

Outer Temple
Chambers

**ANTICIPATING THE *IBM* APPEAL,
IN THE CONTEXT OF DUTIES
OF TRUST AND CONFIDENCE,
WHAT IS MEANT BY
'REASONABLE EXPECTATIONS' ?**

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30 March 2017

IBM – Facts: Early Retirement

- For decades IBM had a policy of allowing early retirement from active service: [27]-[28], [680]-[687] & [1299]
- It had become an “*automatic entitlement*”: [685] & [1299]
- 3% p.a. ERDF was written into the Main Plan Rules: [683]
- Unusual format for benefit statements, setting out pension available from age 50, 51, 52, etc, based on the 3% p.a. ERDF [683]
 - Small print reference to “*at the discretion of the company*” ...
- Policy & practice gave rise to an expectation that early retirement on this basis would be available.

IBM – Facts: Project Ocean (2005)

Project Ocean increased member contributions.

IBM told members:

- IBM would cover the deficit (with a parent company guarantee re: contributions up until Q1 2014, when the deficit was predicted to be removed)
- *“With these proposals, IBM is taking action with the intention of securing the sustainability of our defined benefit pension schemes”*
- *“This series of initiatives demonstrates IBM’s commitment to underpin the sustainability of the defined benefit plans in the UK”*

Project Ocean was designed to address the funding cost of DB

IBM – Facts: Project Soto (2006)

Within a few months, IBM wanted further changes to reduce the 2006 Net Periodic Pension Cost under US GAAP, so as to help meet Earnings per Share targets: [743]-[750] & [771]

From early stage, IBM had concerns that further changes only a year after Ocean would be a ‘breach of trust’: [758], [767], [777] & [838]

Project Soto required members to make an election between:

- DB accrual with 1/3rd non-pensionability of pay rises; OR
- DC accrual with enhanced employer contributions (but ongoing final salary link for past service DB accrual)

IBM told members that Soto “*addresses IBM's long term cost and volatility objectives*” and that the changes were “*long-term*” [847](vi), [866] & [881]-[886]

IBM – Facts: Project Waltz (2009)

In July 2009 IBM announced still further changes:

- a cessation of DB accrual
- complete non-pensionability for pay rises: unless DB members signed NPAs, they would be entirely ineligible for any pay rise
 - subverted expectation of continued accrual in accordance with the Soto changes (on basis that pay rises 2/3rd pensionable)
- withdrawal of the existing Early Retirement policy (after a brutally short Early Retirement ‘Window’)
 - despite the emerging rectification claim, which left C Plan members in material uncertainty as to what their early retirement rights would be: [50]-[54] & [1290]-[1321]

IBM – Facts: the impact of Waltz

- Individual members lost over £1 million in expected pension: [1256]
- In roadshows, the CEO had answered the question “*How will you re-build employee trust?*”:
 - “*if I'm really honest, I think I would say that we probably won't be able to re-build trust with some employees, and, as an IBMer who has been with IBM for 25 years, I don't say that with any sense of pride at all. But I think that's a reality, not only from the changes we are talking about here but other changes that have been made in past years which have also been referenced a lot*”: [1322]
- In cross-examination, the CEO:
 - accepted characterisation of removal of the Early Retirement policy, affecting all past accrual, as “*a retrospective cut in pensions in pay*”;
 - testified that “*for the DB population, the fact we had had a number of changes in a short period of time ... had a very significant and devastating impact on trust*”

IBM – the RBs alleged breaches of both

- the Contractual Duty
 - the term implied into employment contracts that “*employers will not, without reasonable and proper cause, conduct themselves in a manner likely to ... seriously damage the relationship of confidence and trust between employer and employee*” (described in *Imperial* as “*the implied obligation of good faith*”); AND
- the ‘*Imperial* duty of good faith’
 - “*Construed against the background of the contract of employment, ... the pension trust deed and rules themselves are to be taken as being impliedly subject to the limitation that the rights and powers of the company can only be exercised in accordance with the implied obligation of good faith*”, so that any employer power “*shall not be exercised so as to ... seriously damage the relationship of confidence and trust between the company and its employees and former employees.*”

The CONTRACTUAL Duty & expectations

Woods v W. M. Car Services [1981] ICR 666 at 670H-671A:

“the tribunal's function is to look at the employer's conduct as a whole and determine whether it is such that its effect, judged reasonably and sensibly, is such that the employee cannot be expected to put up with it: ... The conduct of the parties has to be looked at as a whole and its cumulative impact assessed”:

Likewise *Malik v BCCI* [1998] AC 20, at 35B-C & 46C.

The assessment is objective; and applies a high threshold (repudiation).

Clear that the Contractual Duty may be breached by employer using its powers in a way inconsistent with employees' reasonable expectations: e.g. by altering a policy to an employee's financial disadvantage after the employee has relied on that policy at the employer's request, as in *French v Barclays Bank* ...

French v Barclays Bank [1998] IRLR 646

- Bank induced Mr French to relocate from Oxfordshire to Essex under a ‘mobility clause’, with a relocation package which – as discretionary policy – included an interest-free bridging loan re: the value of his existing property pending its sale [2] & [14].
- When the housing market fell, Bank required Mr French to accept the present value of the property (with over a 20% loss of value) or to start paying interest on the loan: [2]-[4].
- *“It is important to pause at this stage, prior to there being any application for a loan, to consider what the terms of the contract of employment of Mr French were ... and what Mr French's legitimate expectations from those terms would be”* [18]
- [24]-[26] explained how past practice could affect employee expectations, and whether trust & confidence would be breached, although practice had not become a contractual right by ‘custom’.

“Anything more calculated to destroy the trust and confidence as between Mr French and the Bank is hard to imagine. He had been asked to move. A bridging loan interest-free had been sanctioned to enable him to do so. His expectation would be that the Bank would not wish him to suffer financial loss by virtue of the relocation. Now he is being asked to take £40,000 less than the agreed valuation on which he had based the borrowing for and purchase of his new house, or pay interest on his bridging loan which on his salary at the Bank he could not begin to pay.”

“I accept that in considering whether there was a breach of the terms of the loan, it adds nothing to say that in breaching the terms the bank was involved in a change of policy.

However, in considering whether there was a breach of the implied term not to breach trust and confidence, the quality of the conduct of the bank is clearly relevant. To seek to invoke a change of a policy or a change in the terms on which loans were made to employees requested to relocate which (a) has been applied to other employees over many years and (b) appeared in terms in the manual at the time when the loan was made, is conduct which would be likely to destroy the confidence and trust between the bank and its employees.”

- Assurances given to employees of a guaranteed bonus pool from which discretionary bonuses would be awarded in the usual way: [22]
- The assurances were intended to retain and incentivise employees
- Unilateral power for employer to vary the employment contract: [8]
- That power used to introduce a ‘material adverse change’ clause (“the MAC clause”) entitling Dresdner to reduce provisionally awarded bonuses if Dresdner’s earnings materially deviated from forecast: [30]
- The introduction of the MAC clause was driven by Commerzbank (which had bought Dresdner) simply as a means of enabling Dresdner to go back on the assurances as to the guaranteed bonus pool (not because of Dresdner’s financial performance): [120]-[125]
- CA held (obiter): in the circumstances, the introduction of the MAC clause was a breach of the Contractual Duty

Attrill v Dresdner Kleinwort – law

- [106] *“The bonuses paid were so out of line with the reassurance given ... that even if **the introduction** of the clause had not, objectively viewed, involved a breach of the duty ..., there would be a powerful case for saying that **the implementation** of the clause would have done so.”*
- [108] *“The judge set out the context against which the MAC clause had been introduced: a promise made with the intention of retaining and incentivising staff, **which the staff were intended to rely upon when making decisions as to their future ...**”*
- [135-6] *“[C] rightly placed considerable emphasis on the importance of the original promise. It had been reiterated time after time from its inception ... Even if it was not legally binding, it was a promise to pay the bonus from a guaranteed pool, ‘no matter what’, made in good faith by the Bank and intended to be honoured. It is not difficult to imagine how in those circumstances the introduction of a clause which involves a volte face by the Bank and threatens the guaranteed fund would cause considerable alarm.”*

Hills v Nixsun [2016] EWCA Civ. 115,
[2016] IRLR 715

- Nixsun had a contractual discretion as to allocation of commission
- CA held: applying *Braganza* (not NB the Contractual Duty of trust & confidence), Nixsun had failed to establish that its exercise of discretion was rational, having regard to the assurances given
- [33] the Judge “*was particularly influenced by the fact that he had found that Mr Salgame [in the USA] had assured Mr Denton-Powell that the UK team would be ‘looked after’, and that Mr Denton-Powell had reasonably construed that assurance as meaning that the UK would receive two-thirds. That was a legitimate factor to take into account in considering the reasonableness of Nixsun’s decision. ... Nixsun’s interests were relevant to the decision-making but did not overbear the fact that the UK had been assured it would get the lion’s share of the commission on the APAC deal.*”

The IMPERIAL duty & expectations

Long before *IBM*, the relevance of employees' reasonable or legitimate expectations had likewise been recognised in pensions cases:

- *British Coal Corp v British Coal Staff Superannuation Scheme Trustees* [1994] ICR 537, 552F-553A:
*“The employer, if he has a power of amendment, is entitled to exercise it in any way which will further the purposes of the pension scheme **and ensure that the legitimate expectations of the members and pensioners are met** without, so far as possible, imposing any undue burden on the employer or building up an unnecessary large surplus. ... If the assets of the scheme are so large that **all legitimate expectations of the members and pensioners can be met** without continued contribution by him at the rate originally provided, he can by amendment reduce or suspend contributions for a period. What he cannot do is to set limits to the benefits provided for members or pensioners for a collateral purpose **without regard to their legitimate expectations.**”*

The IMPERIAL duty & expectations (continued)

- *Re: the Prudential Staff Pension Scheme* [2011] EWHC 960, [2011] PLR 239, at [146] (obiter):
“members’ interests and expectations may be of relevance when considering whether an employer has acted irrationally or perversely. There could potentially be cases in which, say, a decision to override expectations which an employer had engendered would be irrational or perverse.”
- *Bradbury v BBC* [2012] EWHC 1369, [2012] PLR 283, at [103] (obiter): *“members’ interests and expectations might be of relevance when considering whether an employer had acted irrationally or perversely”*.

IBM – definition of Reasonable Expectations

- Warren J defined a ‘Reasonable Expectation’ at [386](iv) & [454] as *“an expectation as to what will happen in the future engendered by the employer's own actions (and in relation to matters over which the employer has some control), which gives employees a positive reason to believe that things will take a certain course”*.
- As distinguished from a ‘mere expectation’:
“A ‘mere expectation’ is one which an employee may have in fact as to the future, in the sense that they anticipate, assume or expect that something (e.g. a discretionary increase) will happen in the ordinary course of events if things ‘carry on as they are’. Employees may have a mere expectation independently of any encouragement by the employer.”

Conclusions – what is meant by disappointing Reasonable Expectations ? (1)

- Properly understood, the reliance upon ‘Reasonable Expectations’ in *IBM* are nothing new ...
- Reasonable Expectations are simply a factor which may contribute to an employer’s conduct seriously damaging trust & confidence in all the circumstances of a particular case:
“... breach of expectations is, at root, an aspect of irrationality or perversity. In other words, if expectations have been engendered by an employer, that may have been done in such a way that to disappoint those expectations would, absent some special change in circumstances, involve the employer acting in a way that no reasonable employer would act; in which case, irrationality or perversity, as those concepts are to be understood in this context, is established”: [441]

Conclusions – what is meant by disappointing Reasonable Expectations ? (2)

- Not every disappointment of a Reasonable Expectation will be a breach of trust & confidence:
 - that will depend on all the circumstances, including the value of the subject matter to employees, how & why the expectation was engendered, whether & (if so) how the expectation was relied upon by employees, etc; e.g. [463]
 - *“the disappointment of Reasonable Expectations is only the start of the assessment”*: [1043]

So:

- disappointment of Reasonable Expectations is not a free-standing cause of action;
- Reasonable Expectations do not of themselves make communications ‘binding’; and
- Reasonable Expectations are nothing to do with public law.