

# OCCUPATIONAL PENSION FUNDS

## 24.1 PENSION FUNDS AS INVESTMENT ENTITIES

### 24.1.1 The central role of trusts law concepts

The growing economic importance of pension funds has profound ramifications for the social significance of trusts law principles. Pension funds are trusts. Consequently, the rights of pensioners, of pension fund managers and of employers creating occupational pension funds for their employees are governed by general principles of trusts law, the precise provisions of pension fund deeds and the provisions of those statutes which have been enacted specifically in relation to pension fund trusts. The development of the law relating to pension funds has come on apace in recent years. This is due in part to the increased social importance of pensions and also to the impact of the Maxwell pension funds scandal as it became apparent that there was a need for a review of pensions law. This culminated in the Pensions Law Reform Committee<sup>1</sup> which recommended the continued use of the trust for the purposes of pensions law, but with the modifications to ordinary trusts law which are contained in the Pensions Act 1995 and in the Pensions Act 2004.

These legislative developments constitute a scheme for the regulation of pension funds which displace in large part their control by means of the ordinary law of trusts. Whereas the ordinary law of trusts allows the trustee to limit her own liabilities by means of contract<sup>2</sup> and relies on the beneficiary principle to ensure that trustees carry out their duties properly,<sup>3</sup> the pension trusts legislation creates a code which subjects pension fund managers to more exacting standards of behaviour and to regulatory scrutiny beyond litigation begun by beneficiaries under ordinary trust law principles. The occupational pension funds which constitute the primary focus of this chapter are typically entered into as a part of the contract of employment between employer and employee. Therefore, the issue will arise below whether it is the trusts law duties of investment or the contractual concept of reasonable expectations<sup>4</sup> which will govern significant questions concerning the obligations of the trustees when making investments, title to the pension fund, and title to any surplus identifiable in the pension fund.

Another issue which is raised more naturally by employment lawyers than by property lawyers is an understanding of payments to occupational pension schemes by employees as being a form of deferred pay.<sup>5</sup> As part of the contract of employment, the employer is required to make contractually-calculated contributions to the fund, as is the employee. This is a benefit from the employment which can be considered to be a portion of the employee's salary deferred until

1 Goode Report, *Pension Law Reform*, Cmnd 2342, 1993.

2 *Armitage v Nurse* [1998] Ch 241.

3 *Re Denley* [1969] 1 Ch 373.

4 Ie, the members' contractual expectations of the level of pension that they will receive.

5 *Deakin and Morris*, 1998, 375 *et seq*; *Parry v Cleaver* [1969] 1 All ER 555, 560, *per* Lord Reid; *The Halcyon Skies* [1976] 1 All ER 856; *Barber v Guardian Royal Exchange* [1990] IRLR 240.

pensionable age.<sup>6</sup> This strengthens the argument that contractual thinking falls to be applied in place of trusts law thinking with reference to the respective parties' rights and obligations under the pension scheme. Much is also made on the loaded dice with which the employer is able to play, having been the person who drafted the precise terms of the scheme rules.<sup>7</sup> This issue will return us to the central question of whether or not traditional trusts law principles fit all of the situations in which the trust is used in the 21st century.

At present, pensions are provided in three ways:

- (a) by way of the basic (state) pension;

(b) by way of the top-up state earnings-related pensions scheme (SERPS) which provides for an earnings-related pension in addition to the basic pension; and

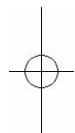
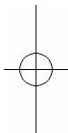
(c) by way of private pensions, either in the form of occupational pensions schemes (which form the basis of this chapter) or via personal pension schemes which are privately arranged.

The state pensions are paid by means of national insurance contributions collected, in effect, in parallel with the tax system.<sup>8</sup> Private and occupational pensions contributions are direct payments made voluntarily by citizens to pension schemes not as part of the tax or national insurance systems. Private pension funds are divisible into two categories: those which are occupational pension schemes; and those which are not related to the individual's employment but are undertaken entirely privately.

### **24.1.2 Management and regulation issues**

Occupational pension funds are organised on trusts law principles but in a particular statutory context which provides for a regulation of the obligations of trustees and the rights of beneficiaries different from ordinary private trusts. The purpose of this chapter is to unpack those trustee and beneficiary relationships (particularly in the light of the specific rights and duties contained in the legislation) which are different in significant ways from the case law dealing with ordinary private trusts. One specific issue is the fact that the pensioner occupies a position both as beneficiary and settlor of the trust. It is also possible that such a person could be a trustee. This clearly creates possibilities for conflicts of interest outwith the ordinary context of many private trusts.

The trustees are responsible for the investment of the trust fund and payment of moneys from the fund to pensioners. However, there is a statutory scheme governing the form of investment and the responsibilities of the trustees contained in the Pensions Act 1995 and in the Pensions Act 2004. To the extent that pension funds have a correlation with ordinary trusts law, the issues raised have been dealt with as additions to the ordinary case law.<sup>9</sup>



6 Economists differ over whether or not salaries have fallen to account for the increased benefit provided by the pension fund. Were it demonstrable, it would appear that the employee were suffering a detriment (a cut in salary) in reliance on the provision of a pension. Arguments based on promissory estoppel could therefore obtain in theory.

7 See Deakin and Morris, 1998, 375.

8 Although not legally – strictly national insurance contributions are ‘contributions’ to the scheme and not ‘taxation’. The effect for the majority of taxpayers is, however, the same.

9 See, eg, *Mettoy Pension Trustees v Evans* [1991] 2 All ER 513; *Cowan v Scargill* [1985] Ch 270. Cf *In Re Landau* [1998] Ch 223.

The trustees’ powers of investment are also regulated by the terms of the trust scheme, but liability for trustees’ breach of such provisions cannot be excluded by agreement. The trustees are entitled to delegate their responsibilities and be free from liability provided that they have made a reasonable selection of delegate and undertaken reasonable supervision of that delegate.<sup>10</sup> Investment is required to be conducted in accordance with formal investment principles set out by the trustees, in accordance with statute. These issues are considered in greater detail below.

## 24.2 OCCUPATIONAL PENSION SCHEMES

The occupational pension scheme is deserving of particular attention because it raises the joined questions of the law of employment contracts together with the law of trusts in relation to the treatment of pension fund property.<sup>11</sup> This section seeks to categorise the various forms of occupational pension scheme before analysing the constituent parts of the two principal types of structure.

### 24.2.1 Types of occupational pension scheme

There is a range of pension schemes. While this chapter does not intend to concern itself with the detail of pensions beyond the rights and obligations of the participants, it would be practical to examine some of the varieties of structure which are available. The most common structure is an occupational pension fund to which both employer and employee contribute. It is in this sense that the expression ‘joint contribution scheme’ is used. It is not meant to suggest that each party need make equal contribution, but simply that both contribute some amount provided for by the scheme rules. As considered below, this creates some important structural questions as to the rights which each is intended to take both as settlor and as beneficiary under that scheme.

The joint contribution schemes fall into two types: ‘defined-benefit schemes’ and ‘defined-contribution schemes’. These structures are considered in outline immediately below and then throughout the ensuing discussion. Defined-benefit schemes are generally set up to provide for pensions in accordance with length of service and salary received at the appropriate times. The administration of the fund requires, as provided for in the Pensions Act 1995,<sup>12</sup> that a minimum funding requirement is maintained in the fund, such that the employer is responsible for maintaining the assets of the fund at a level at which it will be able to meet its obligations. This process is conducted on the basis of actuarial calculations as to the exposure of the fund plotted against its assets and investment performance at any given time. Therefore, funds veer between deficit and surplus depending on the financial obligations and the investment performance of the fund.

Defined-contribution schemes are typically organised around the contributoremployee’s contributions, such that it is the employee who takes the risk of the

10 *Speight v Gaunt* (1883) 9 App Cas 1.

11 This chapter will concern itself with occupational pension schemes rather than consider in specific terms the nature of the large range of fund management institutions which could potentially generate pension-type income for the pensioner.

12 Pensions Act 1995, ss 56-59.

investment performance of the pension fund. There is no minimum funding requirement for this kind of pension fund scheme because of the contributors' assumption of the investment risk.

### **24.2.2 Role of contributor and trustee to occupational pension scheme**

Therefore a difference exists between the legal interaction of the contributor and trustee to the defined-benefit schemes and the defined-contribution schemes. In the defined-benefit scheme, there is a contractual relationship between the contributoremployee and the employer as to the employer's obligation to maintain the level of the fund. The trustee owes investment and other management obligations not only to the employee-contributor, but also to the employer. Obligations owed to the employer are complex because the board of trustees will typically be made up in part of directors and other officers of the employer's organisation. These issues are considered below. Defined-contribution schemes do not have the issue of the employer's role within the structure because there is no obligation on the employer to maintain a minimum funding requirement. Therefore, the only investment obligations owed by the trustees to the employee-contributors are based directly on general principles of the law of trusts and the precise terms of the pension scheme itself.

## **24.3 INVESTMENT OF PENSION FUNDS - THE STATUTORY SCHEME**

Having considered the analytical nature of occupational pension schemes, this section turns to an account of the statutory code introduced to administer them outwith the confines of the ordinary law of trusts. The trustees' powers of investment are regulated by the terms of the trust scheme, but liability for trustees' breach of such provisions cannot be excluded by agreement. The trustees are entitled to delegate their responsibilities and be free from liability provided that they have made a reasonable selection of delegate<sup>13</sup> and undertaken reasonable supervision of that delegate. Investment is required to be conducted in accordance with formal investment principles set out by the trustees, in accordance with statute.

An essential part of the conduct of pension funds is that the pensioners hope to receive a return of their investment (by way of pension) which is greater than their contributions. Therefore, the manner in which the pension fund is invested is all important. The Pensions Act 1995 makes specific provision for the principles by which investment should be undertaken. This legislation is somewhat more progressive than the investment rules considered in Chapter 9 regarding the investment of trust funds in relation to ordinary private trusts. Therefore, the categories of investment are generally broader. There are also rules facilitating the use of investment professionals by the trustees to achieve these investment goals.

### 24.3.1 Powers of investment

#### *General powers of investment – the absolute owner provision*

Whereas there are stringent controls on the investment powers of trustees under express trusts, there is a different, statutory regime in relation to pension trust funds. The content of the powers of investment is generally without statutory restriction. Thus, s 34(1) of the 1995 Act provides: 'The trustees of a trust scheme have, subject to any restriction imposed by the scheme, the same power to make an investment of any kind as if they were absolutely-entitled to the assets of the scheme.' Consequently, the trustees are entitled to make any investments which they would have made had they been the absolute owners of the trust fund. What is meant by this provision is that there is no restriction on the capacity of the trustees in making investment decisions. Therefore, the trustees are given a broad scope in making investment decisions to select those opportunities which will accord most closely with the underlying purpose of the trust. This is always subject to any express provision in the trust instrument itself.

#### *A central question of policy – a limited liability provision?*

There is another sense in which this provision is interesting. There is nothing in Part I of the 1995 Act to generate a standard of duty for the trustee: that is, to set out a general principle – such as the principle of 'conscience' – against which the trustee must measure any investment decision. The standard of the duty implied by s 34(1) differs markedly from the general principle in relation to ordinary private trusts which requires the trustee to make such investment decisions as would have been made by a prudent person of business providing for someone for whom she felt morally bound to provide.<sup>14</sup> In relation to a pension fund trust, the trustee is entitled to treat the fund as though absolutely-entitled to it, as compared to the trustee of an ordinary trust who is required to observe the terms of the trust and the limits of her own trusteeship denying her any beneficial interest *qua* trustee. It is suggested that the implication is different from that under an ordinary private trust, although the TA 2000 has introduced similar principles in that context too (as considered in Chapter 8).

In policy terms the difference is explicit: pension fund trustees will be professionals (or will hire professionals) and should be given broader competence and freedom than trustees under ordinary trusts principles. While the difference may appear at first blush to be a slight one, the moral tone of the obligation is very different. In considering the investments to be made there is not that overriding obligation to be prudent before taking risk. A market professional would tend to have these obligations limited in a contractual conduct of business letter. Furthermore, it should be pointed out that the trust documentation can specify more stringent investment criteria, although that would be a rare occurrence.

<sup>14</sup> *Speight v Gaunt* (1883) 9 App Cas 1.

### *Liability for delegation – protecting the professional*

In all trusts situations the trustee will seek to exclude its own liability so far as possible. Furthermore, trustees will frequently want to use professional investment advisers to manage much of the fund's investment business. The question therefore arises as to the ability of trustees and third party investment professionals to restrict their own liabilities in respect of losses, or failures to profit suitably, suffered by the pension fund. As considered elsewhere in this book, professional investment advisers will agree to act only on the basis of a contractual limit on their own liabilities.<sup>15</sup> This indicates an acceptance in the law that qualified professionals are entitled to be subject to a lesser standard of duty of care, as set out in their professional services contract, than non-professional trustees who are subject to the principles set out under the general law of trusts. However, that position does not obtain in relation to pension funds, because s 33 of the 1995 Act precludes any exclusion of liability in relation to obligations to take care or to exercise skill in the making of investments. Section 33 of the Pensions Act 1995 provides that: '... liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions ... cannot be excluded or restricted by any instrument or agreement.' This rule operates, except in relation to prescribed forms of pension schemes, as identified by the regulatory authorities. Liability for breach of obligation would appear to cover negligence, misstatement, knowing receipt and dishonest assistance.

#### **24.3.2 Powers of delegation**

Within the context of the investment powers of the trustees are the possibilities for those trustees to delegate their responsibilities to finance professionals. Section 34(3) of the 1995 Act provides that: 'Any discretion of the trustees of a trust scheme to make any decision about investments (a) may be delegated ... to a fund manager ... but (b) may not otherwise be delegated ...'

This rule operates in general terms, except in relation to trustees who have gone abroad. Where a fund manager is appointed, such manager must be properly authorised.<sup>16</sup> Therefore, the policy of delegating investment authority only to authorised fund managers is established in the legislation. It was considered preferable for trustees to be empowered to use fund managers generally when the legislation was framed to ensure a sufficiently high level of expertise in the investment of occupational pension scheme funds.

The question then arises as to the duties of observation, control, and so forth which are incumbent on the trustees if the discretion to make investments has been delegated in this way. Section 34(4) of the 1995 Act provides that:

The trustees are not responsible for the act or default of any fund manager in the exercise of any discretion delegated to him ... if they have taken all steps as are reasonable to satisfy themselves or the person who made the delegation on their behalf has taken all steps as are reasonable to satisfy himself – (a) that the fund manager has the appropriate knowledge and experience for managing the

<sup>15</sup> See para 8.5.1 above.

<sup>16</sup> Formerly the fund manager had to be approved under s 191(2) of the Financial Services Act 1986; now under s 252 of the Financial Services and Markets Act 2000.

investments of the scheme, and (b) that he is carrying out his work competently and complying with section 36 ['choosing investments'].

The significance of this provision is that, having delegated responsibility to a recognised fund manager, the trustees are absolved from responsibility from any resulting default of such manager. The obligation on the trustees is to take 'all steps as are reasonable to satisfy themselves'. The question remains as to the level of reasonableness applicable here. In relation to ordinary express private trusts this would require the actions of a person who was investing for persons for whom she felt morally bound to provide.

The matters over which the trustees must be reasonably certain are expressed as follows: the trustees are entitled to be free of responsibility for the acts or defaults of a fund manager provided that the trustees have taken 'all such steps as are reasonable to satisfy themselves ... (a) that the fund manager has the appropriate knowledge and experience for managing the investments of the scheme, and (b) that he is carrying out his work competently ...'.<sup>17</sup>

Reasonableness, in terms of professional investment practice, is likely to involve receipt of statements of account, discussion of investment strategy, and so forth, from the fund manager. It is unlikely that trustees would be held responsible for intervening in the day-to-day business of investment – after all, that is the whole point of empowering the trustees to delegate to investment professionals in the first place.

### **24.3.3 Investment principles**

The 1995 Act requires that there be formal investment principles created and acted upon, rather than simply leaving the trustees and the delegated investment professional to cobble together investment policy on an *ad hoc* basis. Under s 35(1) of the 1995 Act: 'The trustees of a trust scheme must secure that there is prepared, maintained and from time to time revised a written statement of the principles governing decisions about investments for the purposes of the scheme.'

The statement referred to in s 35(1) must contain statements about the matters set out in s 35(3), which refers to: '... the kinds of investment to be held, the balance between different kinds of investments, risk, the expected return on investments, the realisation of investments, and such other matters as may be prescribed.'

This list of issues to be considered, in effect, requires the trustees and their advisers to produce a portfolio investment strategy, that is, an investment plan which does not commit the fund to a narrow range of investments. This portfolio strategy necessarily involves a consideration of the balance between different kinds of investment.

Perhaps the biggest distinction from the law relating to ordinary private trusts is the express inclusion of 'risk' in this list, indicating a modern approach to investment. As considered in Chapter 9 in relation to the investment of trust funds, there is an equivocal approach to the risk element of express private trusts in the cases. The broad rule is that trustees are required to obtain the maximum possible

<sup>17</sup> Pensions Act 1995, s 34(6).

return<sup>18</sup> while taking little or no risk.<sup>19</sup> Professional investment practice requires that there be a trade-off between the level of risk that is taken and the return that is generated. In this way, bonds issued by companies with poor credit worth necessarily generate higher rates of return to compensate the investor for the higher level of risk taken.

The trustees are required to consider the written advice of a suitably qualified person in the preparation of the statement.<sup>20</sup> However, it is a matter for the trustees and their advisers to decide on the appropriate levels of risk, without direct statutory control. The only level of control is provided by the Pensions Regulator, as considered at section 24.4 below.

### 24.3.4 Choosing investments

The choice of investments follows from the statement of investment principles, as considered above. The trustees or fund manager must consider the need for the diversification of investments appropriate to the circumstances of the scheme and the suitability to the scheme of any investments chosen, in accordance with the pensions regulations.<sup>21</sup> The trustees are required to consider 'proper advice on the question whether the investment is satisfactory' in terms of suitability and diversification.<sup>22</sup> The trustees are required to give effect to the prescribed investment principles prepared in pursuance of s 35, discussed at para 24.3.3 above, and to be fully cognisant of the extent of their powers under the trust deed.

### 24.3.5 Surplus

The most esoteric feature of the pension trust fund is the surplus which is generated typically to insulate the fund against movements in the value of the underlying investments. Being a surplus it is necessarily an amount which is not essential to meet the obligations of the trustees and contractual liabilities of the employer-settlor. Rather, it is a surplus amount of money beyond those requirements. The size of the surplus is controlled by tax legislation to prevent companies from seeking to set off too much of their income as pension surplus.<sup>23</sup> The Pensions Act 1995 provides that the surplus may be repaid to the employer if a valuation of the scheme's assets shows that that is appropriate.<sup>24</sup>

Consequently, there is a problem with the issue of title to the surplus of the fund. The case of *Mettoy Pensions Trustees v Evans*<sup>25</sup> is considered below. In that case it was held that the contributions made by the beneficiaries meant that the employer owed a fiduciary duty to them in respect of that surplus where the employer was also a trustee of the fund, such that the creditors in the employer company's insolvency were not entitled to recover that surplus.<sup>26</sup> However, the varying approaches in *Imperial Tobacco*<sup>27</sup> – contractual 'self-interest approach' – and *Re Courage*<sup>28</sup> – 'employer's rights approach' – also fall to be considered.<sup>29</sup> This issue is discussed in greater detail below at para 24.7.4.

18 *Cowan v Scargill* [1985] Ch 270.

19 *Bartlett v Barclays Bank* [1980] Ch 515.

20 Pensions Act 1995, s 35(5).

21 Pensions Act 2004, s 245, amending the Pensions Act 1995, s 36.

22 *Ibid*, s 36(3).

23 Income and Corporation Taxes Act 1988, s 640A.

24 Pensions Act 1995, s 37, as amended by Pensions Act 2004, s 250.

25 [1991] 2 All ER 513: see para 24.7.4 below.

26 See also *Thrells Ltd v Lomas* [1993] 1 WLR 456.



### 24.3.6 Winding up

Winding up will occur either on the insolvency of the employer-company, or in circumstances in which the pension fund itself provides that winding up is to take place. The liabilities of the fund are to be met and then the remaining money is to be distributed among the beneficiaries according to the provisions of the trust deed. This position is similar to that on distribution of the assets of an unincorporated association. The modern view appears to be that such winding up should be carried out in accordance with the terms of the trust deed rather than on the basis of a resulting trust.<sup>30</sup>

The detail of the regulations concerning winding up and the discharge of liabilities, deficits and surpluses is contained in ss 74–77 of the 1995 Act. In short, an independent trustee is required to oversee the winding up, in particular by allocating deficits in the payment of expenses and other creditors between funds.

## 24.4 THE REGULATORY SCHEME – IN OUTLINE

The 1995 Act created a regulatory authority for occupational pension schemes, since replaced by the Pensions Act 2004, and an Ombudsman for the Board of the Pension Protection Fund.<sup>31</sup> The significance of this twin regulatory scheme is its recognition that the protective rationale of ordinary trusts law cannot be relied upon in relation to pension funds. It is not considered adequate that there be some beneficiary who is entitled to bring the trustees to court in the event of any misuse of the trust property as with ordinary trusts. Instead, the social role played by pension funds means that they are significantly more sensitive an issue than ordinary trusts funds. Particularly in the wake of the Maxwell-Mirror pension funds scandal and other pensions misselling scandals, there was significant political pressure for a more systematic regulatory schemata for these institutions.

The Pensions Act 2004 renovates the regulatory regime dealing with pensions, with effect incrementally from April 2005.<sup>32</sup> The 2004 Act applies to all pension schemes and not simply the work-based pension schemes which are the subject of this chapter. Readers requiring a more detailed discussion of pensions law and regulation should consult the appropriate practitioner works on that subject. The previous regulator – the ‘Occupational Pensions Regulatory Authority’ – is replaced by the ‘Pensions Regulator’. The new Regulator’s objectives are to protect the

27 [1991] 1 WLR 589.

28 [1987] 1 WLR 495.

29 *International Power plc v Healey* [2001] UKHL 20.

30 See Martin, 1997, 470.

31 On the role of the Ombudsman before 2004, see *Edge v Pensions Ombudsman* [1999] 4 All ER 546; *Westminster City Council v Haywood (No 2)* [2000] 2 All ER 634; *Marsh & McLennan Companies UK Ltd v Pensions Ombudsman* [2001] All ER (D) 299.

32 It should be noted that this legislation had not come into full force and effect at the time of writing.

benefits of members under pensions schemes, to reduce the risk of situations which may lead to compensation being payable to members, and to promote good administration of pension schemes.<sup>33</sup> The new regulator has the power to issue 'improvement notices' to any person who is contravening pensions law,<sup>34</sup> to force any employer to make any contributions to a pension fund which remain unpaid by it,<sup>35</sup> to deal with any property 'liberated' from a pension fund unlawfully,<sup>35a</sup> to disqualify identified people from being trustees of pension funds and to keep a register of such people,<sup>35b</sup> to secure financial support for occupational pension schemes,<sup>35c</sup> to maintain a register of occupational pension schemes,<sup>35d</sup> and also to provide for the education and assistance of those involved with pensions management.<sup>35e</sup>

In Part 2 of the 2004 Act, the Pension Protection Fund and the Fraud Compensation Fund, overseen by the newly-created Board of the Pension Protection Fund, are also created to protect the position of pensioners under funds which are compromised by any relevant 'insolvency event' relating to the employer or the fund. The Board's objectives are to invest the funds passed to it so that it can pay for any loss suffered by pensioners. Thus, a complex bureaucracy has been created with the intention of ensuring the proper running of pension funds now that private pensions have become so significant in modern society with the decline of the state pension.

## 24.5 SETTLORS IN PENSION FUNDS

This section analyses the two principal structures for private pension schemes considered in section 24.2 above: defined-benefit schemes and defined-contribution schemes. Its aim is to consider the trusts law analysis of the role of settlor, trustee and beneficiary in these structures.

### 24.5.1 General issues with pension fund settlors

The ordinary, private express trust revolves around the triangle of settlor, trustee and beneficiary. While that structure is replicated in the context of pension trusts, it takes a subtly different form from the ordinary private trust. In an ordinary trust created to provide pensions outside the occupational pension scheme context, it is the members of the fund who contribute the capital of the fund. Therefore, they are its settlors.<sup>36</sup> In relation to the identity of the settlor, a pension scheme will necessarily require that the members of the fund are contributors to the fund and that they intend to be pensioners from it: therefore, the beneficiary is a settlor.

<sup>33</sup> Pensions Act 2004, s 5.

<sup>34</sup> *Ibid*, ss 13–15, including powers in relation to the issuing of injunctions and third party notices.

<sup>35</sup> *Ibid*, s 17.

<sup>35a</sup> *Ibid*, s 18 *et seq*.

<sup>35b</sup> *Ibid*, ss 33 and 37, by amending the Pensions Act 1995, s 3.

<sup>35c</sup> *Ibid*, s 43 *et seq*.

<sup>35d</sup> *Ibid*, s 59 *et seq*.

<sup>35e</sup> *Ibid*, s 12.

<sup>36</sup> Eg, Hayton and Marshall, 2001.

With reference to an occupational pension scheme the employer will also be a settlor, as considered below. With most pension schemes, there is no single settlement of the entirety of the trust property at the time of the creation of the trust; rather, the employer will typically contribute initial, nominal capital sums and together with the member-settlor will make contributions by way of settlement throughout the life of the trust. More complex than that, however, is the fact that in most pension funds new pensioners will join the fund and thus become settlors during the life of the fund. This issue of contributions at different stages is examined below. Before that, however, it is worth considering the particular context of occupational schemes at the outset.

### **24.5.2 Occupational pension schemes in particular**

There is no general, legal obligation on employers to create occupational pensions schemes for their employees, subject to the provisions of the Welfare Reform and Pensions Act 1999.<sup>37</sup> Yet many employers do offer occupational pension schemes as part of the employee's remuneration package. In many occupations, the pension has entrenched itself as a habitual feature of the employment contract. So much so that one question which will arise in the ensuing discussion is whether the occupational pension ought properly to be considered as a form of property right, or whether it ought to be interpreted in accordance with the general law of employment and of employment contracts.

The employer usually contributes the initial seed capital for the pension fund: however, the role of settlor is a complicated one. Most of the treatises on this subject begin with the evident truth that in a defined-benefit fund the employer will be a settlor. However, most of those books express the employer as being 'the settlor' as though the only one.<sup>38</sup> It is true that the employer will usually be the motivating force behind the creation of an occupational pension fund in most circumstances. It will be the employer which pays for legal and financial advice in the creation and documentation of a pension scheme. The employee members of the scheme will be reactive to the initiative taken by the employer. The employer will also provide the (often nominal) amount of seed money required to constitute the initial trust capital. In that sense, the employer does perform the role of settlor.

However, it is not true to say that the employer is the only person to act as settlor. The capital of the trust fund will be derived from two sources. The first will be the employer, as mentioned. The second source of capital will be the scheme members themselves. The employees who make up the membership of the scheme will contribute either voluntarily or from a fixed percentage of their salaries. Over and above the employees' contributions will be the employer's contributions.<sup>39</sup> The aim of the fund is to achieve a given return for the beneficiaries. In a defined-benefit scheme, the employer will therefore contribute amounts as required to maintain the level of the fund at that necessary to achieve the required return for the fund. The employer therefore bears the risk of the fund failing to achieve a desired return.

<sup>37</sup> Hudson, 2000:1, 167.

<sup>38</sup> Eg, Moffat, 1999, 497.

<sup>39</sup> The size of each person's contributions will be a matter for the scheme rules.

As mentioned in considering the position of settlor, the employees who are intended to benefit from the fund also constitute settlors each time they contribute to the pension fund. Consequently, the employee acts as a settlor on a mutual basis with other members of the scheme. This category of settlor has a fixed obligation to contribute. The obligation to contribute itself is founded on the employee's contract of employment. Therefore, the employee occupies the position of settlor and beneficiary. However, the employee-beneficiary is not a volunteer because she has contributed to the trust fund directly from her earnings. The obligations which arise between settlor, trustee and beneficiary are both contractual and fiduciary. All settlors are required to continue making contributions; all beneficiaries acquire contractual and fiduciary rights *inter se* contemporaneously. The precise nature of these fiduciary and contractual liabilities is considered in greater detail below. A welter of judicial commentary has obfuscated the picture somewhat, as will emerge from the discussion to follow.

## 24.6 TRUSTEES IN PENSION FUNDS

### 24.6.1 Particular aspects of trustees in pension funds

The trustees of the fund are generally directors of the settlor company. It is important to recall that it will be the employer (typically a company with separate legal personality) which acts as settlor alongside employee-contributors. The director-trustee will generally be part of the controlling mind of that company but not the same legal person as the settlor. The director-trustee can also be a member of the pension scheme as a beneficiary. Therefore, the director occupies the position of controlling mind of the original settlor, a settlor in her own right as well as being a personal contributor to the fund, a trustee of the fund, and a personal beneficiary of the fund. As considered below, there will be issues as to the investment of the fund, the distribution of the fund and the treatment of any surplus in the fund. In each of these contexts, the same human being will be occupying a number of legal capacities and opening herself up to conflicts of interest as a fiduciary.

The questions of personal benefit from the trust in such circumstances have to be considered. Scott VC has dismissed as 'ridiculous' the argument that such a person could not be a beneficiary of the fund as well as a trustee of it.<sup>40</sup> However, such a trustee retains an obligation to act in good faith. As with any trustee, subject to what is said below about the provisions of the Pensions Act 1995, there are potential liabilities with references to losses suffered by the fund on account of breach of trusts. Even where the trustee does not receive a personal gain, there are possible liabilities under breach of trust principles.<sup>41</sup>

To be a trustee of a pension fund or an employer creating an occupational pension fund carries with it extensive potential liabilities beyond ordinary liability for fraud and so forth. The enactment of the Pensions Act 2004 has provided for a number of criminal offences in relation to trustees and managers of pension funds who knowingly or recklessly provide the Pensions Regulator with false or misleading information in general terms or particularly in relation to the exercise of the regulator's powers of inspection and requests for information of trustees or

<sup>40</sup> *Edge v Pensions Ombudsman* [1998] 2 All ER 547; McCormack, 1998. <sup>41</sup> *Target Holdings v Redferns* [1996] 1 AC 421.

employers about occupational pension funds. Sections 68–88 of the 2004 Act give the Pensions Regulator wide powers to gather information, to seek warrants for arrest of wrongdoers and so forth in relation to the mismanagement of pension funds; the Board of the Pension Protection Fund also has similar powers in relation to insolvency and fraud in ss 190–205 of that Act.

The particular context of the respective contributions by employer and employee means that the employer, acting as regards the pension fund, occupies a relationship of trust and confidence towards the employee-beneficiaries. Consequently, the manner in which the employer treats its powers and obligations under the terms of the pension fund, must be viewed in the context of that relationship, as considered in *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*.<sup>42</sup>

#### **24.6.2 Member-nominated trustees**

The Maxwell pensions farrago has had a wide-reaching impact on the legal treatment of pension funds. Pensions have developed from being an aspect of social relations in the sole province of private law into something which is overseen by a statutory regulator. The regulatory structure for occupational pension schemes was introduced by the Pensions Act 1995 and bolstered by the Pensions Act 2004. The Pensions Regulator is considered at section 24.4 above. The other development aimed at ensuring a level of regulation of pension funds was the introduction of independent trustees to the board of occupational pension schemes by s 16 of the Pensions Act 1995, as adjusted by s 241 of the Pensions Act 2004 in the person of member-nominated trustees. There is also a requirement for member nominated directors of corporate trustees in s 242 of the Pensions Act 2004.

The thinking was comparatively straightforward. One of the identified shortcomings in the regulation of pension funds before news broke of the looting of the Mirror pension funds by Robert Maxwell was the ability of one or more individuals effectively to control the trust fund without the knowledge of the members. Therefore, it was decided that there should be a class of member-nominated trustees on the board of trustees. While these independent trustees need to be nominated by the members, it is not necessary that they are members of the pension scheme themselves. The intention was to include these individual member-nominated trustees to reduce the risk of fraud or misuse of the scheme property. The policy underlying this provision anticipates that this class of trustee will ensure the proper running of the scheme.

Two types of issue arise. First, the true ability of the member-nominated trustees to control the activities of the scheme. Secondly, the departure this legislative development marks from the ordinary law of trusts.

##### *Effective powers of member-nominated trustees*

The member-nominated trustees will have full voting rights as part of the board of trustees of the scheme. As such, the member-nominated trustee ought to be able to carry as much weight as other trustees. It should be possible then for whistleblowing in the event of irregularities in the conduct of the scheme's activities, if not for such occurrences to be stopped outright. The shortcoming with the system is the

42 [1991] 1 WLR 589.

power of the board of trustees to delegate investment functions to some of the trustees or to nominated delegates (typically professional investment advisers).<sup>43</sup> Therefore, the member-nominated trustees will not always be able to supervise the minutiae of the scheme's most important activity if they are not included in the day-to-day activities of the investment functions of the scheme.

#### *Member-nominated trustees and ordinary trusts law*

The impact of the introduction of independent trustees is a necessary commentary on the utility of the trust model for this type of entity. Ordinary trusts law approaches the issue of misuse of trust property in two ways. First, the beneficiary principle<sup>44</sup> requires that there be some person capable of acting as a beneficiary who can control the activities of the trustees by bringing such matters in front of the court.<sup>45</sup> Secondly, the rules governing breach of trust provide for restitution of misused trust property by the trustees personally, or equitable compensation in the event that the trust fund has been dissipated.<sup>46</sup>

To take breach of trust first: it is unlikely that individual trustees of occupational pension schemes would be likely to be in a position to effect restitution of a dissipated trust fund. This is simply due to the size of such pension funds. There is no doubt that the model used by ordinary trusts law is optimistic in assuming that a malfeasing trustee will always be able to effect restitution of the fund, when there is no reason to suppose that an unscrupulous private individual breaching a trust will necessarily have sufficient funds to provide such compensation.<sup>47</sup> This is one context in which principles based on family trusts in the 19th century will not meet the needs of commercial trusts in the 21st century.

More significantly than that, perhaps, is the acceptance in relation to pension funds that the cornerstone of the English law of trusts, the control which the beneficiaries are able to exert over the trustees, is insufficient to provide for the effective regulation of a pension fund. Whereas the rights of the beneficiary are accepted by the judiciary as being sufficient to ensure the enforceability of rights in an ordinary private trust, the legislature has accepted that pension funds occupy a more sensitive social position and therefore their trustees require two tiers of regulation: one by the fund's own trustees (in the person of beneficiaries under the fund) who can be expected to stand their own corner; and the other by the Pensions Regulator (the statutory regulator).

### **24.6.3 The nature of the obligation to make investments**

The issue of investments is given particular attention in section 24.3 above. A few key points are worth reiterating at this stage. The extent of the trustees' duty in relation to investments was significantly different from ordinary trusts law principles until the enactment of the TA 2000. The Pensions Act 1995 permits the taking of risks and empowers the trustees to deal with the scheme property as though absolutely entitled to it. With the enactment of the TA 2000, as considered in

<sup>43</sup> These issues are considered in at section 24.3 above.

<sup>44</sup> See *Re Denley* [1969] 1 Ch 373, as discussed in Chapter 4.

<sup>45</sup> *Ibid*, per Goff J.

<sup>46</sup> *Target Holdings v Redferns* [1996] 1 AC 421.

<sup>47</sup> *Ibid*.

Chapter 9,<sup>48</sup> ordinary trustees have similar title and are also required to consider the scope of their investment activities.<sup>49</sup>

## 24.7 EQUITABLE INTERESTS IN PENSION FUNDS

### 24.7.1 Identifying the beneficiaries

On trusts law principles the beneficiaries under the scheme will generally be understood to be the members of the scheme. Benefits will be paid out in accordance with the scheme rules to the members who reach pensionable age.<sup>50</sup> It is also common for persons other than the members to be nominated as beneficiaries from the scheme. For example, the beneficiary may nominate family members or next of kin as being entitled to the employee's share on death. Thus, the class of beneficiaries may extend beyond the member-settlers.

It is also possible that the employer will be entitled to some rebate of contributions in the event of a surplus being generated. It is more usual in the event of a surplus being generated that the employer is entitled to a 'contributions holiday'<sup>51</sup> until the excess amount contributed has been absorbed into the contributions which would otherwise have been owed subsequently by the employer. The issue of title in any surplus and the nature of the employer's ability not to make contributions have raised difficult questions in the cases. These problems are considered below.

### 24.7.2 Member is not a volunteer

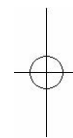
Due to the financial contributions which the member makes to the pension scheme further to her contract of employment, the member is not a volunteer. The member is, as discussed above, generally to be considered to be a beneficiary of the scheme under trusts law principles. The importance of the beneficiaries not being volunteers arises in relation to title to the surplus of the trust fund. In *Mettoy Pension Trustees Ltd v Evans*,<sup>52</sup> the company employer went into insolvency. It was contended on behalf of the creditors under the insolvency that the duty owed by the company to the beneficiaries was merely a personal obligation, such that title in the surplus invested in the fund remained vested in the company. However, Warner J held that because the beneficiaries had contributed to the fund they were not volunteers. Consequently, it was held that the duty owed by the company to the beneficiaries was a fiduciary one, such that the pensioners had acquired rights in the surplus of the trust fund.

This line of thinking was pursued in *Davis v Richards & Wallington Industries Ltd*<sup>53</sup> such that, even though the trust deed had not been validly executed, the

<sup>48</sup> See section 9.2 above.

<sup>49</sup> What is unclear is the extent to which ordinary principles of trusts law as to investment

intrude at this point where the pensions statute is silent. <sup>50</sup> And to any applicable dependants as identified under the scheme rules. <sup>51</sup> Ie, a period of time during which contributions otherwise contractually required need not be made. <sup>52</sup> [1990] 1 WLR 1587. <sup>53</sup> [1990] 1 WLR 1511.



beneficiaries' contributions to the fund gave them equitable rights against the fund including the surplus. Therefore, it is clear that in some situations the member does acquire some proprietary rights in relation to the trustee's fiduciary duty and is not restricted to having a mere debtor-creditor claim in relation to her contribution to that fund. The alternative analysis would have been to identify the employee contributor as being entitled merely to a payment at pensionable age on a contractual basis under the terms of the pension trust document. The Privy Council in *Air Jamaica v Charlton*<sup>54</sup> doubted whether on the winding up of a fund there ought to be a resulting trust in favour of the beneficiaries, preferring instead to distribute the fund in accordance with the rules of the scheme.<sup>55</sup> Beneficiaries under a pension fund trust are also entitled to pre-emptive costs orders due to their contributory status, as opposed to the lesser rights of other forms of beneficiary.<sup>56</sup> However, those statements, while identifying the member as being more than a mere volunteer, do not necessarily translate exactly into a definitive statement by the courts that the member constitutes a beneficiary in all circumstances in relation to the entirety of the pension scheme property.

### **24.7.3 Equitable title in the trust fund**

The scheme property is held in accordance with the terms of the scheme rules on trust for the benefit, primarily, of the members to provide them with pensions on qualifying as pensioners under those scheme rules. The members are intended to be the beneficiaries of the scheme. To qualify for the tax benefits of being an occupational pension scheme, the scheme must be established under an irrevocable trust. This provision is intended, in part, to prevent employers from receiving the tax advantages of being an occupational pension fund and then seeking to recover the scheme property absolutely beneficially. However, there is a notional division in the scheme property between those funds necessary to meet the obligations of the scheme from time to time and those funds which are surplus to such requirements. I use the expression 'notional division' advisedly. The issue of the surplus is considered at para 24.7.4 below. At this stage it is sufficient to point out that a surplus constitutes a book entry representing the overpayment of contributions beyond the needs of the scheme's outgoings from time to time.



It does appear that the portion of the scheme property required for the payment of pensions ought to be considered to be held on trust for the beneficiaries until such time as it is transferred absolutely to the appropriate pensioner. As such the trust in favour of the beneficiaries does not appear to give any particular member proprietary rights in any particular part of the scheme property. Given the structure of the scheme as a quasi-protective trust providing for the old age of the members, the beneficiaries will not be entitled to exercise *Saunders v Vautier*<sup>57</sup> rights over the entirety of the fund.

54 [1999] 1 WLR 1399.

55 This issue was discussed in detail in para 4.3.4 in relation to the winding up of unincorporated associations.

56 *McDonald v Horn* [1995] 1 All ER 961. 57 (1841) 4 Beav 115.

Therefore, the rights of the members are personal claims against the trustees of the fund to ensure that the scheme property is dealt with according to the terms of the scheme rules. The member has a contractual right to receive a proportionate share of the scheme property on qualifying as a pensioner under the scheme rules. The scheme property is held on a trust under which the member constitutes one of a number of beneficiaries.<sup>58</sup> Therefore, until some money is appointed to the member, that member has no identifiable proprietary right to any part of the scheme property other than the general right to supervise the trustees. The right is a right of proprietary control and not a direct property right.<sup>59</sup>

#### 24.7.4 Title in the surplus

##### *The issue*

The surplus is identified (and dealt with) in the cases as an identifiable item of property to which title is a matter of some difficulty, depending usually on a close interpretation of the scheme rules. It is my opinion that the surplus ought not to be considered to be property at all, but rather ought to be considered to be a contractual debit or credit available to the parties at any particular time in accordance with the scheme rules.

First it is important to understand the various shades of opinion in the cases. The authorities fall into two schools: the 'employer rights thesis' and the 'contractual self-interest thesis'. The employer rights thesis advances the view that the employer should typically be considered to have retained rights in the surplus. The contractual self-interest thesis considers the question to be one of construction of the scheme rules in each case on the basis of the contractual principle of good faith, while also permitting self-interest.<sup>60</sup>

This writer advances a third thesis – the 'contractual credit thesis' – which advances the view that the surplus ought not to be considered as segregated and identified property at all. In consequence, the surplus should be treated straightforwardly as a part of the scheme property which cannot be separated from the rest of the fund and is therefore to be held on trust accordingly.

##### *The employer rights thesis*

This thesis is based primarily on the judgment of Millett J in *Re Courage Group's Schemes*.<sup>61</sup> In his judgment the approach taken is that the employer is the only person entitled to withhold contributions in the event that a surplus has been generated. As Millett J put it:

Such surpluses arise from what, with hindsight, can be recognised as past overfunding. *Prima facie*, if returnable and not used to increase benefits, they ought to

58 Cf *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399.

59 Which returns to the theoretical discussion of property rights in Chapter 31: these rights are Hohfeldian rights against another person in relation to control of the use of property but not rights attaching to any segment of specific property within the fund.

60 *Woods v WM Car Services (Peterborough) Ltd* [1981] ICR 666; *National Grid Co plc v Laws* [1997] PLR 157.

61 [1987] 1 All ER 528, 545.

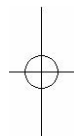
be returned to those who contributed to them. In a contributory scheme, this might be thought to mean the employer and the employees in proportion to their respective contributions. That, however, is not necessarily, or even usually, the case. In the case of most pension schemes, and certainly in the case of these schemes, the position is different. Employees are obliged to contribute a fixed proportion of their salaries or such lesser sum as the employer may from time to time determine. They cannot be required to pay more, even if the fund is in deficit; and they cannot demand a reduction or suspension of their own contributions if it is in surplus. The employer, by way of contrast, is obliged only to make such contributions if any as may be required to meet the liabilities of the scheme. If the fund is in deficit, the employer is bound to make it good; if it is in surplus, the employer has no obligation to pay anything. Employees have no right to complain if, while the fund is in surplus, the employer should require them to continue their contributions while itself contributing nothing. If the employer chooses to reduce or suspend their contributions, it does so *ex gratia* and in the interests of maintaining good industrial relations.

From this two consequences follow. First, employees have no legal right to a 'contributions holiday'. Second, any surplus arises from past overfunding not by the employer and the employees *pro rata* to their respective contributions but by the employer alone to the full extent of its past contributions and only subject thereto by the employees.

The rationale presented here is that the employer is making payments when the employer would otherwise be entitled to withhold payments at this period of time, whereas the employee is contractually required to continue to make periodic payments. Consequently, it is said that the employer is making voluntary payments to constitute a surplus such that the surplus should be said to have come only from those voluntary payments. And so a virtue is made of handing the surplus to the employer. It is said that the member is merely making contractually obligatory payments, whereas the employer is acting out of the goodness of its heart in maintaining industrial harmony.

The logical sense of this argument is not entirely apparent. The surplus arises because there are more assets in the fund than there are obligations to be paid out of it. That surplus exists because *all* of the contributors to the scheme have added so much property that there is more than is needed; not simply that the employer alone has over-contributed. The power for the employer to cease making contributions to the scheme has been conflated with the inquiry as to who has contributed the surplus. Suppose two hoses are filling a bucket and that neither tap serving the hoses can be turned off. Suppose that only one of those hoses has a rubber stopper - so, in the same way that it is only the employer which is capable of withholding contributions to the pension scheme in certain circumstances, it is only the hose with a stopper which could cease adding water to the bucket. It is not true to say that it is only the hose with the stopper which causes the full bucket to overflow; rather, the water that spills over the bucket comes from both hoses. It is both sources of water which can claim credit for the overflow. Similarly, the surplus in the scheme property comes from two sources: employer and employee. Therefore, it is not correct to say that only the employer can claim title in that surplus (or overflow).

What is significant in this employer rights thesis is the absence of any concept of employment law (and in particular of the employment contract) in its thinking. The approach instead demonstrates a fetish for principles of property law. It is reminiscent of resulting trusts cases which follow carefully the proprietary rights of the parties without concerning themselves with any other concept.<sup>62</sup> The particular approach in *Courage* is hauntingly reminiscent of restitution thinking which seeks to vindicate the original ownership of the employer:<sup>63</sup> that is, an approach which is motivated by the logic of those property rights and not by external factors. Alternatively, why could not the employees argue that their contributions create expectations as to their property rights in the fund?<sup>64</sup>



The weakness in the thinking in *Courage* is that the contract of employment and the creation of the pension trust have intervened to make the employer's assertion of retention of title incapable of vindication. Further, as considered below, the surplus is not an identifiable fund of property and therefore cannot be segregated so as to be held on trust solely for the employer. It is suggested that the better argument would be that under employment law principles the court should seek to vindicate the reasonable expectations of the fund member rather than some illusory proprietary entitlement of the employer.

### *The contractual self-interest thesis*

The employer rights thesis is only one possible explanation on the cases as to the titleholder in the surplus. Browne-Wilkinson VC developed another way of considering similar issues in *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*, which rejected any suggestion of fiduciary responsibility in favour of a contractual approach.<sup>65</sup> This approach is dubbed the contractual self-interest thesis, in that the employer is bound by contractual (rather than purely fiduciary or property) obligations and thus entitled to act with an eye to its own self-interest. The single proviso to this ability to deal self-interestedly is a requirement, culled from the law of contract, that the employer acts in good faith. Therefore, the employer will be precluded from denying the contractual rights of the members.

The Imperial Tobacco Company (ITC) had become a target for a takeover by the asset-stripper Hanson. One of the attractions of ITC as a target was the large surplus invested in its pension fund. Under the pension scheme, ITC was not a trustee. Hanson's objective appears to have been to gain access to the cash fund constituted by the surplus. Therefore, a 'poison pill' was inserted in the scheme rules which created a power to pay fund members a 5% benefits increase and precluded ITC from recouping the surplus. Therefore, ITC was not entitled to recover the large surplus of about £130 million which had accumulated. Hanson's strategy was to set up an alternative pension scheme to attract ITC members into the new scheme. The merged entity's pension fund would (circuitously) entitle that entity, as employer, to claw back the surplus in a way that the ITC pension scheme was not entitled to do. The question was therefore whether the successor/merged entity had the power to seek to acquire the cash surplus, or whether the employer (and the successor) were bound by a fiduciary duty to the members.

62 Eg, *Tinsley v Milligan* [1993] 3 All ER 65, in which Lord Browne-Wilkinson distinguishes the older principle in *Gascoigne v Gascoigne* [1918] 1 KB 223 (that illegality precludes an assertion of resulting trust) on the basis that *strictu sensu* the claimant's rights were acquired otherwise than through the illegality itself.

63 See *Virgo*, 1999.

64 *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27; *London Regional Transport v Hatt* [1993] PLR

227. Cf *Re Imperial Foods Ltd Pension Scheme* [1986] 2 All ER 802. 65 [1991] 2 All ER 597.

Browne-Wilkinson VC held that the employer did not owe a fiduciary duty to the members of the scheme in relation to the surplus. Rather, the employer was entitled to rely on the terms of the pension scheme rules, provided that it observed the contractual duty of good faith in employment contracts. This is a duty which it owes to each member individually, beyond simply a general duty to observe its contractual obligations.<sup>66</sup> The employer was required both to concern itself with the 'efficient running of the scheme' and not act 'for the collateral purpose of forcing the members to give up their accrued rights in the existing fund'. On the facts, Hanson was not able to demonstrate either that its takeover strategy would address the efficient running of the scheme, or that it was not aimed simply at forcing the members of the ITC scheme to give up their accrued rights. This approach has been followed in *British Coal Corporation v British Coal Staff Superannuation Scheme Trustees Ltd*,<sup>67</sup> which similarly precluded an alteration in scheme rules to enable the surplus to be used to pay off obligations to pensioners who had retired early on the basis that applying the surplus in such a way would not be in accordance with the duty of good faith which was upheld in *Imperial Tobacco*.

The significance of finding that the duty was not a fiduciary duty was that the employer would be entitled to consider its own self-interest. In short, the trust would therefore not be bound by rules such as that in *Keech v Sandford*<sup>68</sup> and *Boardman v Phipps*<sup>69</sup> prohibiting a person identified as a fiduciary from allowing its personal position and its fiduciary position to conflict.<sup>70</sup> Therefore, the employer is entitled to recoup the trust fund where that is in the interest of the employer itself. There is no requirement to consider the status of the beneficiaries under the trust beyond ensuring the efficient running of the trust and the satisfaction of the members' accrued rights. Necessarily the surplus is said to constitute a value which is extraneous to the proper running of the fund and the contractual entitlements of the members. This issue was considered in *National Grid Co plc v Laws*<sup>71</sup> by Walker J, who held that the employer is within its rights when 'looking after its own financial interests, even where they conflict with those of the members and pensioners'.

The approach in *Imperial Tobacco* differs from that taken in the judgment of Warner J in *Mettoy Pension Fund*. As considered at para 24.7.2 above, Warner J took the view that the employer's creditors were not entitled to establish title to the scheme surplus on the employer's liquidation. A vitally important distinction in that instance was that the employer in *Mettoy* was also acting as trustee of the pension fund, unlike the employer in *Imperial Tobacco*. Therefore, the fiduciary duty in *Mettoy* is in part attributable to the express trusteeship borne by the employer. The rationale applied by Warner J was thus that the employer was required to act in a fiduciary capacity in relation to the surplus, such that the liquidator could not exercise the employer's power in ignorance of the fiduciary duty because of its trusteeship. In consequence the members were to be understood as having proprietary rights in the surplus to the extent that the employer would not have been able to alienate that

66 *Milhenstedt v Barclays Bank International Ltd* [1989] IRLR 522; *Sally v Southern Health and Social Services Board* [1991] IRLR 522.

67 [1994] OPLR 51; *International Power plc v Healey* [2001] UKHL 20.

68 (1726) Sel Cas Ch 61.

69 [1967] 2 AC 46.

70 Issues considered in Chapter 9.

71 [1997] PLR 157.

property in breach of the fiduciary duty. Clearly, this approach can be reconciled with that in *Imperial Tobacco* only if the differences in the facts as to the employer's express duties of trusteeship are relied upon.

It is suggested that the Vice Chancellor could have applied his contractual thinking in another way on the facts of *Imperial Tobacco*. That approach would be to extend the analysis of the employment contract between ITC and the members. Remember, the ITC scheme rules precluded recovery of the surplus. Based on principles of employment law, it could be said that the employer ought properly to be required to observe the terms of the original employment contract and of the original scheme rules. It could be said in consequence that it would be unconscionable for the merged entity, as successor to ITC's contractual obligations, to renege on the terms of the original scheme rules in relation to the surplus contained in the contract of employment. However, the Vice Chancellor took the approach of a property lawyer once again in conceiving of the matter as one of fiduciary duties and not of contract.

### *Inequality of bargaining power*

Particularly drafted scheme rules could obviously require that the surplus be used only for an identified purpose. Therefore, the employer would be precluded from asserting title to the surplus. However, this would require an alteration in the inequality of bargaining power which typically obtains when occupational pension schemes are created.<sup>72</sup> The employer will generally ensure that the rules contain an express power for the employer to recover any surplus. The employer would be well-advised to provide for an obligation on the trustees to segregate the surplus from time to time so that the contractual credit thesis would not obtain: a segregated fund of money could be validly held on distinct trusts.<sup>73</sup> Again the difference in thinking between a property lawyer (concerned with the identification of trusts) and an employment lawyer (concerned with addressing unjustifiable inequalities of bargaining power) emerges as central to the question of title in the invested surplus.

### *An equivocal position*

The authorities are therefore left in an equivocal position. Warner J in *Mettoy Pension Fund* was explicit in his finding that the employer owed a fiduciary duty to the members in relation to the surplus. Meanwhile, Browne-Wilkinson VC expressly rejected any such fiduciary duty, preferring instead to rely on a mixture of the contractual obligation of good faith and permissible self-interest within the bounds of the contract. Yet a third approach is identified with Millett J, who took the property lawyer's approach to allocating property rights in the surplus to the employer on the basis of an assumed contribution of the entirety of the surplus by the employer instead of the employee.<sup>74</sup> It is impossible to provide a single answer to the question 'who owns the surplus?'. Rather, the courts can each be understood as having interpreted the precise arrangement created on the facts before them.

<sup>72</sup> On this point generally, see Deakin and Morris, 1998, 368 *et seq.*

<sup>73</sup> *Re Goldcorp* [1995] AC 74.

<sup>74</sup> Cf *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399.

The correct approach therefore is to construe the terms of the appropriate scheme rules. That may lead to one of three approaches: that the employer necessarily retains rights in the surplus; that the employer can act in its own selfinterest according to the contractual duty of good faith; or that the employer will be subject to a fiduciary duty over the surplus. The following section presents an argument that in many cases the argument as to 'ownership' of the surplus is to overestimate the ability of the surplus to be considered as property in any event.

### *The contractual credit thesis*

To return to the thesis of this section, that the surplus is not properly to be considered segregated trust 'property' at all, it is important to consider the nature of the surplus in a pension fund. On the basis of actuarial calculations, it is said to be possible to identify at any particular time the likely obligations of the scheme and its correlative assets. A defined-benefit scheme will require the employer to make additional contributions in the event of a shortfall, or to be entitled not to make any contributions in the event of a surplus. The nature of this process is a contractual mechanism which entitles the trustees to make a personal claim against the employers to make further payment, or entitles the employer not to pay as otherwise required by the scheme rules.

The surplus is not any particular part of the scheme property, however. The scheme property is held on irrevocable trust. A person arguing for title in any part of the scheme property is therefore arguing that she is a beneficiary of a trust over that particular part of the scheme property. It is an essential part of the law of trusts that a trust fund subject to particular trusts be segregated and separately identifiable.<sup>75</sup> Consequently, to have any proprietary rights in the fund it would be necessary that the trustees be holding that particular property distinct from the remainder of the scheme property. However, to say that there is a surplus is not to identify any particular, segregated sum of money which is surplus to the requirements of the scheme at that time. Rather, it is a calculation that the value held in the fund is greater than the obligations of the fund at that time. Therefore, to suggest that there can be 'title' in this surplus is meaningless because there is no particular property identified as being surplus. Rather, it is merely a book entry: that is, a value ascribed to the surplus and not to any particular property. This is an approach more recognisable to employment lawyers than to property lawyers. Therefore, all that is available to the person arguing for proprietary rights in the surplus is a credit which recognises that past contributions are more than is then necessary to discharge the obligations of the scheme.

In that way, it is suggested that no single party has separate title to the surplus of a pension fund unless that surplus is first separated from the general scheme property, which would require a specific power in the hands of the trustees. Rather, the surplus is held on trust as part of the general scheme property and falls to be distributed according to the scheme rules. To suggest that the employer retains title in the surplus would be contrary to the principles of trusts law.

<sup>75</sup> *Ibid.*

### *A note on proportionate rights of members under non-occupational schemes*

An ordinary pension scheme would operate on ordinary principles of trusts law, as considered above. Therefore, those same ordinary principles would apply in a situation in which the fund fell to be wound up. It is therefore important to point out that pension funds are to be treated very differently from ordinary private trusts with reference to their winding up. Hayton draws the comparison<sup>76</sup> with the well-established principles on dissolution of an unincorporated association and suggests that the approach set out by Walton J in *Re Bucks Constabulary Fund Friendly Society*<sup>77</sup> could equally be adopted. Hayton's argument is based on the idea that members of a pension fund could be seen as being in an analogous position to members of an ordinary club whose rights should depend on the contractual terms of their agreement. Alternatively, the older principle in *Re West Sussex*,<sup>78</sup> which would return property to the members on resulting trusts, could be deployed to calculate the rights of the scheme members.

Continuing Hayton's analysis, more complex issues arise on winding up the scheme. A properly constituted scheme ought to have express provision for the calculation of the rights of the pensioners from the trust. However, in circumstances in which funds are organised as mutual trusts without a methodology for distribution of the fund's assets, there are complex questions as to identifying the amounts which the employees are entitled to, the time for which such investment has been made, the time-value of that investment, and a weighting for benefits already received.

These issues are similar to those raised in the *Barlow Clowes*<sup>79</sup> litigation in which a mutual fund fell to be wound up. The Court of Appeal accepted the principle that the first in, first out principle established in *Clayton's Case*<sup>80</sup> was inappropriate in distributing the assets of a mutual fund in which investors made investments of varying amounts at different times over the life of the fund. Instead, the court accepted that there ought to be some calculation of the proportionate rights of the beneficiaries in the total value of the fund by way of a rolling charge.<sup>81</sup> Unfortunately, their Lordships balked at the suggestion that the calculation ought to take into account not only the size of the contribution but also the length of time for which that contribution formed a part of the fund. This would recognise that those who had contributed to the fund for a longer period of time would deserve a larger proportion of the assets of the fund at the date of the calculation.

### *In conclusion ...*

In these ways the core structure of the pension fund differs from ordinary express trusts in that the rights of the members are partially compromised by the nature of the structure and relationship to the company and its directors as trustees. Further differences are introduced by the Pensions Act 1995 and the Pensions Act 2004, as

<sup>76</sup> Hayton, 1996, 718.

<sup>77</sup> [1979] 1 WLR 936.

<sup>78</sup> [1971] Ch 1.

<sup>79</sup> [1992] 4 All ER 22.

<sup>80</sup> (1816) 1 Mer 572.

<sup>81</sup> *Re Ontario Securities* (1966) 56 DLR (2d) 585.



considered in this chapter. What must be remembered is that the other rights and duties of trustees under ordinary trusts law, for example as to giving information and acting fairly between beneficiaries, apply in the same manner as considered in Chapter 3 in relation to the administration of trusts.<sup>82</sup>

Significantly, these ordinary property law approaches are not referred to by the courts considering pensions cases. Rather, pensions law has begun to establish itself as a system apart from ordinary trusts law. The question arises whether or not this ought to be a cause for concern. As Milner and Moffat argue, it is probably not a cause for concern provided that the occupational pension continues to operate broadly as a traditional trust with the adaptation of specific principles in circumstances in which pensions simply operate in a different context.<sup>83</sup> As considered in Chapter 3, it is likely that the law of trusts will have to fragment in acknowledgment of the fact that the various social uses of the trust (whether for commerce, allocation of property within a family, or in relation to pensions) will require that different understandings of the core notion of conscience are developed to function effectively in these environments.

In Cotterrell's terms, it is important that the legal treatment of trusts is put in its social and moral context.<sup>84</sup> The strength of equity is in its ability to adapt to changing circumstance. It was a regrettable feature of trusts law in the 20th century that these flexible principles, developed originally as a bulwark to the rigour of the common law, began to become overly rigid. To continue to deal adequately with pensions, the law of trusts will have to absorb many of the employment law and contract law thinking considered above to understand the form of trust-based conscience necessary in those situations.

The question for the courts in applying these rules is to understand the need for principles which recognise the risks associated with such personal welfare provision in preference to the protection of professional investment advisers through their contractual exclusion of liability clauses. In tandem with financial regulation, the role of equity and the common law ought to be to ensure the well-being of ordinary pensioners through the application of suitable fiduciary obligations of frankness in the selling of financial products, the provision of information about the management of the pension fund, and liability to make good any loss to the fund caused by the misapplication of those funds by professional fund managers. While the protection of the competitive position of UK financial markets is a central goal of the Financial Services and Markets Act 2000, the greater policy priority ought to be the welfare of ordinary citizens. Recognition of rights of equivalent proprietary title between pensioner and employer under occupational pension schemes is one reform of the common law which would contribute to greater protection of pensioners at a time when many pension funds are considered to be underfunded and a reduction of the level of risk prevalent in the provision of income-replacing financial services.

82 *Wilson v Law Debenture Trust Corp plc* [1995] 2 All ER 337, and see also *Re Londonderry's Settlement* [1965] Ch 198.

83 Moffat, 1999, 537.

84 Cotterrell, 1993:2; see section 2.5 above.