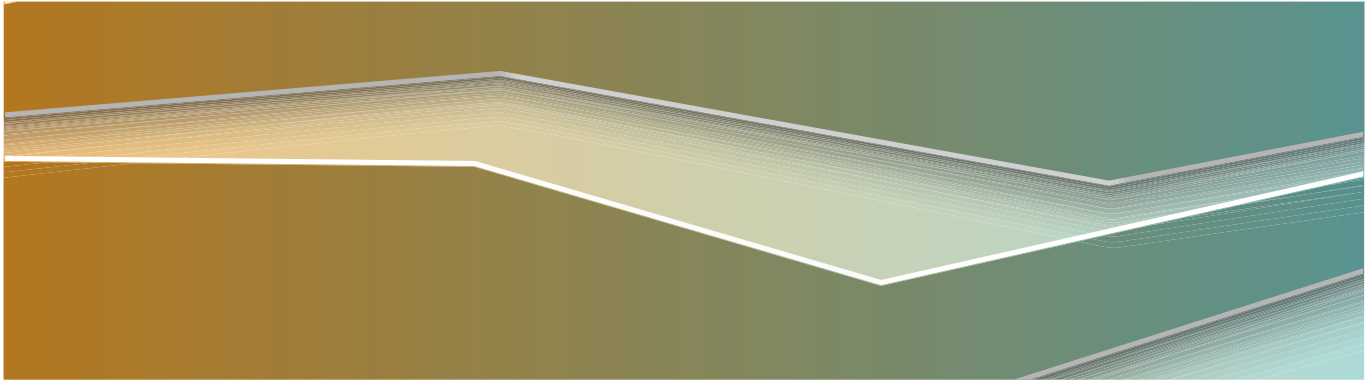


TRUSTEE DISCRETIONS

Wider than you think?



The trust deeds and rules that govern DB pension schemes allocate different powers between the schemes' trustees and employers. Whether a power rests with trustees or employers is often dictated by overriding law or common sense. But for some powers, there can be a lot of variation over who has it, and what the scope of it is. Many important powers often lay with trustees and how they are used can have significant cost consequences for the employer. Typically they can be exercised "at the trustees' discretion". It isn't always clear what that really means, and sometimes this can lead to litigation.

A recent example of this is the case brought by British Airways against the trustee of one of its final salary schemes. The crux of the dispute involved the vexed issue of pension increases and whether they should increase by reference to RPI or CPI. The scheme's rules required pensions to increase by reference to what was happening with certain public sector schemes. Historically this had been RPI. When the government changed the basis of indexation for the public sector to CPI, this change automatically flowed through to the BA scheme rules. The scheme has a huge deficit and it was estimated by BA that this change would remove c.£770MIL of liabilities. It was therefore hugely material to BA's funding costs.

The trustee was concerned about the impact of this on pensioners. It therefore decided to use its discretionary powers under the rules to amend the scheme to give itself a new unilateral power to award additional pension increases. It then used the new power to award a higher increase than the CPI based one that applied automatically under the rules. This went against the very strong wishes of BA, who were concerned about the impact of that on the scheme's deficit. BA therefore brought a court challenge to the trustee's use of its powers in this way. BA threw "every argument in the book" at the trustee's decision, including arguments that the decision was perverse, had failed to consider relevant factors, and that some trustee directors were biased. However every argument failed.

The factual background to the case and the trustee's deliberations is very involved. But the point of interest for employers with DB schemes is that the court followed traditional trust principles and held that the trustee had a very wide margin of discretion. Its decision was valid despite the deficit and the position of the employer, and despite at least some suggestion in the reported facts of very single minded views by some of the trustee directors.

When we discuss "balance of power" issues with employers, we often hear the belief expressed that "trustees must act reasonably mustn't they?". It is true that they mustn't act perversely, but that is an extremely difficult thing to prove in practice. However there is no objective test of "reasonableness". The legal reality is that trustees have far more latitude than that. What an employer might consider an unreasonable or perverse use of a discretionary power against its interests, may well be perfectly legally sustainable.

BA is appealing the decision and the case is therefore being watched with great interest. However the moral of this story is that employers should have a healthy respect and wariness for the limits of trustee discretion making. They should not assume that their view of what is reasonable will always align with the views of their trustees, and pension scheme strategies need to allow for this.

addleshawgoddard.com

Aberdeen, Doha, Dubai, Edinburgh, Glasgow, Hong Kong, Leeds, London, Manchester, Muscat, Singapore and Tokyo*

* a formal alliance with Hashidate Law Office