



# IMG pension plan case: scheme changes ineffective

SEVERING THE LINK BETWEEN DB BENEFITS AND FINAL SALARY; AND COMPROMISING DB BENEFITS

EMPLOYMENT, PENSIONS AND BENEFITS BRIEFING 192

The UK High Court's decision in *HR Trustees v Peter German* has made it more difficult to change past defined benefits under the scheme's amendment power or by direct agreement with employees.

This briefing outlines the decision and its implications for other pension schemes.

In *HR Trustees v Peter German* [2009], Arnold J, in the High Court, held that changes made in 1992 to the IMG pension plan (a defined-benefit (DB) pension scheme) had been ineffective in their attempts to convert members' benefits from DB to defined-contribution (DC).

The judge also held that compromise agreements, later entered into with members and under which they waived DB entitlements, were contrary to section 91 of the Pensions Act 1995 and ineffective.

## What happened?

In this case, the amendment power in the IMG pension plan's 1977 deed (the 1977 deed) stated that 'no amendment shall have the effect of reducing the value of benefits secured by contributions already made'. However, scheme rules introduced in 1981 (the 1981 rules) contained a different amendment power with a less restrictive fetter.

The trustees and employer executed a deed on 3 March 1992 (the 1992 amendment deed) to convert the DB scheme into a DC scheme and backdated the deed to have effect from 1 January 1992.

Before the purported conversion, the employees were given:

- memorandums and a scheme booklet explaining the changes to the scheme;
- a presentation on the changes; and
- membership application forms to join the new DC scheme.

The members returned the application form after having signed it and ticked the 'yes' box.

## Amendment power

Arnold J held that it was contrary to the restriction in the 1977 deed to convert DB benefits that accrued before the 1992 amendment deed into DC benefits. He gave the following reasons.

- The fetter in the 1977 deed was the relevant restriction that needed to be satisfied before the conversion could be ruled valid. The 1977 deed amendment power did not give trustees the power to introduce a less restrictive amendment power in the 1981 rules. In coming to this decision, Arnold J relied on *UEB Industries v W S Brabant* [1992] and *Air Jamaica v Charlton* [1999].
- The effect of the fetter in the 1977 deed was to 'render ineffective the amendments made by the 1992 [Amendment] Deed in so far as they reduced the value of benefits, and in particular the future final salary benefits, which had accrued to members by virtue of their Service'. Arnold J relied on a number of cases, including *Re Courage Group's Pension Schemes* [1987] and *BHLSPF* [2001].
- 'An amendment to convert such benefits from a final salary entitlement to a money purchase entitlement is permissible, but only subject to an underpin which preserves the future monetary value of the proportion of Final Pensionable Pay which the member has accrued in respect of pre-amendment Service.'

- The 1992 amendment deed converted the scheme only from the date it was executed in March 1992, instead of the earlier January date. To backdate the deed to January was to treat some DB benefits as though they had always accrued on a DC basis (instead of accrued on a DB basis and then been converted into DC benefits) so was an unlawful ‘attempt to re-write history’. This was also restricted by the 1977 deed fetter.

## Member agreement?

Arnold J also rejected the employer’s alternative argument that even if the conversion was unlawful under the trust deed and rules the employees had contractually agreed to changes outside the scheme. The employers relied on *South West Trains v Wightman* [1998] in support of their argument. The judge held that:

- unlike the ordinary position with commercial contracts, the position in this case was ‘analogous to an allegation that a contract should be inferred from conduct, and accordingly the burden of proof of intent to create legal relations is upon the proponent of the contract [ie the employer in this case]’;
- the employer could not prove that there was an intention to create contractual relations because:
  - the memorandum and application forms directed attention to the booklet for the full details of the proposals;
  - the presentation could not create contractual relations because it was not a comprehensive statement of the proposed changes. So the employees would still be left with the understanding that the booklet explained the proposed changes;
  - the memorandums and the booklet presented the changes as already having been made (instead of being presented as proposals);
  - the booklet stated that it was not comprehensive and was subject to the trust deed and rules; and
  - the application form was not comprehensive. For example, it did not indicate that members were being asked to give up rights they were entitled to and that were protected by the 1977 deed fetter;
- the position was fundamentally different from *South West Trains* because the agreement was contrary to restrictions contained in the trust deed and rules

of the IMG pension plan. Furthermore, there had been no informed consent from the members that could prevent them from asserting a breach because: the members had been unaware of the fetter in the 1977 deed; they received no advice; the effects of the proposals were not ‘clearly explained’ to them; they were ‘not given any real choice as to whether or not to consent’; and they ‘received the impression that they would not be adversely affected by the changes’; and

- unlike the facts of the present case, *South West Trains* only involved making future pay rises non-pensionable.

For similar reasons to those mentioned above, Arnold J rejected a further alternative argument that the employees had represented themselves as having accepted the changes (eg by signing the forms) and it would be unconscionable for them to act otherwise.

## Compromise agreements

On a different point, the judge held that the later individual compromise agreements (entered into when the members later left employment) did not preclude members from retaining DB interests. This was because under section 91 of the Pensions Act 1995 these compromises were an unlawful ‘surrender’ of a pensions right to which the members were ‘entitled’. This was true even in situations where ‘the member has surrendered his or her rights by entering into the agreement even if there was a *bona fide* dispute as [to] the existence of those rights at the time of the agreement’.

## Comment

The effect of this judgment is that it will most likely cost the employer more to fund the IMG pension plan’s liabilities. Therefore, this judgment will be of significant interest to many in the pensions industry, given the continuing trend for employers to manage their pension costs or de-risk.

This case, the recent High Court judgment in *Walker Morris Trustees v Masterson* [2009] and the Supreme Court of New South Wales’s decision in *ING Funds Management v ANZ Nominees* [2009] highlight the importance of carefully examining the effect of any restrictions in the amendment powers when making changes to benefits.

If an employer is seeking to rely on *South West Trains* to agree a change directly with employees outside the scheme, this case suggests that, among other things, it is prudent to give members comprehensive information about the proposed changes.

However, there are elements of the judge's decision that are difficult to reconcile with established legal principles. For example, it is unclear why a contract in these circumstances is not governed by the same rules as an ordinary commercial contract or why it is important for the members to be given a 'choice' before they can consent. Furthermore, it can be prudent to ensure that members receive advice to minimise the risk of claims for mis-selling but in this case the judge seemed to be suggesting that not obtaining advice could also invalidate consent.

A further concern for employers will be Arnold J's decision that the compromise agreements were an unlawful 'surrender' of pension benefits under section 91 of the Pensions Act 1995 even if there is a 'bona fide dispute as [to] the existence of those rights at the time of the agreement'. This suggests that any future

compromise agreements would be void (maybe even if approved by the Court under the Civil Procedure Rules). Employers may also need to check carefully whether any past compromise agreements are effective.

But if the parties changed the scheme and complied with section 67 of the Pensions Act 1995 when changing past benefits (rather than solely relying on a compromise agreement), then it is generally thought that the restrictions in section 91 of the Pensions Act 1995 will not be triggered.

We understand that an appeal has been lodged in the Court of Appeal. Therefore there may be further litigation on the issues raised in this case.

*HR Trustees v German (IMG Pension Plan)* EWHC 2785 (Ch)

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