Case No: HC 01CO4944

Neutral Citation Number: [2002] EWHC 2732 (Ch)

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 17th December 2002

Before :

THE HONOURABLE MR JUSTICE PATTEN

Between :

The Law Debenture Trust plc	**Claimant**
- and -	
(1) Lonrho Africa Trade & Finance Limited	**Defendant**
(2) David Simpson	

Michael Furness QC (instructed by **Dibb Lupton Alsop**) for the Claimant
Christopher Nugee QC and **Jonathan Evans** (instructed by **Mayer Brown Rowe & Maw**) for the First Defendant
Jules Sher QC and **Caroline Furze** (instructed by **Eversheds**) for the Second Defendant

Hearing dates : 25th – 27th November 2002

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

The Hon. Mr Justice Patten

Mr Justice Patten :

Introduction

1. This is an application by the sole trustee of the John Holt Pension Scheme ("the Scheme") seeking the determination by the Court of a number of questions of construction relating to the power of the trustee to augment benefits. The Scheme is currently constituted under a supplemental definitive deed dated 3rd March 1989 and the rules contained in the schedule thereto, together with certain subsequent amendments. I shall refer to them as the 1989 Rules. These rules came into effect on and from 6th April 1988, replacing in their entirety the previous rules of the Scheme.

2. The Scheme is a contributory, exempt approved, final salary scheme under which the members' contribution rate is 5% of pensionable earnings. The normal retirement date for those in the service of the principal employer, as defined, is 65 years of age or 60 in the case of a member whose contract of service provides for early retirement. The date is slightly lower for the employees of other companies in the group who have been permitted to join the Scheme. The principal employer under the Scheme is the First Defendant, Lonrho Africa Trade & Finance Limited ("the Company"), formerly named John Holt Group Limited, and under section 5 of the 1989 Rules the Company covenants to pay such contributions "as may be necessary" to make up the balance of the cost of the Scheme. As things stand, the Scheme is in substantial actuarial surplus. I am told that as early as 1992 the funding exceeded the 105% funding basis prescribed under Schedule 22 of ICTA 1988. After discussions with the Inland Revenue the Claimant has concluded that Revenue approval for the Scheme may be jeopardised if steps are not taken to reduce the surplus. To meet this difficulty, the Claimant has applied to the Occupational Pensions Regulatory Authority ("OPRA") for a modification order under Section 69 of the Pensions Act 1995 ("the 1995 Act") to enable it to reduce or eliminate the excess. The terms of any modification order will inevitably include either or both of the augmentation of the benefits structure under the Scheme and a return of part of the surplus to the Company. But before the Claimant trustee can properly formulate the terms of the proposed order and OPRA can consider the merits of the proposal, it is necessary for the trustee to know definitively what is the scope of its powers of augmentation under the Scheme as it stands.

3. If the true position is that the trustee is already empowered under the Scheme to augment pension benefits out of the surplus still further without the consent of the Company, then the Company's bargaining position in relation to the terms of a modification order becomes correspondingly weaker. But I need to make it clear at the outset of this Judgment that I am not concerned on this application to offer to the trustee and the other parties directions or guidance as to how the trustee should deal with the surplus as between the Company and those entitled to benefit under the Scheme. It became apparent early on in the submissions of Mr Nugee QC on behalf of the Company that even if, on the true construction of the Scheme, the trustee has *prima facie* an unfettered power to augment benefits, the Company would wish to contend that those powers should not be exercised on a narrow basis, having regard

only to the interests of the members and other beneficiaries. I was referred to various authorities, including the decision of the Court of Appeal in *Edge v Pensions Ombudsman* [2000] Ch 602, as supporting a requirement for the trustee to exercise its powers so as to further the purposes of the Scheme as a whole, thereby bringing into consideration the legitimate interests and expectations of employee and employer alike. At the highest level of generality I doubt whether this statement of principle is likely to attract dissent from any of the parties represented before me. But Mr Sher QC (on behalf of the Second Defendant, Mr Simpson, who has been joined to represent all the Scheme beneficiaries) expressed concerns about my venturing beyond the terms of the application. He submitted that on the material before the Court, it is not possible to do more than to answer the questions of construction raised. That seems to me to be right, and in the end all Counsel concurred in that view. The more liberal approach to the exercise of the trustee's powers, outlined in Mr Nugee's submissions, may require a more far-ranging assessment of the trustee's responsibility, but it does not dictate the necessary outcome of that process. How the trustee decides to distribute the surplus will ultimately depend upon a detailed consideration of factors such as the reasons for the surplus, the history and sources of the overfunding, the scale of existing benefits and the needs, actual and prospective, of the beneficiaries in the light of current and future economic circumstances. This is not intended to be an exhaustive list, but it is sufficient to explain why the Court should be wary about laying down guidelines for what is bound to be a difficult discretionary exercise. Once the issue of *vires* is determined, it will fall to the trustee and not to the Court to decide how those powers should be exercised, if at all. If either the Company or the beneficiaries wish to challenge the terms of any proposed modification order, on the basis that the trustee proposes to exercise its powers on a wrong basis, that will have to be dealt with in separate proceedings.

The 1989 Rules

4. The powers of the trustee to augment pension benefits are contained in section 11 of the 1989 Rules, which prior to the amendment were in the following terms:

> "11.1 Review of Pensions
>
> The trustees in consultation with the principal employer shall in each year review all pensions whether currently in payment or deferred for the purpose of determining whether the powers conferred by this section should be exercised.
>
> 11.2 Increases in current pensions
>
> The trustees, acting on actuarial advice, may increase pensions in course of payment in accordance with the following provisions of this rule
>
> (a) subject to rule 11.5 the trustees, with the consent of the principal employer, may increase any pension or payment by such amount as they may decide;

(b) the pension referred to in paragraph (a) shall exclude after state pension age, or in the case of a pension payable to a widow, the guaranteed minimum pension except to the extent referred to in rule 13.3(d);

(c) the increase under paragraph (a) above shall be a proportionate increase if the pension commenced in the preceding twelve months and for the purpose of deciding when the pension commenced any deferred pension shall be deemed to have commenced when it was first granted and not when it came into payment and any widow's pension following the death of a pensioner or deferred pensioner shall be deemed to have commenced when the pensioner's payment commenced or the deferred pensioner's pension was granted.

11.3 Increases in deferred benefits

The trustees, acting on actuarial advice, shall grant increases in short service benefits granted under section 9 or any other deferred benefits granted under section 8 or section 9 which have not yet come into payment (all of such being referred to in this rule as "deferred benefits") in accordance with the following provisions of this rule:-

(a) subject to rule 11.5 the trustees with the consent of the principal employer may increase any deferred benefits by such amount as they may decide, acting on actuarial advice;

(b) the increase under paragraph (a) above shall be a proportionate increase if the member left the service in the preceding twelve months or, in the case of a benefit granted under section 8, if the allocation took place in the preceding twelve months.

11.4 Increases in additional pensions

The trustees, acting on actuarial advice, may from time to time increase the additional pensions payable to members under appendix I at rates which are the same as or different from the rates of increases granted under rule 11.2 or 11.3. (Increases under this rule will only be granted if the rates of accretion to the AVC Scheme so permit).

11.5 Statutory increases

Nothing in this section shall prejudice the operation of:-

(a) Sections 41A and 41B of the Pensions Act which provide for increases to maintain the value of the guaranteed minimum pension up to state pension age

without prejudice to the continued payment of the full amount of the benefits in excess of the guaranteed minimum pension; and

(b) Section 52B and Part I of Schedule 1A to the Pensions Acts (introduced by the Social Security Act 1985) as amended, which provisions lay down (in general terms and not so as to prejudice their operation) that deferred benefits which have accrued since 1st January 1985 shall be increased by 5% per annum or the rate of inflation, whichever is the lower up to the date on which they come into payment.

11.6 Augmentation of pensions

The trustees shall have power, in their absolute discretion, to augment any benefit payable or prospectively payable under the rules by such amount as does not or will not cause the limits set out in section 10 to be exceeded; and, in augmenting any such benefits, the trustees may impose such terms as to payment of additional contributions, whether by way of lump sum or periodical payments, and either by the employer or the member or both of them, as they shall, acting on actuarial advice, decide."

The controversy centres on the interpretation of rule 11.6.

5. There have been some amendments to the 1989 Rules since they came into effect, but for the purposes of this application I intend to ignore those changes in answering the questions of construction. It is common ground that the 1989 Rules fall to be construed by reference to the form which they originally took and not by reference to subsequent changes, which at best indicate what a draftsman later thought the earlier rules may have meant: see *National Grid Company plc v Mayes* [2001] UKHL 20 (paragraph 67); [2001] 1WLR 864 at page 881A. That rule of course only applies if the provision under consideration has maintained its original form, notwithstanding the amendments to other rules, but in this case rule 11.6 remains unamended.

6. The primary question to be resolved is whether rule 11.6 confers on the Claimant a general power to augment benefits, which is exercisable without the consent of the Company as employer. Mr Nugee submits that it falls to be construed in the context of rule 11.1, which indicates that "the powers conferred by this section" are to be exercised as part of a consultation and therefore a consensual process between the trustee and the employer. Rules 11.2 and 11.3 in terms subject the exercise of those powers of augmentation to the employer's consent. The contrary argument, advanced by Mr Sher on behalf of the beneficiaries, relies of course on the inclusion of those express requirements for consent and the absence of any similar words in rule 11.6 as indicating that 11.6 is not so fettered. But the argument does not end with the issue of employer's consent. If the proper construction of rule 11.6 is that no such consent is

necessary as a precondition to the exercise of the power, then the Company contends for a number of other limitations on the scope of the power. They are:

i) that the power in 11.6 to impose terms about additional contributions is only exercisable so as to make such contributions a condition of the increase, which both the employer and the member are free to reject;

ii) that 11.6 is only exercisable in relation to pensions currently in payment or to deferred pensions and does not apply to the accrued and prospective benefits of active members (i.e. those still currently in service with a Scheme employer);

iii) that even if 11.6 does apply to active members, it only does so in relation to their accrued benefits and does not entitle the trustee to vary, for example, the rate of future accruals of benefit;

iv) that whatever its scope as between classes of beneficiaries, the rule 11.6 power can only be exercised to deal with individual cases rather than with class-wide increases in benefits, which are the province of rules 11.2 and 11.3;

v) that the rule 11.6 power cannot be used to augment benefits in a way which would be inconsistent with the existing rules of the Scheme. Such changes must be effected by an amendment of the rules, which under section 16 requires the consent of both the trustee and the principal employer;

vi) that, on the evidence, the provisions of rule 11.6 are intended to provide a measure of "predator protection" by safeguarding the fund, and in particular any surplus, from the hands of a corporate raider determined to asset-strip the participating companies. The power is therefore only exercisable in such limited circumstances.

7. It will be immediately apparent that these alternative constructions of rule 11.6 necessarily impact on the primary question of employer's consent. The absence of any requirement for such consent may be more easily explicable if the scope of the power is limited in other ways. Conversely, if these alternative points on construction are to be rejected, then the Company contends that the case for the primary restriction is considerably enhanced. It is not, however, possible to answer all the questions simultaneously, and I shall therefore deal with them in the order indicated, having regard to the other relevant possibilities. Before, however, I do that, it is necessary to say a word or two about the principles of construction which are likely to come into play.

The Approach to Construction

8. The authorities confirm that there is no particular magic to be performed in the interpretation of pension schemes. As with any other document having legal effect, the language is to be construed in context, with a view to ascertaining what the parties to the deed intended to mean by the words they used. Because evidence of the parties' actual intentions is inadmissible (except for purposes of rectification) the process of construction is necessarily an objective exercise. This manifests itself most obviously in the statements of principle to the effect that words should be given their natural and ordinary meaning, and that the meaning of the language under consideration should be the one which the document would convey to a reasonable person, having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time: see *Investors Compensation Scheme Limited v West Bromwich Building Society* [1998] 1WLR 896 at pages 912H to 913D.

9. As Lord Hoffmann recognised in his speech in that case, the process of attempting to put oneself in the shoes of the parties at the time, whilst adopting the attributes of the reasonable man, can create a tendency to overlook the fact that the parties may have made a mistake. The effect of the *ICS* case is therefore to remind one that the range of possible meanings intended by the parties may well include ones which lie outside the rules of grammar and the ordinary use of language, without changing the basic approach to construction. But in documents (like the Scheme Rules) which are drafted by lawyers, the presumption has to be that the language used was both correct and intentional, unless it is clear from the background and the consequences of the language used that something must have gone wrong. There is nothing in *ICS* which requires the Court to treat the use and misuse of language as equal possibilities.

10. The possibility of mistakes aside, a number of obvious factors need to be taken into account when considering the terms of a pension scheme. Most obviously, these include the relevant fiscal background to, and the purpose of, the scheme, together with the relationship of employer and employee which underpins the scheme and as a term of which the scheme was brought into existence and maintained. In *British Airways Pension Trustees Limited v British Airway plc* [2002] EWCA Civ 672; [2002] PLR 247, Arden LJ adopted a similar approach to that of Warner J in *Mettoy Pension Trustee v Evans* [1990] 1WLR 1587 at page 1610, who declared that the Court's approach should be "practical and purposive rather than detached and literal". Technicality, said Arden LJ, was to be avoided and a construction which created an impractical or over-restrictive regime might for that very reason not be the right one. However, she also recognised that there are dangers in any slavish adherence to a test based on the practical consequences of any particular construction. Most pension schemes (and this one is no exception) are built up and amended over a period of time, having regard to various legislative and economic changes. The so-called "patchwork" nature of such schemes makes a purely purposive construction difficult. This was a point recognised by Robert Walker J in paragraph 65 of his judgment in *National Grid Company plc v Laws* [1997] PLR 157 at page 172, where he said this:

> "A practical, purposive approach does not necessarily provide an easy route to a simple answer. Occupational pension

> schemes are of great importance to millions of scheme members and pensioners and it would be a very good thing if the terms of pension schemes were always clear and unambiguous to lawyers and laymen alike. But all pensions professionals know that unfortunately the terms of pension schemes are often complicated and obscure. The funding of pension schemes is inevitably a technical subject. Pension scheme documentation tends to be a patchwork put together partly by way of reaction to legislative change, including (but not limited to) changes as to contracting-out, preservation of benefits, equal treatment and taxation
>
> .....
>
> Major legislative or economic changes of that sort are often the reason (or 'mischief') behind amendments to occupational pension schemes and a purposive construction requires them to be taken into account. Such amendments often result in a loss of uniformity in drafting, and difficulty in seeing how one part of the scheme is intended to fit in with another part. In construing a pension scheme the court will try to reconcile inconsistencies so far as possible, but the purposive approach cannot justify rewriting different parts of the text (and possibly misinterpreting both parts) in an attempt to avoid apparent inconsistency between them."

11. The conclusion of Arden LJ in the *British Airways* case (which is of course binding on me) was that the function of the Court is "to construe the document without any predisposition as to the correct philosophical approach" (see paragraph 31). In that, she concurred with a passage in paragraph 54 of the judgment of Brooke LJ in the *National Grid* case [1999] PLR 37, page 48, that:

> "The solution to the present problem lies within the terms of the scheme itself, and not within a world populated by competing philosophies as to the true nature and ownership of an actuarial surplus."

12. One discrete point which sometimes arises in pension scheme cases (and which arises in this one) is whether and to what extent the Court can look at the history of the amendments to the scheme to assist it in construing the provisions in question. In the *National Grid* case Robert Walker J accepted that the archaeology of the scheme could be a legitimate aid to construction, because the superseded provisions undoubtedly form part of the matrix of fact surrounding the scheme at the relevant time, and may assist to explain the purpose and meaning of a new provision. He cautioned, however, against the practice on the ground that it was inconvenient and uncertain to provide any useful assistance. With these words of warning well in mind, I do, however, intend to say something of the history of the Scheme and its provisions, for reasons which will become apparent when I come to the specific questions raised by the application.

The History of the Scheme

13. The Scheme has been in existence for almost 70 years. It was established under a deed dated 6th July 1934, when the principal employer was John Holt & Company (Liverpool) Limited. This was then the ultimate parent company of the John Holt Group. The Company (then called Holt, Sons & Company) was a member of the group and was admitted to participation in the Scheme by a deed dated 13th August 1962. In 1983 a restructuring of the group took place, under which the Company became the ultimate parent of the group in place of John Holt & Company (Liverpool) Limited, and on 21st December 1983 it became the principal employer under the Scheme. It was then called John Holt Group Limited. In 2001, following a management buy-out of John Holt & Company (Liverpool) Limited, the Company agreed to change its name to Lonrho Africa Trade & Finance Limited.

14. The original Scheme established by the deed of 6th July 1934 contained a single power of augmentation which was contained in clause 9 of the regulations as part of the provisions dealing with the employer's liability to contribute the balance of the cost of the Scheme by half-yearly payments. Clause 9(a)(iv) provided that with effect from 1st January 1974 there were to be five-yearly actuarial valuations of the fund. If these disclosed a deficiency, then the company was to resume its half-yearly contributions. If they revealed a surplus, then the trustees had a discretion to apply the surplus either in reduction of the contributions of the employer or in increasing the pensions paid or to become payable. The employer was given power under regulation 20 to alter or repeal any of the regulations, but this required the consent of the trustees and could not be used so as to result in the return to the Company of any part of the fund. The employer could therefore only benefit from a surplus during the life of the Scheme by obtaining a reduction in its contributions at the trustees' discretion and could not veto the use of the surplus to augment pensions.

15. In 1961 (by deed dated 4th July 1961) a new regulation 65A was inserted into the Scheme, which gave the trustees, subject to the approval of the directors of the employer, power to award cost of living increases to current pensioners and annuitants. This was followed on 13th August 1962 by the wholesale replacement of the current rules with a new set of rules which took effect from 30th June 1961. Rule 79 gave the trustees power (with the consent of the employer) to award cost of living increases to those already in receipt of pensions. It therefore continued the provisions of what used to be rule 65A. Rule 82 conferred on the employer a similar power of amendment to that contained in regulation 20 of the original Scheme: i.e. subject to the trustees' consent and with a prohibition on the return of any part of the fund to the Company. There were no specific provisions dealing with a surplus, except in the event of a winding-up.

16. On 15th February 1973 there was a further consolidation and replacement of the existing rules. The new rules (which took effect on 1st October 1972) contain a power of augmentation in rule 34. Unlike previous versions of the rules, it applies not only to current pensions but also to deferred pensions. The available increases were limited to increases in the Retail Price Index. The most significant change is the

removal of the express requirement for the employer's consent to such increases. The power to amend the rules is contained in rule 82, but with no significant changes from the scheme of the earlier rules. However, rule 79 gave the principal employer power to determine the Scheme on 3 months' notice. Then on 22nd August 1974 rule 34 was amended with effect from 1st October 1973 by deleting from the rule the restriction based on increases in the RPI.

17. On 8th June 1979 a new supplemental definitive deed was executed, with another new set of rules which took effect from 6th April 1978. The 1979 Rules are the first to adopt a new style of drafting, which sets out in section 11 comprehensive provisions for augmenting pensions. The 1979 version of section 11 contains three rules. Rules 11.1 and 11.2 deal with current pensions and deferred pensions respectively. The trustees' power of augmentation has to be exercised on actuarial advice, but there is no requirement for the employer's consent to be obtained. Rule 11.3 contains, on its face, an unfettered power to increase "any benefit coming into payment" up to the Revenue limits, on terms which may include the payment of a lump sum or increased contributions by the employer and/or the employee. This rule is repeated without significant amendment in the 1983 Rules, which are set out in full later in this Judgment. The 1979 Rules adopt the same provisions about amendment as in the earlier rules. Under rule 17.1 the principal employer retains an express power to terminate the Scheme on three months' notice, expiring at any time. From the expiration of the notice all further liability to contribute will cease. That gave the trustees the option of either winding up the Scheme or continuing it as a closed fund, but under rule 17.5(g), in the event of a winding-up, any balance left after securing benefits was to be paid to the employers in the Scheme.

18. These provisions on winding-up were retained in the 1983 Rules for the Scheme, which came into effect as from 1st May 1981 under a supplemental definitive deed executed on 13th December 1983. The power of amendment is retained in similar form to the earlier versions of the rules. Section 11 of the 1983 Rules provides as follows:

> "11.1 Increases in current pensions
>
> Any pension or annuity (including children's allowances and pensions payable to a beneficiary in accordance with section 8) currently payable out of the fund may from time to time be increased by such amount and at such times as the trustees, acting on actuarial advice, shall decide and so that the trustees may in their absolute discretion:-
>
> (a) exclude from the provisions of any general increase any pension payable to the member which is derived from the AVC scheme if the trustees are satisfied that acting on actuarial advice, such increases are not warranted;
>
> (b) restrict the amount of the increase to the reduced pension payable to the member where he has

surrendered part of his pension under the provisions of rule 6.10 or section 8;

(c) contract that any deferred benefits secured by the allocation of a member under the provisions of section 8 shall be increased prior to payment by the same increases as are granted in respect of current pensions under this rule;

(d) exclude from any increase that part of any pension which is equal to the guaranteed minimum pension or widows guaranteed minimum pension, as the case may be, payable to the member or which would have been payable if a female member had not elected to pay reduced rate contributions under section 3(2) of the Pensions Act and the regulations made thereunder.

11.2 Increases in deferred benefits

Any short service benefits granted under section 9 which have not yet come into payment and any other deferred benefits referred to in rule 11.1(c), may from time to time be notionally increased by such amount as the trustees, acting on actuarial advice, shall decide and so that, without prejudice to the generality of the foregoing, the notional increases in deferred benefits need not correspond to the increases in pensions in course of payment under rule 11.1. When short service benefits or such other deferred benefits come into payment the member shall be entitled to the notional increases as of right.

11.3 Augmentation of pensions

The trustees shall have power at their absolute discretion to augment any benefit coming into payment by such amount as does not cause the limits set out in section 10 to be exceeded, and on such terms as to payment, whether by way of lump sum or increased contributions by the employer or the member or both of them, as the trustees, acting on actuarial advice, shall decide."

19. It is therefore apparent that until the 1989 Rules took effect, there had been no express requirement to obtain the consent of the Company to the exercise of the power of augmentation since 15th February 1973. The power of augmentation had, since 1973, extended to deferred pensions, but in both the 1979 and the 1983 Rules provision was made in rule 11.3 to include "any benefit coming into payment" up to Revenue limits. I shall return to this phrase when I come to consider the arguments on construction in relation to rule 11.6 of the 1989 Rules, but in the context of the 1983 Rules, the phrase is obviously intended to contrast with the reference in rule 11.2 to benefits "which have not yet come into payment and any other deferred benefits". It seems to me therefore that rule 11.3 must have been concerned with benefits due to active

members which were not yet currently payable, but shortly would be. The power must therefore have allowed the trustees to augment benefits at the point of retirement in a way which could not be achieved once they had fallen into payment. If that is right, then it includes a power to alter accrued rights, for example by adding notionally to a member's years of service for purposes of calculating his or her final pension.

20. I have taken the trouble to investigate the history behind the provisions of section 11 of the 1989 Rules because it does at the very least reveal what the draftsman did when formulating the 1989 Rules. Rules 11.1 to 11.3 are new. The 1989 Rules introduce for the first time an annual review of current and deferred pension benefits. Specific provisions were also introduced for additional pensions (i.e. under the AVC Scheme) and to give effect to statutory increases under the Pensions Acts. Under the 1983 Rules that left rule 11.3, which has been replaced by rule 11.6. The main internal changes are: (i) the deletion of the phrase "coming into payment" and its replacement by the words "payable or prospectively payable under the rules"; and (ii) the reformulation of the latter half of the rule, dealing with the power to impose terms. Section 16 (amendment of the rules) and section 17 (winding up) remain in substantially the same form. Against this background I now turn to the specific questions raised by the application.

Question 1: Is the Rule 11.6 Power to Augment Benefits exercisable only with the Consent of the Principal Employer?

21. Mr Nugee began his submissions on this issue by describing rule 11.6 as strange, even bizarre, if on its true construction the consent of the principal employer is not required for the exercise of the power of augmentation. He said that such a construction would create an immediate conflict between rule 11.6 and rules 11.2 and 11.3, both of which contain a requirement for the principal employer's consent to be obtained. This submission was, he said, fortified by rule 11.1, which in terms contemplates the trustee conducting the annual review referred to "in consultation" with the principal employer in order to determine whether "the powers conferred by this section" should be exercised. His case is that that is a clear reference to all the powers contained in section 11, including rule 11.6. On that basis the various rules contained in section 11 do not, he submitted, create free-standing powers, but rather powers which are only exercisable on a review under rule 11.1. To construe 11.6 as outside the ambit of rule 11.1 would (absent any other restrictions on its exercise) allow the trustee to conduct the annual review, establish the maximum increase which the employer was willing to consent to, and then without that consent opt for a higher increase under rule 11.6. That would, Mr Nugee said, produce a nonsensical result and, to use a well-known phrase in this context, flout business commonsense.

22. It seems to me that if that argument is right, it must follow that the draftsman has made an error in not including in rule 11.6 an express reference to obtaining the consent of the principal employer. For the Company to succeed on this point, I have to be prepared to write those words into rule 11.6. This is not a case where the Court is dealing with an ambiguity in the meaning of the words actually used and can simply

choose between two alternative meanings. When I put this point to Mr Nugee, he did not shrink from asserting that the draftsman must have made a mistake.

23. I intend to approach this first question on the assumption that Mr Nugee is wrong in his alternative submissions about the other possible restrictions on the scope and exercise of the rule 11.6 power. If, for example, it is right that the imposition of additional contributions by the principal employer can only be made with that employer's consent, then some of the objections to the idea of an unrestricted power disappear, at least in terms of it being used to impose additional burdens on the Company. But it would still leave open the possibility of the power being used to absorb a surplus, thereby defeating or reducing the residual right of the Company to share in the surplus on a winding-up. The only point which might assist the Company in relation to that is Mr Nugee's argument about the relationship between rule 11.6 and section 16 (the power of amendment).

24. Taken in its most unrestricted form, rule 11.6 is clearly at odds with rules 11.2 and 11.3, if one proceeds on the footing that the whole of section 11 is governed by rule 11.1. Although I accept Mr Sher's submission that consultation does not mean consent, the scheme of rule 11.1 is clearly to establish a process which is designed to produce agreement. The references in rules 11.2 and 11.3 to obtain the principal employer's consent bear that out. But early on in the argument it seemed to me that even Mr Nugee's construction did not produce a scheme for section 11 in which all the constituent parts could be reconciled and given a separate purpose. The difficulties start with rule 11.1 itself. Although this refers, as I have said, to "the powers conferred by this section" without further qualification, the annual review is limited in terms to current and deferred pensions. The reference to powers therefore clearly includes rules 11.2 and 11.3, which deal with such pensions. But it is difficult to see how it encompasses rule 11.4, which deals with additional pensions which are separately funded by members under the AVC Scheme. There is no express requirement for the employer to consent to the increase of *those* pensions under rule 11.4, nor any reason why the principal employer should be required to do so, given that the AVC Scheme involves no contributions by the Company and does not affect the application of an actuarial surplus in the main fund. However, once one accepts that rule 11.4 lies outside the scope of rule 11.1, it becomes clear that the reference in that rule to "the powers conferred by this section" cannot be a reference to all the powers in the section, but only to those relevant to the annual review.

25. When therefore one comes to consider the terms of rule 11.6, it is against the background not only of rules 11.1 to 11.3, but also of rule 11.4. Rule 11.6 applies to "any benefit payable or prospectively payable under the rules". These words clearly include current pensions and deferred pensions, but the reference to the trustees having the incidental power to impose terms about the payment of additional contributions by members seems to me also to point to active members still in service. Neither current pensioners nor deferred pensioners would be required to contribute, not least because they are not employees of a participating employer and cannot therefore be members within the terms of rules 2.3 and 2.4. On this basis rule 11.6 covers both the classes of pensions to which rules 11.2 and 11.3 also apply, as well as the further class of active members to which rules 11.1 to 11.3 have no application at

all. It is therefore difficult to accept (even if one limits oneself to the evidence provided by section 11 itself) that rule 11.6 was intended to form part of a newly formulated structure governed by rule 11.1. This remains the case even if one were to read into rule 11.6 a requirement for the principal employer's consent. That would remove the alleged inconsistency between rules 11.1 to 11.3 on the one hand and rule 11.6 on the other, but it would also indicate the existence of a considerable degree of overlap between the two sets of rules. Mr Nugee submits that surplusage is preferable to inconsistency, but neither supports the view that section 11 in its entirety was intended to be an interlinked set of provisions, each designed to take account of the other and to deal with different aspects of a single consistent power.

26. It is at this point in the analysis that the history of section 11 becomes important. Mr Nugee submits that even if one looks at the historical background, it gives no clear guidance. I do not agree. I accept that it may be less helpful, and perhaps inconclusive, in relation to Mr Nugee's subsidiary arguments, but in relation to the question of principal employer's consent it gives the lie to any suggestion that rule 11.6 was reformed so as to be part of the mechanism of an annual review. It is clear that the draftsman introduced new provisions requiring the review of current and deferred pensions on an annual basis with the principal employer's consent. Rules 11.1 to 11.3 are new provisions which replace rules 11.1 and 11.2 of the 1983 Rules. Additional pensions (under the AVC Scheme) which could formerly be dealt with under rule 11.1 (see rule 11.1(a)) were made the subject of a separate rule 11.4 for the reasons already explained. That left old rule 11.3. This was incorporated into the 1989 Rules with the changes I have mentioned. The replacement of the words "coming into payment" with the words "payable or prospectively payable" represents an obvious widening of the scope of rule 11.6 to include current and deferred pensions. That was completely unnecessary if rule 11.6 was intended to form part of the annual review provisions, because current and deferred pensions are already catered for in rules 11.2 and 11.3. If the draftsman had intended to include rule 11.6 as part of the annual review machinery, he could have left the phrase "coming into payment" intact, to deal with active members, and merely added an express requirement for employer's consent. He chose to do neither and in my judgment there is every indication that this was deliberate. I simply cannot accept that the omission of the requirement for employer's consent from rule 11.6 was accidental. It has to be viewed in the light of the other changes to the old rule 11.3, which, for the reasons I have indicated, are inconsistent with the alignment of rule 11.6 with rules 11.1 to 11.3.

27. That still leaves one asking why it was necessary to include a wide power of augmentation without principal employer's consent in a scheme incorporating a consensual annual review of at least current and deferred pensions. In other circumstances I might have taken refuge in a refusal to speculate and have based my Judgment on the fact that no grounds have been made out for adding the requirement of consent to a provision which did not already contain it. But the evidence in this case goes further than that. I have been shown a witness statement by Mr John Garnett, who is the managing director of the Company. He says that he has been advised by Mr Derek Morris, a solicitor at Messrs Alsop Stevens Batesons & Co, who acted for the trustee at the time, that rule 11.3, and therefore its successor rule 11.6, were introduced solely for the purpose of predator protection by allowing the trustee

to augment members' benefits unilaterally in the event of aggression by the principal employer towards the fund. Although I had, and still have, some concerns about the admissibility of this evidence, all Counsel, including Mr Nugee, were agreed that I should take this into account in reaching my decision. Its admission on the first issue of principal employer consent seems to me to confirm the view which I had already formed, based on the other available material, and to provide a rationale for the existence of an independent power of augmentation in the Scheme.

Question 2: Is the Power in Rule 11.6 to require Additional Contributions only exercisable with the Consent of the Employer or the Member Concerned?

28. The issue on this question is whether the power "to impose terms as to the payment of additional contributions" means that the trustee can unilaterally add to the contractual obligations of the employer or the member so as to require them to provide the additional contributions specified, or whether the power extends no further than to making the payment of such contributions a condition of the pension increase awarded, which it is then open to the employer and the member to refuse or accept, as they think fit.

29. The first point to make is that this question does not arise in relation to the fund in surplus, because the trustee must act on actuarial advice and any exercise of the rule 11.6 power at a time of surplus will be effected by utilising the surplus to meet the additional costs involved. There is no question of requiring additional contributions in such circumstances. The question is not therefore relevant to the proposed modification order, but is raised simply to give the trustee guidance on the point.

30. In support of his argument Mr Nugee drew my attention to paragraph 2 of Appendix I, which contains the rules governing additional pensions under the AVC Scheme. Paragraph 2 states that the purpose of the appendix is to:

> "set out the terms upon which members may elect to make additional voluntary contributions to the Scheme in order to secure additional relevant benefits on retirement or payable on death."

But that makes obvious sense in the context of an arrangement which is itself wholly voluntary. The position seems to me to be much less obvious in relation to the Scheme under which contributions by members are compulsory. Employers' contributions to the Scheme are dealt with under section 5 of the 1989 Rules. Rule 5.1 mirrors the provisions of rules 11.1 to 11.3 by requiring the employers to contribute such amounts as shall be determined by the trustee acting on actuarial advice after agreement with the principal employer. Additionally the principal employer is given power under rule 5.3 to reduce or suspend contributions due under rule 5.1. These provisions do not, however, deal with the liability to contribute which may arise under rule 11.6. They are confined to contributions agreed as part of the annual process of review.

31. It seems to me that Mr Nugee therefore gets no real help from these other rules. If anything, they indicate that the draftsman made it expressly clear when consent was required. He also recognised that rule 11.6 had an operation independent from that of section 5. The resolution of this question therefore turns on the wording of rule 11.6, looked at against the background to that rule which I have already outlined. We know that the draftsman did make slight changes to rule 11.6, which included the addition of the words "may impose". I agree with Mr Sher that this is a strong indication that he intended to emphasise that the terms of any increase are to be binding. I do not accept that once the trustee decides to exercise the rule 11.6 power in circumstances which require additional contributions in order for the increase to be funded, the employer and the members are then free to choose whether or not to comply with those terms. The safeguard against the unreasonable imposition of an additional burden on either party is the requirement that the power to impose terms should be exercised on actuarial advice and must of course be exercised in a fiduciary manner. When no surplus exists, the trustee will have to satisfy itself on proper grounds that a reason exists to utilise the power over and above the annual review, and that a proposed increase which can only be funded by additional contributions is justified, having regard, amongst other things, to the burden which will be imposed on employer and member alike. In practice this is likely to involve consultation by the trustee with the Company and the members of the Scheme. But once this process is complete, it is for the trustee to decide whether, and if so on what terms, to exercise the power. Consent is not, as I see it , a prerequisite to the imposition of contributions, if they are otherwise considered by the trustee to be appropriate.

Questions 3 and 4: (a) Does the Rule 11.6 Power extend only to Current and Deferred Pensions and not to Active Members; (b) If it applies to Active Members, does it apply so as to allow Augmentation of both Accrued and Future Service Benefits?

32. For the reasons already set out in paragraphs 19 and 25 of this Judgment, I take the view that rule 11.6 does include active members. Mr Nugee submitted that the use of the words "payable or prospectively payable" confines the power to pensions in payment and deferred pensions. But this argument was based essentially on rule 11.1, which I have dealt with, and on rule 11.7 of the rules as they stand today, which contains new provisions for the annual indexation of: "all pensions currently payable at 31st March 1991, all deferred pensions prospectively payable at that date and the pensions and deferred pensions to which members who are contributing members at that date and their dependents may become entitled under the rules . . . "

33. However, rule 11.7 is excluded as an aid to construction by the fact that it was introduced as a later amendment and therefore postdates rule 11.6 in its present form. The words "payable or prospectively payable" replace the phrase "coming into payment" under rule 11.3 of the 1983 rules, but the reference to the payment of contributions is maintained. There is nothing therefore in rule 11.6 to indicate that the words "prospectively payable" were not intended to include active members as well as deferred pensioners, and Mr Sher drew my attention to rule 10.6(c) of the 1989 Rules, which uses those words to describe the benefits which would have accrued to a member in service but for his death.

34. But the more difficult question is whether the power is limited to the augmentation of accrued benefits. Rule 11.6 applies to "any benefit" which is "payable or prospectively payable". On the basis that the benefits of active members are amongst those "prospectively payable", it can be said that there is nothing in the language used in rule 11.6 to justify restricting the power of augmentation to accrued benefits. However, the word "benefit" is used by the draftsman to denote something which is "payable" either currently or prospectively, and it is easier to equate this concept with accrued rights which entitled the member to payment of a benefit either currently or in the future than with future rights which may never come into existence.

35. It is clear, for the reasons already indicated, that both rule 11.3 of the 1983 Rules and rule 11.6 are the only provisions in their respective sets of rules which deal with the augmentation of benefits payable to active members. The reference in rule 11.3 to increasing benefits "coming into payment" recognised (by the inclusion of a power to impose additional contributions) that the trustee could adjust the accrual rates retrospectively simply by increasing the benefits which had been obtained by reference to past years of service. The same went for deferred pensions under rule 11.2. When dealing with someone close to retirement, the exercise of the power under rule 11.3 did not necessitate any alteration of the future accrual rates, except notionally for the short period of time before the benefits actually became payable.

36. The same goes for rule 11.6 in relation to members approaching retirement. But although the phrase "payable or prospectively payable" by including current and deferred pensions does not alter the basic criteria for augmentation of a benefit (i.e. that it is one which is either currently or prospectively payable), it no longer focuses on the short term. I think that the words "prospectively payable" do not limit the power in the case of active members to accrued benefits at the time of the exercise of the power. It extends to revising the accrual rates for future service benefits. It seems to me unrealistic to suppose that the draftsman, having preserved for the trustee an otherwise unlimited power of amendment covering all three types of beneficiary, should then have restricted the power in the case of active members to accrued service benefits. It also seems to me that the reference to imposing a liability on members for additional contributions makes more sense if the power can be used to cover alterations to the contributions consequent upon an increase in future rates of accrual.

Question 5: Is the Rule 11.6 Power restricted to dealing with Individual Augmentations?

37. The attraction of the argument that rule 11.6 was included so as to deal with individual cases as opposed to class-wide augmentations is that it avoids any duplication between rule 11.6 and rules 11.2 and 11.3. But for the reasons set out earlier in relation to Question 1, there is an explanation for this. Therefore whilst I accept that rule 11.6 can be used to deal with one-off cases, the history and the background to the rule indicate that it is not limited to that. The use of the singular ("any benefit") in rule 11.6 is simply the style of drafting used in the 1983 Rules. If one looks at rule 11.1 of those rules, the trustee's power to augment current pensions (which clearly could be exercised on a class-wide basis) was expressed in terms of a

power to increase "any pension or annuity". The reference to "all pensions" in the new rule 11.1 of the 1989 Rules simply reflects the introduction of an annual review of all current and deferred pensions. I do not accept that it alters the meaning of "any benefit" in rule 11.6 by permitting the trustees to augment a benefit only where they are satisfied that there are grounds for doing so in relation to each individual pensioner or member in question. The distinction between individual and class-wide circumstances is not, in any event, always easy to draw. If the trustee decides, for example, that part of the surplus should be used to increase the benefits of all members in a particular class, because it is preferable to increase their pensions rather than to transfer those funds to the employer, that is obviously a decision which could be made simply by balancing the interests of the class as a whole against the competing claims of the employer. But the same decision is likely to be reached if the trustee, applying the same criteria, considers each of the pensioners individually. Similarly, if the trustee decides that general economic circumstances make it justifiable to increase pensions by more than inflation, then that is a conclusion which would be the same whether one looks at the pensions collectively or on an individual basis. The only decisions which would need to be made on a case-by-case basis are those in which the criteria for augmentation require proof of hardship or some other set of personal circumstances. For rule 11.6 to be limited to cases of this kind, it would require, in my judgment, more than the mere use of the singular. There would have to be some express limitation of the power to increases dependent on individual circumstances. The language of rule 11.6 is in fact entirely general.

Question 6: What is the Relationship between the Rule 11.6 Power and the Power to Amend the Rules contained in Section 16?

38. The next issue raised by the Company is whether the power of augmentation in rule 11.6 cannot be used so as to produce a result inconsistent with the existing rules of the Scheme. As already mentioned, section 16 of the Scheme permits the principal employer, with the consent of the trustee, to alter or replace any of the rules of the Scheme. The only express limitations on this power are that it cannot be used to alter the purpose of the Scheme (i.e. the provision of benefits for employees on retirement or death) and cannot be used so as to return part of the fund to the employer.

39. Mr Nugee's contention on this issue is that rule 11.6 must be read as subject to an implied constraint preventing the exercise of the power so as to achieve a result inconsistent with the purposes and safeguards inherent in the Scheme. As a general statement of principle, it is difficult to disagree with this, but in order to decide whether it has any particular application to the issues raised in these proceedings, it is first necessary to identify the safeguards which are said to be potentially at risk. Mr Nugee's argument is directed to the power of amendment being exercisable by the principal employer. It would, he says, undermine the purpose of this feature of the Scheme if the trustee, without the approval of the principal employer, could, for example, change the future accrual rates for a class of members within the Scheme. One-off increases granted to individual members do not alter the Scheme, but operate as exceptions to it. He is also prepared to accept that the one-off increase for current and deferred pensioners is probably acceptable. His submissions concentrate therefore on the future service benefits of active members, and this is really just a

further argument in support of the proposition that rule 11.6 has no application to that class of benefits.

40. In the *National Grid* case the argument that a free-standing power (in that case, to deal with a surplus) did not confer upon the employer power to amend the scheme was considered by the House of Lords. Lord Scott at paragraph 77 ([2001] 1 WLR at page 882) said that the power under clause 14 (5) of the scheme to make arrangements to deal with a surplus could not be used to make arrangements which were "inconsistent with one or other of the provisions or rules of the scheme" without recourse to the power of amendment. Lord Hoffmann (at paragraph 57), on the other hand, considered that the operation of the scheme should not be burdened by unnecessary technicalities such as requiring the arrangements to be affected by a change in the rules unless the amendment procedure contained important safeguards for the members.

41. In the present case the safeguard relied upon is one for the benefit of the Company: i.e. the requirement for it to approve any changes in the rules. This is only a safeguard in the sense contemplated by Lord Hoffmann if it was intended to provide the Company with a veto on the exercise of the relevant power. In relation to the future accrued rights of active members, the adverse effect on the Company, whether in relation to a surplus or in respect of an increased liability to future contributions, is largely countered by the power conferred on the employer by rule 17.2 to terminate the Scheme. Draconian as that is, it does nonetheless provide the employer with a significant counter to any attempt by the trustee to increase the benefits to members without the employer's consent. I am not therefore persuaded that section 16 should be regarded for these purposes as embodying a safeguard for the employer which was intended to limit the power of the trustee under rule 11.6 to deal with the future service rights of active members. If one also takes into account the alleged purpose behind rule 11.6 of providing predator protection, then that conclusion is fortified.

Question 6: Is the Rule 11.6 Power only exercisable in order to provide Predator Protection?

42. The final issue raised on this application does not depend on the points of construction which I have already dealt with. Mr Nugee has raised a more general question, which is whether the Rule 11.6 power can be used at all in circumstances in which it is not relied upon to provide the "predator protection" for which it was designed. Reliance is placed by the Company upon a general principle that a power can only be used for the purpose for which it was conferred.

43. The most obvious manifestation of this principle is in the rule against committing a fraud on the power. The trustee must act within the confines of the power and use it only to benefit those who are the objects of the power. In the case of discretionary powers contained in pension funds, the Courts have indicated that a trustee must exercise those powers "honestly and for the purposes for which the power was given and not so as to accomplish any ulterior purposes": see *Edge v Pensions Ombudsman* [1998] Ch 512 at page 535. This approach was confirmed by the Court of Appeal:

see [2000] Ch 602. The power under consideration in that case was one vested in the trustee to deal with an actuarial surplus. After stating that the duty of the trustees, in deciding how to deal with the surplus, was to "act in a way which appears to them fair and equitable in all circumstances", Chadwick LJ said this at pages 626-627:

> "The need to consider the circumstances in which the surplus has arisen does not lead to the conclusion that the trustees are bound to take any particular course as a result of that consideration. They are not constrained by any rule of law either to increase benefits or to reduce contributions or to adopt any particular combination of those options. Nor does the need to consider the circumstances in which the surplus has arisen lead to the conclusion that the trustees are not required to take – or are prohibited from taking – any other matters into account in deciding what course to adopt. They must, for example, always have in mind the main purpose of the scheme – to provide retirement and other benefits for employees of the participating employers. They must consider the effect that any course which they are minded to take will have on the financial ability of the employers to make the contributions which that course will entail. They must be careful not to impose burdens which imperil the continuity and proper development of the employers' business or the employment of the members who work in that business. The main purpose of the scheme is not served by putting an employer out of business. They must also consider the level of benefits under their scheme relative to the benefits under comparable schemes; or in the pensions market generally. They should ask themselves whether the scheme is attractive to the members whose willingness to continue paying contributions is essential to its future funding. Are the benefits seen by the members to be good value in relation to the contributions ; would the members find it more attractive to pay higher contributions for higher benefits; or to pay lower contributions and accept lower benefits? The main purpose of the scheme is not served by setting contributions and benefits at levels which deter employees from joining; or which causes resentment. And they must ask themselves whether the benefits enjoyed by members in pension have kept up with increases in the cost of living; so that the expectations of those members during their service – that they were making adequate provision for their retirement through contributions to an occupational pension scheme – are not defeated by inflation.
>
> The matters to which we have referred are not to be taken as an exhaustive or a prescriptive list. It is likely that, in most circumstances, pensions trustees who fail to take those matters into account will be open to criticism. But there may well be other matters which are of equal or greater importance in the particular circumstances with which trustees are faced. The essential requirement is that the trustees address themselves to

> the question what is fair and equitable in all the circumstances. The weight to be given to one factor as against another is for them.
>
> Properly understood, the so-called duty to act impartially – on which the ombudsman placed such reliance – is no more than the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power: that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant. If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest – whether that of employers, current employees or pensioners – over others. The preference will be the result of a proper exercise of the discretionary power."

44. In *Re Courage Pension Schemes* [1987] 1 WLR 495, Millett J had to consider the validity of the exercise of a power of amendment so as to allow Hanson Trust Plc, following a takeover, to be substituted as the principal employer under the scheme. On the evidence before the Judge, this would have allowed Hanson (after running down the activities of the existing employer) to bring about the dissolution of the scheme and to gain access to the surplus in the fund. At page 511D Millett J said this:

> "In my judgment, the validity of a power of substitution depends on the circumstances in which it is capable of being exercised and the characteristics which must be possessed by the company capable of being substituted; while the validity of any purported exercise of such a power depends on the purpose for which the substitution is made. The circumstances must be such that substitution is necessary or at least expedient in order to preserve the scheme for those for whose benefit it was established; and the substituted company must be recognisably the successor to the business and workforce of the company for which it is to be substituted. It is not enough that it is a member of the same group as, or even that it is the holding company of, the company for which it is substituted. It must have succeeded to all or much of the business of the former company and have taken over the employment of all or most of the former company's employees. In my judgment, the proposed power to substitute I.B.L.'s holding company for I.B.L. in undefined circumstances is far too wide, alters and is capable of defeating the main purpose of the schemes, and is *ultra vires.*"

45. It is therefore clear that the trustee must exercise its powers in order to uphold and further the purposes of the Scheme. In that sense it must exercise those powers only for the purposes for which they were granted. But there is a clear distinction, in my judgment, to be made between the purpose for which a power was granted (in the

sense contemplated by the authorities I have just referred to) and the circumstances in which the power was granted. Accepting, as I do, that the rule 11.6 power was intended to provide protection for the Scheme by deterring predatory action by a new or would-be employer, it does not follow that the purpose of that power, once created and vested in the trustee, is circumscribed by the factors attending its birth. In the hands of the trustee, the purpose for which the power was given is the augmentation of pension benefits. It cannot be used to achieve some ulterior purpose. And in exercising that power the trustees will be guided by the relevant circumstances at the time and the need to further the purposes of the Scheme as a whole. As part of that exercise, they have to take a balanced approach and to act honestly and fairly. But they are not required, as a prior condition of being able to exercise the power, to consider whether the Scheme is, so to speak, under attack. The motivation for the introduction into the 1989 Rules of rule 11.6 is not the same as the purposes for which that power was granted. Any other construction would, it seems to me, place the trustee in a quite impossible position, by having to decide whether the circumstances justified their concluding that the Scheme was faced with predatory action in the sense contemplated when the 1989 Rules were brought into effect. I simply do not see how the trustee of the Scheme can be expected to make that judgment, nor do I believe that the promulgators of the 1989 Rules intended that the trustee should do so.

Conclusions

46. For these reasons I will make declarations in the terms sought under paragraph 4 of the Appendix to the claim form. I will hear any further submissions on the form of the order when this Judgment is handed down.