ALLEN & OVERY

Pensions in Dispute

May 2017

Welcome to our quarterly pensions litigation briefing, designed to help pensions managers identify key risks in scheme administration, and trustees update their knowledge and understanding. This briefing highlights recent cases and Pensions Ombudsman determinations that have practical implications for schemes generally. For more information, please contact pensions.team@allenovery.com.

RPI switch not possible in practice

In a recent decision (*Thales*), the High Court has ruled that the introduction of the UK house prices index (**UKHPI**) into the Retail Prices Index (**RPI**) earlier this year meant that the power to change the index had been triggered, but that restrictions in the rules meant that a different index could not actually be chosen.

The decision illustrates how the ability to switch from an RPI revaluation method depends on the precise wording of the scheme rules in question. However, it will be of interest to trustees of schemes where the power to change index depends on a similar trigger.

The court considered the following indexation rules for different sections of the scheme (emphasis added):

- 'if the Government retail prices index for all items is not published or its compilation is **materially changed**, the Principal Employer, with the agreement of the Trustees, will determine the **nearest alternative index** to be applied' (CARE rules); and
- 'if the Retail Prices Index is revised to a new base or if that Index is **otherwise altered**…all subsequent variations in that pension will be on a basis determined by the Trustees **having regard to the alteration made** to the Retail Prices Index' (final salary rules).

In relation to the CARE rules, a change was material if it resulted in RPI functioning and operating in a way which either did not fulfil its original purpose (to provide a measure of inflation for the typical household) or did so in a way that was materially different from the way in which it did so before the change. In addition, the nearest alternative index was the one most closely reflecting the existing elements of RPI. The judge concluded that the introduction of UKHPI was a material change, meaning the employer (with the agreement of the trustees) needed to determine the nearest alternative index to be applied – in the judge's view, this needed to be done within a reasonable time. However, RPI as materially changed was still considered to be the nearest alternative, meaning that the judge considered that a different index could not reasonably be adopted.

In relation to the final salary rules, the power to switch index was also triggered, but the rule required the trustees to adopt a basis reflecting the manner in which the alteration caused a departure from the unaltered RPI. Again, in the judge's view, RPI as amended was the only basis which the trustees could properly choose.

To read more about switches from RPI, see our Pensions in Dispute website.

What does this ruling mean for trustees?

Trustees of schemes with a similar trigger for changing index (that is, a material change or alteration) may be approached by sponsors about reconsidering the basis for indexation following this case. For schemes where the choice of alternative index is restricted (whether or not similar wording is used), this may not result in any substantive change although the issue will need to be considered. Conversely, where there is no restriction on the choice of alternative index, it may be possible to select a different basis. Note also the court's view that where a power is triggered, it should be exercised within a reasonable time.

In other news, the Supreme Court has granted permission to appeal from the Court of Appeal's decision in *Barnardo's v Buckinghamshire*, which may result in useful guidance on RPI switches later this year or next year. To read more about the case, click here.

If a member defrauds their employer, is it possible to offset the loss against their pension entitlement? Take a look at our recent PensionsTalk blog post 'When a good employee goes bad…is their pension at risk?'

Calculating pension increase underpins

A recent Court of Appeal decision (*FDR v Dutton*) has considered different methods for calculating pension increase underpins, with a potential increase in scheme liabilities of up to GBP17 million.

In this case, the scheme's pension increase rule was amended by a deed of amendment dated 20 June 1991 – the scheme had provided for 3% compound increases per annum, which was replaced by 5% LPI per annum (that is, the lesser of 5% and the increase in RPI). By the time of the case, it was common ground that a 3% underpin applied to pre-amendment service (because the amendments infringed a proviso on the scheme's amendment power), but the scheme had been administered on the basis of the new rule for a number of years. The issue for the court was how the underpin should be calculated, and three approaches were presented: the annual approach (trustees), an 'alternative' approach (trustees), and the modified cumulative approach (employer).

The key difference between the approaches was that the two methods proposed by the trustees required the increase to be calculated year-on-year by applying the appropriate percentage increase to the amount paid in the previous year. Conversely, the employer's method (which was cheaper), required two annual retrospective calculations over the whole period in which the pension was in payment (and there was a 0% floor applied to the LPI increase to protect against negative RPI) – the amount awarded was the higher under the old rule or the new rule. The Court of Appeal, overturning the decision by the High Court, agreed with the employer that the modified cumulative approach should be applied – to read more, click here (Court of Appeal decision) or here (High Court decision).

What does this ruling mean for trustees?

The case could be of relevance to other schemes operating a pension increase underpin, depending on the drafting of the scheme rules. Expert evidence in the case suggested that it is rare for a cumulative approach to be applied when calculating an underpin. Where the circumstances are similar, it is possible that trustees may receive queries from sponsors about how an increase underpin is calculated and/or requests to reconsider the current approach to calculation following this decision.

Ombudsman likely to increase compensation threshold

For a number of years, the Pensions Ombudsman (**TPO**) has tended to award compensation for non-financial injustice, commonly referred to as compensation for distress and inconvenience, up to a threshold of GBP1,000, with compensation above this threshold only awarded in very few cases. This is based on a court ruling that awards should only be made above GBP1,000 in very exceptional circumstances.

In a recent High Court appeal from a TPO determination (*Baugniet*), the judge's view was that, given the passage of time, the threshold for cases outside the 'very exceptional' category should be increased to GBP1,600 – he therefore urged TPO to increase the upper limit. To read more about the case, click here.

What does this ruling mean for trustees?

TPO is expected to increase the compensation threshold following this decision. Revised guidance on compensation thresholds has not yet been issued (the existing guidance is available here). TPO has in fact awarded compensation of GBP1,600 in a more recent determination, though without specifically commenting on the issue. Any new guidance will need to be taken into account when handling (and potentially settling) member complaints.

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Jason is a Senior Associate in the Litigation group. He specialises in all aspects of pensions disputes, including advising clients in relation to internal disputes and disputes before the Pensions Ombudsman, the Financial Ombudsman Service, the Pensions Regulator, the PPF Ombudsman and the Courts. Jason is ranked in Chambers & Partners Directory in the field of Pensions Litigation.

Need help with a pensions dispute? Visit www.allenovery.com/pensionsindispute for a range of practical resources to help with pensions problems, plus our new case tracker.