *Some mothers do 'ave 'em*, a programme which was extremely popular at the time. Frank Spencer provides benefit consultancy, documentation, administration, actuarial and investment services.

The governing documentation

The Scheme's governing documentation consists primarily of a Second Definitive Deed dated 13th November 2002. That Deed has been amended by three further Deeds:

- an A Day Deed dated 27th March 2006, which also introduced an RPI/2.5% cap on increases to pensions in payment

- a Deed of Amendment dated 23rd February 2009 introducing an RPI/2.5% cap on revaluation

- a Deed of Amendment dated 17th August 2011 incorporating Finance Act 2011 changes.

The exact dates are not material, but give a flavour of the history.

The 2002 Deed closed the Scheme to future accrual from 1st January 2003 and introduced a new DC section. The existing DB benefits are based on 1/60th accrual and the Scheme has been administered on the basis of an NRD of 65 with effect from 1st January 1993.

Relevant provisions of the 2002 Deed

The Scheme's power of amendment is in clause 23. The power is exercisable by the trustees with the consent of the principal employer. The formalities requirement is that it should be exercised by deed or, in the case of the Rules, by resolution of the principal employer and by resolution of the trustees placed before the trustees in writing and signed by the chair of the trustees. It is exercisable retrospectively but is subject to a *Courage* proviso.

Under clause 17 the trustees have an express power to make a transfer payment in respect of any member, with the consent of the principal employer if the member is not entitled to a cash equivalent.

Relevant provision of the 2006 Deed

Clause 7 contains a prohibition on making any unauthorised payments out of the Scheme.

The present situation

The Scheme's last actuarial valuation was as at 31st December 2014 and was signed on 24th March 2016. The process was made difficult by disagreements between Dystopia and the trustees over the strength of the employer covenant. An independent trustee, Standfast Trustees Limited, was appointed in September 2015 to assist in resolving the issues.

Having completed the 2014 valuation, Standfast is now keen to have a new definitive deed updating the 2002 deed and reflecting the new pension freedoms. The trustees have instructed solicitors Prudent and Careful LLP to act.

Prudent and Careful say:

- when (and how) was NRD equalised?

- how was the final salary link dealt with on closure to future accrual?

- the administrators appear to have overlooked the reduction of the revaluation cap from RPI/5% to RPI/2.5%. Have there been overpayments?

- why have there been so many complaints to the Ombudsman about transfers out?

As a result:

- the administrators want to know how to administer the Scheme in the future

- the actuary wants to know on what basis to value the liabilities for the 2017 valuation

- Dystopia Limited is concerned about the potential increase in its contributions and wants to know if it can sue anybody

- the trustees want to know the answers to all those questions and whether they can recover any overpayments which have been made.

The equalisation issue (ignoring GMPs)

The relevant facts are as follows:

- The 2002 Deed is expressed to take effect from 1st January 2003 "unless a different effective date is required by any particular provision".

- The 2002 Deed defines NRD as 65 for all members except for female members in respect of service prior to 1st January 1993, in relation to whom NRD is 60.

- The power of amendment in the original Definitive Deed required all amendments to be made by deed. There was no provision for resolutions. NRD was defined as 65 for male members and 60 for female members.

- There is no trace of an equalisation deed prior to the 2002 Deed, although company minutes record consent to an equalised NRD of 65 from 1st January 1993 and there is a written resolution of the trustees signed by the chair approving such an amendment.

(a) Correctness of the administration

This gives rise to two broad questions: first, is there any basis on which it could be argued that the Scheme has been correctly administered, and secondly, if it appears that the administration has been wrong, how is it to be corrected? Strictly speaking, the first question might be said not to fall within the scope of this talk, but in practice, before launching into an expensive corrective exercise, it is worth examining whether there is a possibility of avoiding the exercise altogether, or at least avoiding it in relation to some classes of members, so I will look briefly at some possible arguments.

As respects members who joined the Scheme after 1st January 1993, there may be a ray of light in the terms of their contracts of employment or the statement of particulars of the employment, which at all material times had to contain particulars relating to pension schemes. There are potentially two lines of argument.

First, if the contract contains a term to the effect that NRD is 65 for all purposes, including the purposes of the Scheme, there may be an extrinsic contract argument along the lines of *South West Trains Limited* v. *Wightman* [1998] P.L.R. 113. The 2002 Deed could then be argued to have reflected the position under the extrinsic contracts and to have amended the Scheme in this respect with effect from 1st January 1993.

Secondly, it is possible that the Scheme documentation allowed Dystopia to specify NRD for particular employees and the documentation given to new joiners contained such a specification. In that event, amendment would not have been required because the possibility of an NRD of 65 for all members was inherent in the original Deed and the contractual documentation was simply a working out of the existing provision. The definition of NRD in the 2002 Deed could equally be said to have taken effect from 1st January 1993.

As we all know, however, what would not, without more, help Dystopia is a Scheme booklet of the traditional kind dating from 1993 and stating that NRD was 65 for all members. Such booklets apparently invariably contain a disclaimer to the effect that if there is a difference between the booklet and the scheme deed and rules, the latter prevail. It follows that arguments based on a booklet do not succeed: see *Steria Limited* v *Hutchison* [2006] EWCA Civ 1551, [2006] I.C.R. 445.

As respects all members, an alternative approach is to consider whether the situation can be salvaged by an argument based on the decision of Arnold J. in *Burgess* v. *BIC UK Limited* [2018] EWHC 785 (Ch), [2018] P.L.R. 13. The case concerned the validity of increases to pensions in payment earned by service before 6th April 1997. In February 1991 the trustees, who were also the executive directors of the employer, resolved that pensions should be increased annually by the lower of 5% and RPI. The resolution was recorded in the minutes of the relevant trustee meeting. At the time, the scheme's governing documentation provided that amendments had to be made by deed. In 1993 a new definitive deed was adopted which was expressed to have retrospective effect to 6th August 1990. It permitted rule amendments to be made by resolution in writing of the trustees with the consent of the principal employer. Arnold J. held that the retrospective exercise of the power of amendment in the earlier deed meant that the February 1991 resolution was a valid resolution complying with the requirements of the new power of amendment in the 1993 deed and so was effective to grant the increases to which it referred.

In the present case, reliance on *BIC* could be successful only if the definition of NRD was treated as amended with effect from 1st January 1993, a question of construction of the 2002 Deed. If that could be established, it might similarly be argued that the company minutes and the trustee resolution complied with the amended power of amendment and so NRD was validly altered from 1st January 1993.

The obvious apparent answer is that this approach would fall foul of both the *Courage* proviso and s.67 of the Pensions Act 1995 and, since the relevant deed was executed in 2002, would be void on either basis in respect of pre-2002 service. Arguably, that is not in fact a complete answer, since the curiosity of *BIC* is that the decision held that a prospective exercise of a new power of amendment was valid, although that consequence depended on the retrospective exercise of the previous power of amendment. Even so, and despite the possibility of some exciting intellectual gymnastics, I would not myself hold my breath for such a result, given that it would be adverse to members, whereas in *BIC* the effect was beneficial to members. In any case, *BIC* is being appealed and the appeal is listed for hearing on February 2019, so it is possible that the argument will cease to be available. Nevertheless, it may be a point worth considering.

(b) Assuming the administration has been wrong

Let us now assume that equalisation did not occur until the execution of the 2002 Deed. Among the points which will call for consideration are the following:

- how is the "better of" test applied?

- what is the position of members who have transferred benefits using a transfer value based on 1993 equalisation?

- what is the position of the estates of deceased members who have received benefits on the basis of 1993 equalisation?

- what is the position of dependants and deceased dependants who have received benefits so calculated?

(i) The better of test

The Scheme, like many schemes, provided for entitlement to benefits to crystallise at NRD and for LRFs to apply to the pensions of members who continued to work after NRD. This will not necessarily be the case; IR12 permitted schemes to provide continued accrual rather than a pension at NRD increased by the applicable LRF. Similarly, in the case of the Scheme ERFs were applied to all retirements before NRD and employer consent was required. Schemes frequently permitted early retirement for members who had reached 60 or a later age before NRD without any reduction, although generally with employer consent.

The Scheme used sex-based actuarial factors at all material times. There continues to be a specific exemption for the use of sex-based actuarial factors in relation to early and late retirement benefits under reg. 4 of the Equality Act 2010 (Sex Equality Rule) (Exceptions) Regulations 2010, S.I. 2010 No. 2132. If and in so far as the decision of the Court of Justice of the European Communities in *Association Belge des Consommateurs Test-Achats ASBL* v. *Conseil des Ministres* [2012] 1 W.L.R. 1933 (and in particular the Opinion of the Advocate-General) might have been thought to point in a different direction, it seems that any change will not affect benefits accruing as long ago as the period 1993 to 2002. The use of different factors may have an effect on the outcome of the better off test.

It is helpful to divide members into groups by reference to their age at retirement. Starting with members in active membership at the date of retirement, a member retiring under 60 is retiring early whether male or female. The difference is that male members will have had an ERF applied for a longer period and their benefits must be equalised up.

A member retiring after 65 is retiring late whether male or female and some element of LRF will have been applied. A male member, however, will have continued to accrue benefits between 60 and 65 and the LRF will have been applied to the member's final pensionable salary at 65. A female member's pension will have crystallised at 60 and the LRF will have been applied thereafter. The question is which calculation produces the more favourable outcome. Very generally, crystallisation at 60 followed by the application of an LRF usually produces more favourable results, but that may not be the case if the member received a significant salary increase after the age of 60.

The position is the same for a member retiring at 65, except that no LRF will have been applied to the male member's pension.

The most difficult case is the case of the member retiring between 60 and 65. A female member's pension will have crystallised and some element of LRF will have been applied. A male member will have continued to accrue benefits until the date of retirement and some element of ERF will have been applied. Is the comparison required between (a) the pension received by the female member and the pension the male member would have received assuming he had an NRD of 60 but continued to accrue benefits (so that the effect of the ERF is removed) or (b) the pension received by the female member and the pension actually received by the male member, that being his entitlement under the unamended Rules? The effect of (a) is to treat all members as having an NRD of 60 during the *Barber* window, so that all male members will receive an increase in pension whether on the basis of crystallisation at 60 or on the basis of continued accrual. The removal of the ERF obviously increases the likelihood that the male basis of calculation may exceed the female basis and so correspondingly increases the likelihood that some female members will also receive an increased pension. The effect of (b) is to make a direct comparison with what the member would have received under the Scheme if he or she were of the opposite sex.

I am not aware of any authority which answers the question, although the remarks of Morgan J. in *Lloyds Banking Group Pensions Trustees Limited* v. *Lloyds Bank Plc* [EWHC] 2839 (Ch) at paragraph 339 about calculation factors and the principle of minimum interference discussed in the judgment might tend to imply that (b) is correct. This aspect of the *Lloyds* case has already been considered by Neil Bowden and Jason Shaw in their talk.

Similar issues arise in relation to members retiring from deferment, except that the issue is the length of the period for continued revaluation under the Scheme rules rather than the length of the period of continued accrual of benefits.

Practically speaking, answer (a) will be more expensive but may be less likely to attract further complaints from members and less likely to mean that the issue has to be resolved by expensive litigation. It may mean, however, that full recovery is not made from Frank Spencer if proceedings for professional negligence are later brought. This might also be the case if the effect of the *Lloyds* approach is that both methods of equalisation are permissible.

It will also be appreciated that the practical benefit for male members will depend very much on the proportion of their pension which is derived from pre-*Barber* service.

(ii) Members who have transferred

The question here is whether the Scheme is under any continuing liability to members who have transferred out or whether the trustees can rely on the statutory discharge contained in s.99 of the Pension Schemes Act 1993 or on the Scheme's own provisions. As respects transfers in, and of course subject to the terms of the transfer agreement, the effect of *Coloroll Pension Trustees Limited* v. *Russell* [1995] I.C.R. 179 is that the Scheme is obliged to equalise benefits in respect of *Barber* window service which have not yet been equalised and may have a claim against the transferring scheme to obtain appropriate additional funding. It was agreed in the *Lloyds* case that such benefits should be equalised.

Although the question of transfers out was raised in the *Lloyds* litigation, it was not, or has not so far been, answered, for the reasons given by Morgan J. at paragraphs 467 to 471 of the judgment. It remains a matter of considerable uncertainty, to which I shall not attempt to give a definitive answer, but I shall comment briefly on the statutory discharge provisions and on the Scheme power, which I have taken from a real deed. In practice, it would also be necessary to consider any relevant Scheme discharge rule and the possibility of discharge under forms used by the Scheme and signed by the members, but it may well be that they give rise to similar issues..

S.99 provides (and has always provided):

"(1) Where –

(a) a member has exercised the option conferred by section 95; and

(b) the trustees or managers of the scheme have done what is needed to carry out what the member requires,

the trustees or managers shall be discharged from any obligation to provide benefits to which the cash equivalent related …"

The option conferred by s.95 is, for present purposes, the option to require the trustees to transfer the cash equivalent value of the member's accrued (or transferrable) rights to another pension provider or to an insurer. Broadly speaking, the Act requires the cash equivalent to be calculated in the prescribed manner and under the Occupational Pension Schemes (Transfer Values) Regulations 1996, S.I. 1996 No. 1847, the cash equivalent is the amount required to make provision within the scheme for a member's accrued benefits, options and discretionary benefits calculated on an actuarial basis.

The argument in favour of discharge, at its most basic, is as follows: the member exercised the option to take a transfer in respect of the right to retirement benefits under the Rules; the trustees got the cash equivalent calculated and made payment of it to the appropriate recipient; the trustees are discharged from any obligation to provide retirement benefits, those being the benefits to which the cash equivalent related.

The difficulty with the argument as a matter of principle is that the reasoning applies to the most egregious errors in the calculation of the cash equivalent (for example, assuming 10 years' pensionable service rather than 20, or a salary of £15,000 rather than £150,000) as well as errors such as a mistaken belief that equalisation has been effected. In the case of those extreme examples, the amount calculated as the amount required to make provision for the member's accrued benefits is manifestly wrong and it is difficult to see why it could not successfully be argued that:

- the member requires the transfer of a properly calculated cash equivalent and until such a calculation has been made and the calculated amount has been transferred, the trustees have not done what the member requires;

- alternatively, and to the extent that partial transfers are and were possible, the cash equivalent related to part only of the member's rights and the trustees are discharged in respect only of that part. It may be noted that IR12 refers to partial transfers as permissible where social security legislation requires or allows.

Although such errors could be seen to have been errors at the time, there is no reason in principle why a member should be prevented from receiving the full value of his or her accrued rights on the ground that at the time it could not have been appreciated that an error was being made. A test based on the nature of the error and the potential for it to be realised would be thoroughly unsatisfactory. The example of the present equalisation error illustrates this, since the mistake could have been appreciated at any time by a professional adviser who considered the equalisation process.

In the case of equalisation, *Coloroll* might lead to a variety of arguments. Although the decision as respects the obligations of receiving schemes and the potential liability of paying schemes related exclusively to the employee who moves from one occupational scheme to another, taking a transfer of the benefits, that may be as a result of exercising the s.95 option or following a bulk transfer. The ECJ was not asked to consider the effect of s.99 and simply referred to the possibility of a claim by the receiving scheme under national law. It might be said:

- the member not only can but also must look to the new scheme for all benefits. It is inconsistent with that analysis that the member retains rights and perhaps benefits in the old scheme, especially if such retention raises the possibility that in the event of a reduction in benefits under the new scheme on financial grounds, the member might seek to top up his or her benefits by a claim against the old scheme. S.99 must be construed accordingly.

- alternatively, far from being inconsistent with that analysis, the member should retain rights and benefits in the old scheme which are exercisable in effect on behalf of the new scheme to meet any shortfall in funding. S.99 must be construed accordingly.

- if s.99 is construed as discharging the old scheme in an equalisation case, that will give rise to an unjustifiable distinction between members who exercise the right to a cash equivalent in favour of a new salary-related scheme, which will have to provide equalised benefits, and members who transfer to a money purchase scheme, whether occupational or personal, under which they will obtain only what their inadequate transfer value purchases.

Turning to the Scheme's own power, it provides that the transfer:

> "shall discharge the Trustees of all liability under the Scheme to and in respect of the Member in respect of those benefits represented by the Transfer Payment."

Similar questions to those discussed above arise in relation to the phrase "in respect of those benefits represented by the Transfer Payment". Does the transfer payment represent the whole of the member's rights to retirement benefits? Or does it represent only the benefits on the basis of which the calculation has been made, whether that be the 10 out of 20 years' service benefits or the £15,000 out of £150,000 salary benefits or the benefits excluding the *Barber* increase?

It may be that different answers would potentially be reached in relation to s.99 and in relation to a scheme transfer power, if indeed the scheme transfer power as exercisable in relation to a cash equivalent does not simply reflect the statutory power. It seems, however, that if the trustees could show an effective discharge under either the statute or the Scheme power, that would be sufficient; they only need to be discharged once, in the absence of a statutory provision imposing continuing liability.

(iii) Other potential claims

Clearly there are potential claims in respect of underpaid lump sums, arrears of pension and interest on arrears by:

- existing pensioner members

- the estates of deceased pensioner members
- existing dependants (who can rely on *Coloroll* if necessary)
- the estates of deceased dependants

This is the issue of back payments, which is one of the issues determined by Morgan J. in the *Lloyds* case and which has been considered in Neil and Jason's talk. I am steering well clear of any discussion of limitation.

In addition to the question of limitation, one of the more difficult questions here, not yet answered by *Lloyds*, is the question how far the trustees are obliged to go in seeking to trace those entitled to benefit from the estates of deceased pensioners or dependants. The *Barber* obligation is to use all the means available under domestic law to eliminate discrimination, but once the governing documentation has been suitably amended, that obligation has been performed. It is generally understood that trustees are only obliged to take reasonable and proportionate steps to trace those who benefit from the equalisation amendments. A greater obligation would be potentially prejudicial, for costs reasons, to existing and prospective pensioners and dependants whose existence and location is well known.

Inevitably, what is reasonable and proportionate will depend on circumstances. If there is an effective scheme rule limiting arrears to a six year period, that may eliminate the need for significant work. If not, a six year period may nevertheless be a useful starting point by way of analogy with a number of limitation periods and pending discovery of whether or not Morgan J.'s decision on limitation is appealed, and if so, the outcome.

As a final thought, where the costs of calculating the entitlement of a pensioner or dependant would be disproportionate to any likely benefit, it might be possible to reach an agreement under s.91(5)(b)(ii) that the pensioner or dependant would surrender the *Barber* benefits in exchange for some other benefit under the Scheme's Rules, such as an augmentation of the existing pension. The wording of that provision does not appear to extend to an agreement with a member's or dependant's personal representatives or the beneficiaries of the estate. It might be arguable, however, that when the member or dependant has died, s.91 has no application and the trustees can reach agreement on the footing of an ordinary compromise over the extent of a claim.

The final salary link issue

When the 2002 Deed was in the course of preparation, members were given the option of:

- transferring their benefits to a new DC section at an enhanced transfer value
- becoming deferred members of the DB section

The communications to the members stated that:

- the enhanced transfer value would be based on the actuarial assumption as to salary increases made for the purposes of an actuarial review as at 31st December 2001

- the value of the benefits of members remaining in the DB section would be protected by revaluation.

About 75% of the members transferred to the DC section.

(a) Correctness of the administration

It should be noted that the closure to future accrual took place before the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006, S.I. 2006 No. 349, came into force and it may be that communications were sparser than would now be the case. It may also be that a careful examination of the contemporaneous documents would nevertheless enable Dystopia to argue that each member had entered into a contract to accept benefits on the basis of their selected option in place of the rights they enjoyed under the previous Scheme documentation, but there is a *fait accompli* air about the communications which makes that seem unlikely. The members had no opportunity to retain their subsisting rights to pensions at their eventual final salary level for the years of service already undertaken. A comparison of *HR Trustees Limited* v. *German* [2009] EWHC 2785 (Ch), [2010] P.LR. 23, the *IMG* case, and *Briggs* v. *Gleeds Head Office* [2014] EWHC 1178 (Ch), [2015] Ch. 212, is helpful in illustrating circumstances in which a contract will and will not be found to exist, even if the reliance by Arnold J. in *HR Trustees* on informed consent was misplaced, as it was considered to be by Newey J. in *Gleeds*.

(b) Underpins

Let us assume that there was no contract with either transferring or remaining members. As respects the transferring members, the solution arrived at in *HR Trustees* was to apply an underpin so far as necessary to give effect to the *Courage* proviso found in that case, rather than to treat the conversion of the scheme from final salary to money purchase as wholly invalid. There seems no reason why such an underpin should not apply here also. The obvious approach would be to compare the amount of the member's pension arising at the date of retirement or leaving service from that part of the pension pot representing the value transferred in and investment yield on that value with the amount of the pension which would have been earned by service to 1st January 2003 using final pensionable salary at the date of retirement or leaving service. How expensive this will prove to be will depend upon the extent to which the 2001 actuarial assumption as to increases in salary was borne out in fact and the extent to which members' final pensionable salary reflected not only annual increases in salary but increases through promotion, as well as on the investment performance of the DC section.

As respects the non-transferring members, as deferred members their pension entitlement as at 1st January 2003 has of course been increased by revaluation. In theory a scheme may either simply follow the statutory provisions relating to revaluation or it may have a scheme specific rule, which will apply to deferred pensions in these circumstances just as it does in any other case. Here there is a scheme specific rule, which apparently mirrors the statutory provisions. The first element in the comparison is simply the pension which is produced at the date of retirement by revaluing the 2003 pension in the usual way.

The second element in the comparison will also be straightforward if the member retires from service with Dystopia, so that the original Scheme definition of final pensionable salary would have been applied at that point. The member will receive the better of the revalued 2003 pension and a pension calculated by reference to final pensionable salary and the member's years of pensionable service before 1st January 2003. It is less straightforward if the member left service before retirement and would have become a deferred member in any event at that point and various possible solutions have been suggested. My own view is that the logic of the situation requires calculation of the deferred pension to which the member would have become entitled on leaving service by reference to final pensionable salary at that date and the years of pensionable service before 1st January 2003 and then to apply the Scheme's revaluation rule until the date of retirement. This seems to be the approach favoured by Warren J. in *IBM United Kingdom Holdings Limited* v. *Dalgleish* [2014] EWHC 980 (Ch), [2014] P.L.R. 335, at paragraph 289 and is consistent with what was said about the relationship between revaluation and the final salary link by Nugee J. in *G4S Plc* v. *G4S Trustees Limited* [2018] EWHC 1749(Ch), [2018] P.L.R. 16. A variant of this approach would be to make the comparison at the date of leaving service and thereafter simply to revalue whichever was the higher pension amount. Mathematically the two approaches ought to produce the same result, since after the date on which service ceases the member's pension, whatever it is, will be increased by revaluation under the Scheme, but there may be administrative advantages to one or other approach.

<u>(c) Underpayment claims</u>

A failure to break the final salary link will of course give rise to questions about members who have transferred out, underpaid pensioners and dependants and the estates of underpaid pensioners and dependants similar to those discussed in relation to equalisation. Similar considerations will also apply in answering them.

The overpayments issue

Here there is no doubt that the administration of the Scheme has been on a wrong basis. Annual increases in RPI exceeded 2.5% in 2010 to 2013 and in 2017. The administrators' failure to apply the 2.5% cap means that:

- some pensions were put into payment at too high a level
- some lump sums were overpaid
- some transfer values were calculated at too high a level.

It is not realistic to argue that the members should have known of the mistake in administration, although the 2009 change itself was communicated.

<u>(a) Recovery back of the overpayments</u>

The starting point is that it is now well established (see most recently *High Commissioner for Pakistan in the United Kingdom* v. *Prince Mukkaram Jah* [2016] EWHC 1465 (Ch), [2016] W.T.L.R. 1763, referring to the decision of the Supreme Court in *Aspect Contracts (Asbestos) Limited v Higgins Construction Plc* [2015] UKSC 38, [2015] 1 W.L.R. 2961) that s.5 of the Limitation Act 1980 provides a 6 year limitation period for claims to recover money paid under a mistake. This is not self-evident from s.5, which refers to actions "founded on simple contract", but the contrary now appears beyond argument.

It follows that, since more than 6 years have now elapsed since the increase in RPI began to exceed 2.5%, there will be some claims which are prima facie statute-barred, in whole or in part. It is true that where the claim is one for relief from the consequences of a mistake, s.32 provides that time does not begin to run until the claimant has discovered the mistake or could with reasonable diligence have done so. There may be room for argument about when the trustees could with reasonable diligence have discovered the mistake in the present case. Something of a warning note was struck, however, by Morritt L.J., as he was then, who said in *West Sussex Properties Limited* v. *Chichester District Council*, transcript and [2000] N.P.C. 74:

> "No doubt the mistake precedes and is different from a failure to exercise reasonable diligence after it has been made. But there may well be cases in which there is a claim for relief from the consequences of a mistake which was honestly but very stupidly made. I see no reason why the continuation of the facts which gave rise to the mistake on the part of the claimant in the first place should not also support a finding of failure to exercise reasonable diligence immediately after the mistake occurred."

There may be difficult questions as to what the trustees ought to have known and when.

The Limitation Act is of course concerned with the lapse of time before the issue of proceedings. These days the court expects to see a claim preceded by a pre-action protocol letter, giving the potential defendant the opportunity of acknowledging the claim and paying up before proceedings are issued. One potential difficulty for trustees is that the result of a letter before action of that kind may well be that the member or beneficiary refers the matter to the scheme's internal disputes procedure and then to the Pensions Ombudsman. Although the trustees could protect their position on limitation by issuing proceedings, which would then be subject to the court's power under s.148 to stay the proceedings if the matter had already reached the Ombudsman, it may be asked what is the position if they do not do so.

This was the situation in *Webber* v. *Department for Education* [2016] EWHC 2519 (Ch), [2017] I.C.R. 198, in which the judge, Mr. Edward Bartley Jones Q.C., had to consider what was the equivalent in an Ombudsman case of the issue of proceedings. The issue arose for decision against the background that in a previous round of litigation, *Webber* v. *Department for Education* [2014] EWHC 4240 (Ch), [2015] I.C.R. 544, Nugee J. had expressed the view that the bringing of the complaint by Mr. Webber was the equivalent of issuing the claim, while the appeal was against a decision of the Deputy Pensions Ombudsman that the relevant date was the date of a letter from Teachers' Pensions claiming repayment. The judge rejected both those possibilities, preferring instead to take as the nearest equivalent the date on which the Ombudsman received a letter from Teachers' Pensions opposing the allegations made in the complaint. Although the judgment identifies cogent reasons for finding the other suggested dates unattractive, there is clearly a risk that it puts pressure on trustees to issue proceedings, particularly in any case where the overpayment results from a mistake by the trustees which it might be argued should have been appreciated much earlier.

<u>(b) Equitable recoupment</u>

For a time after the decision in *Webber* the Ombudsman proceeded on the footing that s.5 applied also to claims to exercise the equitable right of recoupment. In *Burgess* v. *BIC*, however, in the course of considering a number of issues on the footing that he was wrong on the issue of the validity of the increases which had been paid, Arnold J. concluded that that was not the case. The right of recoupment involves an adjustment of the accounts between the parties by withholding further payments, in whole or in part, until the amounts withheld equal the amounts overpaid. This is to be distinguished from a claim that the overpaid member or beneficiary should make a repayment.

The Ombudsman's annual report for 2018 says of the decision in *BIC* that:

> "From our perspective, the judgment does not really deal with the practical side of how these types of complaints are presented to us. In practice we deal with many complaints from public sector schemes that are arguably trying to recoup from pensions in payment as opposed to simply recovering a debt."

Possible defences to a claim for equitable recoupment are of course laches, estoppel and change of position.

Recoupment is obviously a possible alternative course of action for trustees, both when limitation issues may affect the recoverability of an overpayment and when it may seem unduly harsh to seek repayment. It is not surprising if the recoupment approach is indeed adopted in many cases. Before *Webber*, the Ombudsman applied a general approach of looking for recovery over a period equivalent to the period of overpayment.

A further complication for the Ombudsman is that under s.91(6) of the Pensions Act 1995, where there is a dispute as to the amount recoverable through the exercise of a right of set-off, which includes the right of recoupment, the right cannot be exercised unless "the obligation in question has become enforceable under an order of a competent court …". It was concluded in *BIC* that the Ombudsman is not a competent court for this purpose, although if the Ombudsman made a determination and an order to enforce the determination was made in the county court, there would be an order of a competent court. This point, in addition to the decision on limitation, is mentioned in the annual report as explaining why the Ombudsman is currently considering how to deal with overpayment complaints involving recoupment.

At the recent APL Prestige lecture, however, the Ombudsman disagreed with *BIC* on this point, so there may be developments to come in this area.

<u>(c) Other points</u>

In theory a claim to recover money paid under a mistake could be brought against a receiving scheme if a transfer value has been overpaid. In practice, however, difficulties may arise if the size of the payment has determined the benefit the member is entitled to receive under a new scheme.

There may also be difficulties in making a claim against a deceased member's or beneficiary's estate if the estate has been fully administered. In such a case, the personal representatives will have a defence of *plene administravit*.

The transfers issue

On investigation it appears that:

- Dystopia Scheme members were targeted by a firm called Worldly Wise Limited

- Worldly Wise promised excellent returns after the first 3 years of investment from innovative green technologies being developed for challenging environments (examples given being of projects in Outer Mongolia and the Gobi Desert)

- many transfers took place about 4 years ago and members notice with dismay that the return on their investment has remained at 0.01% per annum

- at the time of the transfers members were provided with copies of the Regulator's Scorpion leaflet and advised to get financial advice.

The transferee schemes:

- have been identified as Green Technologies Pension Scheme 1, Green Technologies Pension Scheme 2, Innovative Technologies Pension Scheme 1 and Innovative Technologies Pension Scheme 2

- were all registered with HMRC

- all had a limit of 99 members

- do not appear to have employed any Dystopia Scheme members

- are all currently under investigation by the Regulator, which has appointed an independent trustee.

As to documentation, Standfast has obtained a copy of the trust deed of Green Technologies Pension Scheme 1 and is concerned to observe that it provides:

> "members will be provided with a pension at Normal Retirement Age of an amount permitted by the Finance Act 2004 which may take into account any amounts paid to the Scheme by the member or on the member's behalf."

The other trust deeds are believed to be in similar terms.

<u>(a) Did the trustees take sufficient steps to protect members?</u>

It is notorious that it can be difficult to protect members from themselves and that trustees may find themselves in a difficult position when faced with a transfer request. Ultimately members have a right under s.99 to the cash equivalent and trustees have an obligation to comply with a member's request within the 6 month time limit specified in s.99(2). It should also be noted that at the time material to the transfers in question here, the obligation under s.48 of the Pensions Act 2015 to make checks on the receipt by the member of independent advice had not been introduced, so any failure by the trustees to ensure that members did in fact get independent financial advice did not constitute breach of that obligation and they could not rely on the absence of independent advice as a reason for not complying with the statutory time limit.

The question what steps trustees ought to take has recently been considered again by the Pensions Ombudsman in *N* v. *Northumbria Police Authority* PO-12763, in which the Authority was found to have fallen short. Of course each case is fact specific, but it is useful to note the following points which led the Ombudsman to his decision:

- the relevant events occurred in 2013 and 2014, a time at which the Ombudsman said there was increased awareness of the risk of transfer scams and an increased level of due diligence carried out by, and expected from, trustees

- the Authority failed to send a copy of the Scorpion leaflet to the complainant, relying on the fact that it was on the intranet

- the Authority failed to follow the guidance in *Jerrard* PO-3809 (decided on 8th January 2015) and did not ask why the complainant was transferring to a scheme sponsored by an employer by whom he was not employed and how he had come to hear of the scheme, which might have led to an open discussion about the transfer

- the Authority failed to obtain a copy of the new trust deed and rules to check that the scheme met the requirements for a statutory transfer. In the light of the other circumstances which gave rise to some concern, this check should have been made

- the Authority failed to have any direct discussion with the complainant at all, dealing at all times with the various professionals involved

- very little attention was paid to the fact that the complainant signed forms describing himself as a sophisticated investor when he was not and did not read much of the documentation until well after making the transfer.

It is by no means clear whether the trustees of the Scheme carried out sufficient due diligence in relation to the Worldly Wise transfers. Careful investigation of the facts, against the background of what was expected at the relevant time, will be required.

(b) Are the Green Technologies trusts void for uncertainty?

On the basis of the information available, that seems very possible. The relevant clause has some obvious resemblances to the provisions of the trust deeds at issue in *The Pensions Regulator* v. *A. Admin Limited* [2014] EWHC 1378 (Ch), [2014] P.L.R. 319, the *LPA Umbrella Trusts* case. Clearly, however, it would be necessary to look carefully at the whole trust deed and to construe that clause in the light of the remaining provisions. It is possible that the trusts could be held valid on the basis that it is to be implied that benefits will be determined by an exercise of discretion of the trustees.

(c) Were the transfers unauthorised payments?

Assuming that the Green Technologies trusts were not void for uncertainty, it might be argued that nevertheless the excessively discretionary nature of the benefits means that the member does not acquire anything which is to be regarded as a right for the purposes of ss.95 and 99. Further, given that the Scheme was contracted out, there may be a question whether the receiving scheme satisfied the requirements for receiving GMP rights or s.9(2B) rights, although basic information about the registration of the receiving scheme should have answered that question.

If the Green Technologies trusts were void for uncertainty, the member will not have acquired rights "under the rules" of the receiving scheme.

As respects unauthorised payments, however, the question is whether the member would have acquired "rights under" a registered pension scheme for the purposes of s.169(1) of the Finance Act 2004 so as to constitute the transfer a recognised transfer. If not, there appears to be nothing in s.164 on the basis of which it could be said that the transfer payment was an authorised payment.

This situation arose in *Clark* v. *Commissioners for Her Majesty's Revenue and Customs* [2016] UKFTT 630 TC. Transfer payments had been made to a scheme which contained benefit provisions very similar to those in the *LPA Umbrella Trusts* case and the First-tier Tribunal followed that case in determining the trusts to be void for uncertainty. The Tribunal's first conclusion was that although the scheme was registered as a pension scheme, it was not in fact a "pension scheme" at all and so could not be a "registered pension scheme". The next relevant point was that the Tribunal concluded that the transfer payment was therefore held on resulting trust for the transferring scheme. The question was whether a payment transferring the legal title alone was a payment at all for the purposes of the tax legislation. After a careful consideration of the authorities, the Tribunal concluded that it was and that the member was liable to an unauthorised payments charge and an unauthorised payments surcharge.

The position of the transferring scheme itself was not considered in *Clark*, but clearly the worrying prospect of a scheme sanction charge arises.

The time for appeal in *Clark* did not start running until after a further determination of the validity of the assessment made. I understand that there was an appeal and it was listed for hearing last week.

<u>(d) Rights in relation to transferred funds</u>

If the trusts of the receiving scheme are valid but the transfer payment was an unauthorised member payment, the trustees' only concern is likely to be the scheme sanction charge. It may be that the member did not in fact have a statutory right to a transfer, but as there is also a Scheme transfer power it is probable that the transfer was valid in terms of passing the beneficial interest as well as the legal title. Difficult questions do, however, arise if the trusts were void for uncertainty.

As I have said, in *Clark* it was decided, and indeed it was largely accepted by both parties, that a resulting trust for the transferring scheme arose. This solution is consistent with the decision of the Court of Appeal in *Allan* v. *Rea Brothers Trustees Limited* [2002] EWCA Civ 85, [2002] P.L.R. 169, in which it was held that where a scheme power to make a transfer payment had been invalidly exercised, the legal title passed but the beneficial interest remained in the original scheme.

What neither *Clark* nor *Allan* deals with is the question what that means in practical terms. These issues arose in the *LPA Umbrella* case but were not explored because the case settled. They may be more readily answered where the original scheme provided DC benefits and the trustees holding the legal title can be required to make a repayment which may again be applied to provide DC benefits under the scheme. Where the original scheme is a DB scheme like the Scheme, however, the likelihood is that the transferred fund will no longer be sufficient to provide the DB benefits to which the member was formerly entitled and a potential injustice would be caused to other members if such a course were undertaken.

My tentative solution is that, assuming the transfer payment or some of it is in fact returned, the Scheme trustees are to be taken as holding it on terms that the member has given notice exercising the s.95 option and the transfer value has been properly crystallised and is held by the trustees awaiting further directions from the member as to its application. This seems closest to giving effect to the rights and intention of the transferring member while offering the best protection for the Scheme trustees and the continuing members. To the extent permitted by the Scheme rules, funds could be deducted to meet tax charges resulting from the unauthorised payment.

A further problem for the Scheme trustees is of course that the amendments made by the A Day Deed in 2006 included the insertion of a provision prohibiting the making of unauthorised payments from the Scheme, with the consequence that the trustees were in breach of trust in making the payment, although no doubt they have the benefit of an exoneration clause which they will be able to rely on even if they did not carry out sufficient due diligence in making the transfer payment unless their failure amounted to fraud or wilful default. It is not immediately obvious that it would be a fair result if the transferring member were able to recover any loss from the Scheme's assets at the expense of other members. The answer may be that the trustees could rely on the principle that a beneficiary who concurs in a breach of trust cannot bring a breach of trust claim against the trustees. This principle was applied in *Re Pauling's Settlement Trusts* [1962] 1 W.L.R. 86 at first instance, expressly on the basis that it is not necessary that the beneficiary should know that there is a breach of trust, and [1964] Ch. 335 in the Court of Appeal, without dissent from that proposition. It was made clear in *Pauling* that the court will look at all the circumstances, so the extent of the trustees' due diligence and their dealings with the individual members may have a significant effect.

Lest anyone should think that this particular set of problems is somewhat far-fetched, I draw attention not only to the fact that *Clark* demonstrates that the creator of the Umbrella Trusts was not the only person producing scheme documentation along those lines, but also to the fact that I was recently instructed to advise by the executors of a former LPA Umbrella Trust member whose estate included a sum lent to him which had ultimately been derived from his pension pot and who wanted to know what the estate's liabilities were. There are still chickens out there which may come home to roost.

Any answers?

I have now expressed some views, and perhaps set some hares running, on a number of topics. Does anyone have any answers?

Elizabeth Ovey

Radcliffe Chambers

12th November 2018