Trustees' Discretion: Proper Purposes

Should trustees act to "maximise" benefits or pay the "correct" benefits when exercising their powers of discretion – for instance when setting scheme factors or determining an inflation index to use to increase benefits?

Contents

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1. INTRODUCTION

1.1 Trustees of defined benefit occupational pension schemes can be faced with a tricky situation in relation to how to exercise their powers under the scheme. They can, in any relevant situation, be differing (and competing) interests in play:

(a) the interests of the relevant member – his or her benefit (and potentially those of the spouse/dependants) is affected:

(b) the interests of the other members – their interests are not directly affected but could be affected (in funding terms) as a result of a change in a particular level of benefit to another member; and

(c) the interests of the employer, as ultimate funder of the scheme.

1.2 In addition, there can be other interests in play in occupational pension schemes, for example:

(a) the position of a spouse or dependant as a contingent potential beneficiary;

(b) the interests of the state, in relation to tax and contracted-out benefits; and

(c) the interests of the Pension Protection Fund (***PPF***) as ultimate longstop[1].

1.3 This paper discusses the constraints and influences on the trustee board in reaching particular decisions in this area, in particular the limit that any exercise of a power or discretion must be for a proper purpose (or to put it another way, not for an improper purpose).

1.4 Note that this is looking at the position of the trustee when dealing with benefit changes or setting benefits (eg, indexation or other factors), rather than the position of the trustees when dealing with external parties – for example, the terms of contracts (investment, insurance, etc)

1.5 This paper reaches the conclusion that pension trustees owe no duty, and are not obliged, to maximise member benefits, but instead to pay the envisaged or "correct" benefits. This arises as a combination of the following:

(a) The trustees must act in accordance with the terms of the trust deed and the instrument governing the scheme (and any overriding law).

(b) Where the trustees have a discretion, the trustees are obliged to excise their powers for a proper purpose – this is not the same as saying that they have to

[1] See *Independent Trustee Services v Hope* (discussed below) and the talk by Duncan Buchanan at the White Paper Conference on Pensions (2015).

exercise their powers in the "best interests" of the beneficiaries of the trust; and

(c) Subject to the proper purpose test, trustees need to act fairly (which probably means the same as "impartially" here) between the categories of beneficiaries (this is not to say that benefits must be applied must be applied equally[2]).

[2] Nor where there is a discretionary class do they need to allocate at least a nominal amount to each potential beneficiary – see the Illusory Appointments Act 1830 and the Powers of Appointment Act 1874 (now s158, Law of Property Act 1925), outlined in Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 at 132, footnote 7.

A. THE PROPER PURPOSE TEST

2. PURPOSE TEST

2.1 There is a general rule, applicable to many powers and discretions, whether conferred by contract, in a trust deed or in a company's constitution, that the courts will imply (or impose) a restriction on the power-holder (here, the trustees) limiting[3] the exercise the power to that for a proper purpose – ie, the purpose for which it was envisaged. This clearly applies to powers under pension schemes – see eg *Courage*[4] and *Hillsdown*[5].

2.2 It also applies, regardless of any other obligation, for example, in a company context to act in what the directors consider to be the best interest of the company or (the new statutory formulation) to act with a view to the success of the company.

2.3 The leading modern cases in this area are the company cases dealing with powers of directors. They are *Eclairs Group Ltd v JKX*[6] and *Howard Smith Ltd v Ampol Ltd*[7]. But there are a number of cases in the pensions area as well.

2.4 The proper purpose rule can in some circumstances apply to non-fiduciaries (such as shareholders or employers[8]) as well as to fiduciaries (such as trustees or directors)[9]. This paper, however, focuses on the position of the trustee board[10] (ie trustees or directors of a trustee company).

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3 Charles Mitchell argues that the proper purposes test should be seen as a limitation on the relevant power or discretion, instead of a positive duty: Charles Mitchell, "*Stewardship of property and liability to account*" (2014) 78 Conv 215 at 218. If right, this would be similar to the mitigation principle in damages claims (not a positive duty to mitigate, but damages will be reduced to reflect reasonable mitigation).

4 *Re Courage Group's Pension Schemes* [1987] 1 All ER 528 (Millett J).

5 *Hillsdown v The Pensions Ombudsman* [1997] 1 All ER 862 (Knox J).

6 *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71, [2016] 1 BCLC 1.

7 [1974] AC 821, PC.

8 Eg *Imperial Group Pension Trust v Imperial Tobacco* [1991] 1 WLR 589 (Browne-Wilkinson V-C), 598, *National Grid v Laws* [1997] OPLR 207 (Robert Walker J) at 227.

9 See Matthew Conaglen "*Fiduciary Loyalty: Protecting the Due Performance of Non-fiduciary Duties*" (2010, Hart Publishing) at 44–50.

10 The fact that the proper purposes test can apply to non-fiduciaries as well as fiduciaries is a reason why it may not be classified as a fiduciary power or doctrine in the strict sense (a power or doctrine that only applies to a fiduciary. See Matthew Conaglen "*Fiduciary Loyalty: Protecting the Due Performance of Non-fiduciary Duties*" (2010, Hart Publishing) at 44–50, Charles Mitchell, "*Stewardship of property and liability to account*" (2014) 78 Conv 215 at 218 and Lionel Smith "*Fiduciary relationships: ensuring the loyal exercise of judgement on behalf of another*" (2014) 130 LQR 608. Whether this terminology matters at the end of the day can depend on the remedies being sought. See Sarah Worthington, "*Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae*" [2013] CLJ 720.

3. THERE IS NO LITERAL "BEST INTERESTS" RULE

3.1 As a slight distraction, it is worth reaffirming that, even if it was not clear before, it is now clear, following the decision of Asplin J in *MNRPF*[11], that there is no general overriding or paramount duty on the part of trustees (including pension trustees) to act (or exercise their powers) in the "best interests" of the beneficiaries of the trust (or even the sub-class of beneficiaries, the members of the scheme)[12].

3.2 It is true that Instead, much case law that refers to a form of "best interest" duty[13], in particular *Cowan v Scargill*[14]. But it is clear that (at best) this is merely "shorthand"[15] or a "portmanteau"[16] covering a variety of duties owed by trustees.

3.3 This follows from the seminal articles on this topic by:

(a) Edward Nugee QC in 1998 "*The duties of pension scheme trustees to the employer*[17]; and

(b) the Australian, SEK Hulme QC in 2000: *The basic duties of trustees of superannuation trusts – fair to one, fair to all?*[18].

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11 *Re Merchant Navy Ratings Pension Fund; Merchant Navy Ratings Pension Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch), [2015] All ER (D) 298 (Feb) (Asplin J). Discussed by Stuart Pickford and Andrew Block "*The Merchant Navy Ratings Pension Fund*" (2015) 29 TLI 49.

12 See the Law Commission report "*Fiduciary Duties of Investment Intermediaries*" (2014) at 4.35 and 6.15, David Pollard "*Trustee powers – best interests or proper purposes*", chapter 9 in "*The Law of Pension Trusts"* (OUP, 2013). See also Xenia Frostick *Is there a duty to act in the best interests of beneficiaries?* (2000) 83 Pension Lawyer 2 and Geraint Thomas *The duty of trustees to act in the 'best interest' of their beneficiaries* (2008) 2 Journal of Equity 177. From Australia, see Michael Vrisakis '*The best test of (or the "bestest") interests of members*' (2006) 17(9) Superannuation Law Bulletin 138 and M Scott Donald '*Best interests?*' (2008) 2 J Eq 245.

13 There is also a rather unhelpful statutory "best interests" obligation in reg 4(2)(a) of the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) – see Pollard "*The Law of Pension Trusts*" at 10.106. In Australia, legislation also includes a best interest duty on trustees of superannuation schemes, but this has been interpreted as not changing the position from the common law: *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)* [2013] FCA 1342 (Murphy J).

14 [1985] Ch 270 (Megarry V-C). Discussed by the Law Commission report "*Fiduciary Duties of Investment Intermediaries*" (2014) at 4.35 and by Margaret Stone (extra judicially) in "*The superannuation trustee: Are fiduciary standards appropriate?*" (2001) 1 Journal of Equity 167 at 173. See also Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 at 136.

15 Christopher Nugee QC's previous advice to the trustee quoted in *MNRPF* at [70] and counsel (Brian Green QC) in *MNRPF* at [220].

16 Counsel (Andrew Simmonds QC) in *MNRPF* at [211] and discussed by Asplin J at [229] (see below). They both cite Murphy J in *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)* [2013] FCA 1342, but he does not use this term (although referring to use by others of an "umbrella duty").

17 (1998) 12 TLI 216, based on his 1998 lecture to the Association of Pension Lawyers (APL).

18 (2000) 14 TLI 130.

3.4 This issue was comprehensively dealt with by Asplin J in last year's *MNRPF* case[19] and by Christopher Nugee[20] (speaking extra judicially) in his 2015 APL lecture "*The Duties of Pension Scheme Trustees to the Employer - Revisited*"[21].

3.5 In the *MNRPF* case, Asplin J held that the proposals put forward by the pension trustees involved would be approved by the court. The objections of the representative beneficiary that a better proposal could be formulated was rejected by Asplin J. She held that the trustees were not under a positive overriding duty to act in the best interests of the members – for example, by seeking to maximise the funding within the pension scheme (as additional security). She rejected the submission that the 'best interests' duty is a paramount, stand-alone duty, holding that it is rather part and parcel of the proper purposes principle.

3.6 She agreed with the way it was put by Lord Nicholls, writing extra-judicially, in a 1995 article[22] where he said:

> 'Benefit and best interests are really interchangeable expressions. Both have a wide and elastic but not unlimited meaning. In this context, each requires an examination of the object with which the trust was established. To decide whether a proposed course is for the benefit of the beneficiaries or is in their best interests, it is necessary to decide first what is the purpose of the trust and what benefits were intended to be received by the beneficiaries. Thus, to define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different words a trustee's obligation to promote the purpose for which the trust was created.'

3.7 Asplin J held:

> "*(i) "Best Interests" Principle*
>
> [228] In this regard, I agree with Messrs Tennet, Green and Simmonds [Counsel] that the "best interests of the beneficiaries" should not be viewed as a paramount stand-alone duty. In my judgment, it should not be treated as if it were separate from the proper purposes principle. In fact, it seems to me that the way in which the matter was put by Lord Nicholls extra judicially sums up the status of the best interests principle and the way it fits in to the duties of a trustee. It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests. As a result, I agree with his conclusion that ". . . to define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different

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19 *Re Merchant Navy Ratings Pension Fund; Merchant Navy Ratings Pension Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch), [2015] All ER (D) 298 (Feb) (Asplin J).

20 The son of Edward Nugee QC. Sir Christopher Nugee is a judge in the Chancery Division.

21 (2015) 29 TLI 59.

22 Lord Nicholls "*Trustees and their broader community: where duty, morality and ethics converge*" (1995) 9 TLI 71 and (1996) 70 ALJ 205.

words a trustee's obligation to promote the purpose for which the trust was created".

[229] In my judgment, it is clear from *Cowan v Scargill* that the purpose of the trust defines what the best interests are and that they are opposite sides of the same coin, an approach which is supported by the way in which the matter is dealt with in *Harries v Church Commissioners*, another case concerning investment policy and in *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)* in which Murphy J made comments which were obiter in which he described the principle as a "portmanteau". The learned Judge's comments were made in the context of his consideration of a statutory duty to act in the best interests of the members of a trust. He explored the common law and equity in some depth and concluded that the statute did not extend beyond the general law. If by his conclusion that the "best interest duty" operates "in combination with other duties" he meant that it flows from and is moulded by the trustee's obligation to promote the purpose for which the trust was created, I agree. As Lord Nicholls pointed out, first it is necessary to determine the purpose of the trust itself and the benefits which the beneficiaries are intended to receive before being in a position to decide whether a proposed course is in the best interests of those beneficiaries.

…

[231] I also agree with Messrs Tennet, Simmonds and Green in relation to the relevance of the principles in *Edge v Pensions Ombudsman* and that there is no indicator in that case that the Employer's financial interests are only relevant to the extent that the members are interested in the Employer's financial health. Although that case involved the manner in which an actuarial surplus should be dealt with, it should also be borne in mind that the Employer was not an express object of the power relating to surplus. Nevertheless, it is quite clear from the extracts from the judgment of Chadwick LJ to which I have referred, that it was considered perfectly legitimate to consider the interests of the Employers in that case and that the continued viability of the Employers was something which the trustees were entitled to promote."

3.8 Christopher Nugee in his 2015 APL lecture commented:

"First, although (as pointed out by my father) the primary duty of pension fund trustees, as it is of all trustees, is to obey the trust deed, or in other words to make the payments due under the rules to the beneficiaries entitled to them, pension trusts inevitably confer on the trustees a large number of powers (and statute confers some more). When asking how trustees should exercise their powers, the starting point is to ask for what purpose the powers were conferred, as it is 'trite law' that powers must be exercised for the purposes for which they were conferred, and not for any extraneous or ulterior purpose.[23] That may require quite a careful analysis in the particular case of what the purposes are for which the particular power was conferred."

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23 *Re Courage Group's Pension Schemes* [1987] 1 WLR 495 at 505E per Millett J.

3.9 He went on to look at the cases and in particular Asplin J's judgment in *MNRPF*, finishing:

> "Needless to say this is an approach which I entirely agree with. I suggest that it finally puts to rest (at any rate at the High Court level – I do not believe there is any intention to appeal) the notion that pension scheme trustees have no business concerning themselves with the interests of employers, or have a paramount duty to act in the best interests of the members which would make any such attempt to take the employers' interests into account improper. I hope you will agree that it is also a neat vindication of many of the views articulated by my father 17 years ago."

3.10 This seems to me to be the right approach, for the reasons stated in those cases. Indeed a number of other reasons can be given.

3.11 For example, any purported "best interests" duty runs the risk of extending, in its wider literal manifestations, to be used to:

(a) argue that it overrides any limitations in the trust instrument (this is obviously wrong –for example it would not allow a trustee to invest in land if the investment power prohibited such investment, nor can the trustee used such an implied duty to not perform a non-discretionary obligation under the scheme – eg prevent a beneficiary exercising an option or right under the trust eg to exercise a statutory transfer right[24] or to call a meeting: *Pikos v Territory Homes*[25] or not pay tax[26]);

(b) argue that it overrides any proper purpose limitation – it clearly does not. For example in *Eclairs* at [16] Lord Sumption cites *Hogg v Cramphorn Ltd*[27] where:

> "Buckley J held that the directors' powers to issue shares could not properly be exercised for the purpose of defeating an unwelcome takeover bid, even if the board was genuinely convinced, as the current management of a company commonly is, that the continuance of its own stewardship was in the company's interest. The company's interest was an additional and not an alternative test for the propriety of a board resolution"

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24 See eg *Hughes v Royal London Mutual Insurance Society Ltd* [2016] EWHC 319 (Ch) (Morgan J).

25 *Pikos Holdings (Northern Territory) Pty Ltd v Territory Homes Pty Ltd* [1997] NTSC 30 (Kearney J), noted in (1998) 12 TLI 44, where Kearney J (in the Supreme Court of the Northern Territory of Australia) held the trustee of a unit trust to be in breach of trust when it failed to call a meeting of unit holders following a requisition by the 20% required under the trust deed. It was no defence that the trustee considered that a meeting would not be in the best interests of the unit holders.

26 Eg in an insolvency context, Lord Hoffmann's comments on a liquidator's obligation to pay (as an expense) tax as required by the Insolvency Rules 1986 in *Re Toshoku Finance UK plc, Kahn v IRC* [2002] UKHL 6, [2002] 3 All ER 961 at [17] and [30].

27 [1967] 1 Ch 254 (Buckley J).

See also *Howard Smith Ltd v Ampol Ltd*[28] (directors argued that issue of shares was in the company's best interests, but issue was still invalidated on the proper purpose ground). Thus Henderson J in *ITS v Hope*[29] at [79]:

> "Nor is it a good answer to an allegation of improper purpose that the donee is acting in what he or she believes to be the best interests of those affected by the exercise of the power, or even that the proposed exercise would demonstrably be for their benefit. As Lord Wilberforce said in *Howard Smith Ltd v Ampol Ltd*, at 834G:
>
> > "pleas to this effect have invariably been rejected … - just as trustees who buy trust property are not permitted to assert that they paid a good price.""

(c) impose an objective standard of meeting the final of having an outcome which is objectively turns out (in retrospect) to be in the best interests of the beneficiaries. See further the Law Commission Paper (2014) on "*Fiduciary Duties of Investment Intermediaries*"[30].

(i) For example, a duty to act in the best interests of beneficiaries of the trust would mean that trustees, when (say) choosing investments could later be measured (at least as a literally test) as to how the investments have turned out.

(ii) If the trustees were deciding to invest in equities and it later transpired that share A performed better than share B, does that mean the trustees would be in breach of duty – they have not in fact, as it later turned out, acted in the best interests of the beneficiaries in that they have not achieved the maximum financial return.

(iii) This is clearly much too strict as standard – it would transform trustees in effect into guarantors. Having said which, it would, as a matter of logic, be the necessary outcome of an overriding literal "best interest" duty. It is a telling reason why there is no such overriding duty.

(iv) Murphy J in *ASIC v Australian Property Holdings*[31] commented:

> "463. It is difficult to discern the outer boundaries of the best interests duty from the text of the provisions alone. For example, the expression may be argued to indicate a requirement that the RE [Relevant Entity] meet the "highest" standard rather than just a high standard. It may also

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28 [1974] AC 821, PC.

29 *Independent Trustee Services Ltd v Hope* [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J). Noted by David Fox [2010] CLJ 240.

30 Law Com No 350, June 2014 at 6.14: "The standard of care must be judged at the time the decision was made, not with hindsight". See also Margaret Stone in "*The superannuation trustee: Are fiduciary standards appropriate?*" (2001) 1 J Eq 167 at 181: "input not outcomes".

31 *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)* [2013] FCA 1342 (Murphy J).

> be argued to set a requirement for the RE to obtain an objectively determined "best" outcome rather than requiring the best efforts of the RE. I am disinclined to such a view because such meanings may cause real difficulties for a trustee in performing his or her role. It is not clear to me how in many common circumstances the "highest" standard is to be determined let alone met, or how any requirement to achieve an objectively determined "best" outcome sits with the general law obligation on a trustee to act with care, competence and caution. The language of the statute alone does not make clear where the boundary lies and it is appropriate to consider the meaning of the term under general law.
>
> …..
>
> 488. I do not though wish to be seen as accepting the proposition that to act in the members' best interests a trustee must actually achieve the best outcome. A trustee is not required to be prescient: *Re Chapman* [1896] 2 Ch 763 at 778; *De Bruyne v Equitable Life Assurance Society of the US* [1990] USCA7 1116; 920 F.2d 457 (7th Cir. 1990) at 465; *Nestle v National Westminster Bank Plc* [1994] 1 WLR 1260 at 1282."

3.12 Lionel Smith has pointed out that a literal best interest duty would be impossible to comply with – there could always be more that the trustees could do. He commented in a 2014 article[32] (footnotes included):

> "It is common to formulate the requirement of loyalty as a duty to act in the best interests of the beneficiary[33]. But this immediately raises serious difficulties. An open-ended duty to act in furtherance of the interests of another could not be a legal duty; it would be impossible to say that it had been fulfilled, because a person could always do more to further the interests of that other person. Faced with this difficulty, one commentator has suggested that while the fiduciary duty to act in another's best interests is "foundational", it is at the same time an "imprecise notion" which embraces, but is not exhausted by, other duties[34]. Another has concluded that there is no duty of loyalty as such; loyalty "is best understood as the summation of the various doctrines that are applied peculiarly to fiduciaries, rather than as a legal duty that is directly enforceable in its own right[35]."

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32 Lionel Smith "*Fiduciary relationships: ensuring the loyal exercise of judgement on behalf of another*" (2014) 130 LQR 608.

33 R. Sitkoff, "*The Economic Structure of Fiduciary Law*" (2011) 91 B.U.L. Rev. 1039 at 1043; *BCE Inc v 1976 Debentureholders* 2008 SCC 69; [2008] 3 S.C.R. 560 at [37]. Note however that in another case, the Supreme Court of Canada held that a duty to act in the best interests of the beneficiary "… does not provide a workable basis for assigning legal liability…" and instead formulated loyalty as requiring that the fiduciary not put his own or others' interests ahead of those of the beneficiary: *KLB v British Columbia* [2003] 2 S.C.R. 403; 230 D.L.R. (4th) 513 at [46] and [49].

34 G. Thomas, "*The Duty of Trustees to Act in the 'Best Interests' of Their Beneficiaries*" (2008) 2 J of Equity 177 at 202–203.

35 M. Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Oxford: Hart Publishing, 2010), at p.269

3.13 Instead it is clear that a purpose test can apply. This has its own difficulties and problems.

4. PURPOSE TEST: TRUST LAW

4.1 Tellingly, the latest (2010) edition of *Underhill and Hayton The Law on Trusts and Trustees*[36] does not include a 'best interests of beneficiaries' test. Instead it states the purpose test. It states[37] the general principle applicable to powers of trustees:

> '…a trustee
>
> (a) must consider from time to time the exercise of his distributive and managerial discretions;
>
> …
>
> (d) must exercise his discretions only within the scope of the terms of the relevant power and, then, only for the purposes for which the discretions were conferred on him by the settlor and not perverse to any sensible expectation of the settlor ...'[38]

4.2 In a pensions context, the reference to 'settlor' should be considered as being to the person who set up the trust and decided what powers should be given to the trustees i.e. the employer. There are cases where the members have been considered to be the settlor[39], but the better view is to regard both the employer and the members as settlors for different purposes[40].

4.3 There are lots of cases on the proper purpose test. They are discussed in the Edward Nugee and SEK Hulme articles[41]. As early as 1758, the principle was

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36 18th Ed, 2010 by Hayton, Matthews and Mitchell (LexisNexis). The new 19th edition is scheduled to be published later this month.

Also on proper purpose, see Matthew Conaglen "*Fiduciary Loyalty*" (Hart Publishing, 2010) at page 44; Richard Nolan "*Controlling Fiduciary Power*" [2009] CLJ 293, 298; Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131, D M Maclean "*Trusts and Powers*" (1989, Sweet & Maxwell) at chapter 3, *Thomas on Powers* (2nd ed, OUP, 2012), Michael Ashdown "*Trustee Decision Making: the rule in Hastings Bass*" (OUP, 2015) at Chapter 9 "Fraud on a power"; and Pollard "*The Law of Pension Trusts*" (OUP, 2013) at Chapter 9.

37 Article 57, page 897.

38 Citing (see page 692), *McPhail v Doulton* [1971] AC 424 at 449 (HL), *Re Hay's Settlement Trust* [1981] 3 All ER 786 at 792; *Hayim v Citibank* [1987] AC 730 at 746 (PC); *Re Beatty's Will Trust* [1990] 3 All ER 844 at 846 and *Edge v Pensions Ombudsman* [1998] Ch 512 at 535 (Scott V-C) and on appeal [2000] Ch 602 at 627 (Chadwick LJ). See also the discussion earlier in Underhill and Hayton (at page 29) on the same lines on the position of a fiduciary power.

39 *Brooks v Brooks* [1996] AC 375, HL; *Air Jamaica v Charlton* [1999] 1 WLR 1399, PC.

40 This is also the view of Daniel Fischel and John H Longbein in *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule* (1983) 55 University of Chicago Law Review 1105 at page 1118.

41 See also Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131, Richard Nolan "*Controlling Fiduciary Powers*" [2009] 68 CLJ 293, *Thomas on Powers* (2nd ed, OUP, 2012),

established in *Aleyn v Belchier*[42] that trust powers must be exercised for the purposes for which they were given:

> 'No point is better established than that a person having a power must exercise it bona fide for the end designed, otherwise it is corrupt and void.'

4.4 In *Duke of Portland v Topham*[43] Lord Westbury LC stated the rule:

> "that the donee, the appointor under the power, shall, at the time of the exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view to the real purpose and object of the power, and not for the purpose of accomplishing or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power."

4.5 The proper purpose rule has been called the doctrine of a "fraud on the power". But this is potentially confusing – it is clear that the principle has nothing to do with fraud. Lord Parker of Waddington stated in *Vatcher v Paull*[44], it

> "does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power."

4.6 This principle that powers must be exercised for a proper purpose has been supported by a number of more modern decisions since then[45].

4.7 Lord Browne-Wilkinson summarised the position in *Westdeutsche Landesbank Girozentrale v Islington LBC*[46]:

> '(i) Equity operates on the conscience of the owner of the legal interest. In the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him (express or implied trust) or which the law imposes on him by reason of his unconscionable conduct (constructive trust).' (my emphasis)

4.8 Lord Steyn famously stated that "In law, context is everything."[47] In a pensions context, Millett J in *Re Courage Pension Schemes*[48] held

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Michael Ashdown "*Trustee Decision Making: the rule in Hastings Bass*" (OUP, 2015) at Chapter 9 "Fraud on a power".

42 (1758) 1 Eden 132, 28 ER 634.

43 (1864) 11 HLC 32, 54. Cited by Lord Sumption in *Eclairs* at [15].

44 [1915] AC 372, PC at 378. Cited by Lord Sumption in *Eclairs* at [15].

45 See, for example, *Fouche v The Superannuation Fund Board* (1952) 88 CLR 609 and *Thrells v Lomas* [1993] 1 WLR 456 (Nicholls V-C), in addition to the cases discussed below.

46 [1996] AC 669, [1996] 2 All ER 961, HL at 988.

> 'It is trite law that a power can be exercised only for the purpose for which it is conferred, and not for any extraneous or ulterior purpose. The rule-amending power is given for the purpose of promoting the purposes of the scheme, not altering them.'

4.9 And Knox J in *Hillsdown Holdings v Pensions Ombudsman*[49]:

> '…powers may not be exercised for a purpose or with an intention beyond the scope of or not justified by the instrument creating the power.'

4.10 This proper purpose test is mirrored for company directors – see e.g. *Howard Smith Ltd v Ampol Ltd*[50] and very recently the Supreme Court in *Eclairs Group Ltd v JKX Oil & Gas plc*[51].

4.11 Sections 171 and 172 of the Companies Act 2006 came into force on 1 October 2007 (enacting a DTI white paper on reform of company law[52]) and now impose express statutory duties on directors including:

171 Duty to act within powers

A director of a company must—

(a) act in accordance with the company's constitution, and

(b) only exercise powers for the purposes for which they are conferred.

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other

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47 Lord Steyn in *R v Secretary of State for the Home Dept, ex p Daly* [2001] UKHL 26, [2001] 2 AC 532 at [28].

48 [1987] 1 All ER 528 (Millett J) at 536.

49 [1997] 1 All ER 862 (Knox J) at 879 and 880.

50 [1974] AC 821, PC.

51 [2015] UKSC 71, [2016] 1 BCLC 1.

52 CM6456 (March 2005).

than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

In *Eclairs*[53], Lord Sumption referred to the statutory test in s171(b) as a rule which:

> "thus stated substantially corresponds to the equitable rule which had been applied to the exercise of discretionary powers by trustees".

4.12 The analogy here is to equate the position of the scheme (not the beneficiaries) with that of the company. So to adapt section 172(1) and (3) for pension trustees?:

> 'A trustee of a pension scheme must act in the way he considers, in good faith, would be most likely to achieve the purposes of the scheme.'

5. OVERALL PURPOSE OF A PENSION SCHEME – A SUGGESTION

5.1 SEK Hulme put forward[54] the nature of a pension trust as follows:

> 'A superannuation deed is and it reflects a balancing operation; a reconciliation, agreed to by all parties, of economic interests which in their starkest expression lead the members to seek the maximum amount of benefits at the minimum cost to themselves and lead the employer to seek to confer the minimum amount of benefits at the minimum cost to itself; in a more civilised statement, a reconciliation, seen by all parties as fair to themselves, of the demands of members and the willingness of the employer; a scheme for the provision of benefits to the members at a cost to the employer and perhaps also to members, the expression of both being accepted as fair to all concerned.'

5.2 I have proposed[55] a simpler purpose test as:

> **The purpose of a defined benefit occupational pension scheme is to provide the stated and accrued relevant benefits to (and in respect of) the members at a cost acceptable to the employer.**

5.3 Some comments on this formulation:

(a) *'defined benefit'*: because different principles apply to money purchase or defined contribution (DC) benefits. In a DC plan, there is less obviously a cost to the employer beyond the agreed contribution rate (although there could

53 *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71, [2016] 1 BCLC 1 at [14].

54 See (2000) 14 TLI 130 at 136.

55 Pollard "*The Law of Pension Trusts*" (OUP, 2013) at 9.40. Previously (2006) 20 TLI 21. See also Jonathan Hilliard "*The Flexibility of Fiduciary Doctrine in Trust Law: How Far does it Stretch in Practice?*" (2009) 23 TLI 119.

be if there were, for example fraud by the trustees[56] or the employer had given an indemnity to the trustees).

(b) *'stated' benefits*: because the scheme is to provide the benefits stated[57]. Any augmentations or benefit increases may well impose extra costs on the employers. In practice most schemes require the consent of the employer for such discretionary benefits (save perhaps on a scheme winding-up), so the employer can look after its own interests when deciding whether or not to give consent. But some schemes do not include this (or give an unfettered power to the trustees – e.g. to fix the reduction applicable on early retirement). This cost principle should apply here.

(c) '*accrued benefits*': because many parties would envisage a primary duty on trustees to look after the accrued benefits of member – not any future service benefits. But this is a more contentious point.

(d) *'to and in respect of the members'*: to clarify that the benefit derives from the member's employment. As between the member and any spouse or dependant who may also benefit, the member is the primary beneficiary[58].

(e) *'cost acceptable to the employer*': this allows room for the employer to agree an action that may incur extra cost – e.g. a benefit increase or a change in investments from 'risky' equities to 'less risky' bonds[59].

5.4 Some might want to add at the end of the test:

'balancing the interests of the employers and the members'.

5.5 Without having tested it in a survey, many (most?) of those involved with occupational pensions would recognise and agree with that test as setting out their views on the purpose for which a pension scheme was established and has been operated.

5.6 It might be said that this is all quite interesting, but in relation to an existing scheme such a purpose cannot now be expressly included in the scheme documents. Clearly an express purpose statement on the lines above could be added into a new scheme, but these are not very common.

5.7 That is true, but the caselaw does make it clear that the purpose of a scheme can be changed over time – see the comments of Millett J (as he then was) in

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56 See regulations 10 to 13 of the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678) containing an obligation on employers to contribute to money purchase schemes if a deficiency arises through fraud etc.

57 See eg the comments of Chadwick LJ in *Edge v Pensions Ombudsman* **[**2000] Ch 603, CA at 623.

58 See Chapter 8 (Position of spouses and dependants) in Pollard "*The Law of Pension Trusts*".

59 Margaret Stone J (extra judicially) commented that the intentions underlying the creation of the trust fund "may also include (from an employer's perspective) minimising the cost of the scheme" in "*The superannuation trustee: Are fiduciary standards appropriate?*" (2001) 1 J Eq 167 at 173. See also Jonathan Hilliard "*The Flexibility of Fiduciary Doctrine in Trust Law: How Far does it Stretch in Practice?*" (2009) 23 TLI 119 at 123.

Courage[60], citing *Thellusson v Viscount Valentia*[61], a case involving the Hurlingham Club where a club had changed its objects over time. Millett J's decision was followed by the Privy Council in *Bank of New Zealand v Bank of New Zealand Officers Provident Fund*[62], discussed below.

5.8 The purpose outlined above is, it is suggested in fact already the current purpose of most occupational defined benefit pension schemes. So this purpose is already in place without any need to be expressly stated (and there must be scope for including such a statement in new trust deeds for existing schemes).

6. *EDGE V PENSIONS OMBUDSMAN*

6.1 Chadwick LJ in *Edge v Pensions Ombudsman*[63] (in a paragraph divided up for ease of reading) confirmed this:

> 'In examining the contention that, in exercising their power to amend the rules, the trustees were subject to a duty to act impartially as between individual or classes of beneficiaries--in the sense relied upon by the ombudsman--it is important to have in mind the circumstances in which the need for amendments arose and the nature of those amendments. A convenient starting point is rule 3:
>
> > 'The main purpose of the scheme is the provision of retirement and other benefits for employees of training boards and successor bodies who are members of the scheme. The trust fund is to be constituted and maintained by means of periodical and other contributions to be made by the members and by the employers in accordance with the rules.'
>
> At the risk of stating the obvious, that 'main purpose' rule embodies three concepts which are fundamental to a pension scheme of this nature.
>
> - First, the purpose of the scheme is to provide the retirement and other benefits to which the members, pensioners and dependants are entitled under the rules. The scheme is a 'defined benefits' scheme: the benefits are fixed by the rules. The scheme is not set up as a unit trust, under which the members would be entitled to a proportionate share in the fund.
>
> - Second, the fund out of which the benefits are to be provided is constituted and maintained by means of periodic payments. The amount of those payments will depend not only on the rate of contributions but also on the number of members in service from time to time who are contributors and on the number of employers who continue to participate. In that sense the fund is dynamic. Although it will be possible, at any given time, to measure the value of the assets then held in the fund, and to measure the liabilities which then have to be met out of those assets (on the basis of

60 [1987] 1 All ER 528 (Millett J) at 537.

61 [1907] 2 Ch 1, CA.

62 [2003] UKPC 58, [2003] OPLR 281.

63 [2000] Ch 603, CA at 623.

termination), that is not a particularly useful exercise unless termination is seen to be imminent. What is required is an actuarial valuation of the assets, present and future, taking into account the contributions which are to be made by employers and members over the remaining life of the fund; and an actuarial valuation of the liabilities which will have to be met as employees in service retire and become pensioners (or die and leave dependants).

- Third, the task of the trustees is to maintain a balance between assets and liabilities valued on that actuarial basis; so that, so far as the future can be foreseen, they will be in a position to provide pensions and other benefits in accordance with the rules throughout the life of the scheme. That task is to be performed by setting appropriate levels for employers' and members' contributions. If that task could be performed with perfect foresight there would be no surpluses and no deficits. But, because the task has to be performed in the real world, surpluses and deficits are bound to arise from time to time and prudent trustees will aim to ensure that the likelihood of surplus outweighs the risk of deficit. Nevertheless, it is no part of the trustees' function, in a fund of this nature, to set levels for contributions which will generate surpluses beyond those properly required as a reserve against contingencies.'

6.2 Asplin J applied *Edge* in her decision in *MNRPF*[64], commenting that its impact is not limited to a surplus situation – see para [231], quoted at 3.7 above.

7. MAIN PURPOSE VS SOLE PURPOSE?

7.1 The purpose test proposed above is not inconsistent with any 'sole purpose' or 'main purpose' requirement to provide retirement benefits that might have been required before April 2006 by the Inland Revenue[65] or by the terms of a scheme. It is also consistent with:

- section 252 of the Pensions Act 2004, requiring that an occupational pension scheme must be established under an irrevocable trust; and

- the requirements in section 255 of the Pensions Act 2004 for the activities of an occupational pension scheme to be limited to "retirement-benefit activities".

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64 *Re Merchant Navy Ratings Pension Fund; Merchant Navy Ratings Pension Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch) (Asplin J).

65 See Richard Nobles "*Pensions, Employment and the Law*" (1993, OUP) at 77, s32(3)(b), Finance Act 1921, s590(2)(a), ICTA 1988 and para 1.4 of the last version of the Revenue practice notes, IR12 (2001) dealing with discretionary approval under the Income and Corporation Taxes Act 1988 before their replacement (from 6 April 2006) by the registration concept under the Finance Act 2004:

'In exercising its discretion to approve schemes, the Board require them to be bona fide established for the sole purpose of providing relevant benefits, and continued approval will be dependent on that sole purpose being maintained.'

7.2 Saying that the benefits must be those stated and must be at a cost acceptable to the employer still leaves the benefits as being solely retirement benefits. See for example the decision of the House of Lords in *Fraser v Canterbury Diocesan Board of Finance*[66] that a school remained for the purpose of educating children of the poor of a particular parish even though it may have included (in later years) some children from a neighbouring parish and some children of more wealthy parents.

7.3 Payments back to an employer are not outside the main purpose of a scheme. In the *National Grid* case, *International Power v Healy*[67], Lord Hoffmann held:

> 'On the other hand, some of the matters put forward as relevant by Mr Inglis-Jones QC on behalf of the National Grid members seemed to me of marginal significance. For example, he said that the main purpose of the scheme was to provide pensions for the employees. That I would certainly accept. But then he said that it would be inconsistent with such a purpose to make payments or the equivalent of payments to the employer. In relation to a surplus, this does not seem to me to follow. A surplus is (by definition) money in excess of what is needed to effect the main purpose of the scheme."

7.4 Similarly Timothy Lloyd J at first instance in *Stevens v Bell: Re Airways Pension Scheme*[68].

8. EXAMPLES OF THE APPLICATION OF THE PROPER PURPOSE TEST

8.1 But finding that there is a proper purpose test only gets the trustee board so far. It leads on to the question about how the trustee board (or indeed a court) works out what is the purpose of the scheme and also a particular power.

8.2 For example:

(a) In *Courage*[69], Millett J held that it was contrary to the purpose of the power to allow a substitution of principal employer where the change was purported to be made with a view to the retention of surplus by the holding company of the current principal employer (instead of the scheme (with its surplus) remaining with the old principal employer (which was being sold) and remaining attached to the employees[70]);

(b) It is not an improper purpose to make surplus refunds to an employer in some cases[71]:

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66 [2005] UKHL 65; [2006] 1 AC 377, HL.

67 [2001] 2 All ER 417, [2001] UKHL 20 at para 16.

68 [2001] All ER (D) 193, [2001] PLR 99. Upheld by the Court of Appeal [2002] EWCA Civ 672; [2002] PLR 247.

69 *Re Courage Group's Pension Schemes* [1987] 1 All ER 528, [1987] 1 WLR 495 (Millett J).

70 But see the later gloss by Blackburne J in *Merchant Navy Ratings Pension Fund Trustees Ltd v Chambers* [2002] ICR 359; [2001] OPLR 321.

71 See generally on surpluses, Pollard "*The Law of Pension Trusts*" at Chapter 20.

(i) for schemes to be amended to provide for surplus refunds to the employer, including out of an on-going scheme – *Lock v Westpac*[72] and *National Grid*[73]; or

(ii) for trustees to exercise a discretion on a scheme winding-up to refund some to the employer (instead of increasing member benefits) – *Re Thrells*[74]; and *Alexander Forbes v Halliwell*[75].

(c) In *Hillsdown*[76], Knox J held that it was contrary to the purpose of the transfer-out power to make a transfer to a new scheme with the purpose of allowing a surplus refund to the employer that was prohibited by the old scheme.

8.3 In *Re Manisty's Settlement*[77] (not a pensions case), Templeman J commented (emphasis added):

> 'In practice, the considerations which weigh with the trustees will be no different from the considerations which will weigh with the trustees of a wide special power. In both cases reasonable trustees will endeavour, no doubt, to give effect to the intention of the settlor in making the settlement and will derive that intention not from the terms of the power necessarily or exclusively, but from all the terms of the settlement, the surrounding circumstances and their individual knowledge acquired or inherited. In both cases the trustees have an absolute discretion and cannot be obliged to take any form of action, save to consider the exercise of the power and a request from a person who is within the ambit of the power.'

9. HOW IS THE PROPER PURPOSE TEST APPLIED?

9.1 Clearly, in order to apply the purpose test, the court must go through two stages:

(a) Work out the proper purpose applicable to the relevant power[78]; and

(b) Decide what purpose the decision maker (here the trustee board) has considered when exercising the power.

9.2 When deciding on the proper purpose, it seems clear from the cases that:

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72 *Lock v Westpac Banking Corpn* (1991) 25 NSWLR 593, [1991] PLR 167 (Waddell CJ).

73 *International Power v Healy* [2001] 2 All ER 417, [2001] UKHL 20. See also in Australia *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* [2006] VSC 112 (Byrne J).

74 *Thrells Ltd (1974) Pension Scheme v Lomas* [1992] OPLR 22 (Nicholls V-C)

75 *Alexander Forbes Trustee Services Ltd v Halliwell* [2003] EWHC 1685 (Ch), [2003] OPLR 355 (Hart J).

76 *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862 (Knox J).

77 [1974] Ch 17 (Templeman J) at 26.

78 Eg Richard Nolan "*Controlling Fiduciary Power*" [2009] CLJ 293, 300-304.

(a) It is necessary to look at the particular power or discretion being exercised. Not just at the overall purposes of the trust; and

(b) It is not just relevant to the proper purposes test whether a non-object (ie non-beneficiary) of the trust or power benefits (although many of the private trust cases are concerned with power exercises being set aside as being really for the benefit of a non-object[79]).

9.3 The first stage "what is in fact the purpose" involves looking at the particular power and working out its purpose. This can be expressly stated in the instrument (eg a discretion or power to reduce an early retirement pension may refer to it being on an actuarial basis or "to reflect the earlier payment"). If the power is silent that the court will look at the context. In *Eclairs*[80], Lord Sumption listed various factors where the power is silent:

(a) an inference from the mischief of the provision which is itself deduced from its express terms,

(b) an analysis of their effect; and

(c) the court's understanding of the business context.

9.4 According to Lord Sumption in *Eclairs*[81] at [30]:

> "The rule is not a term of the contract and does not necessarily depend on any limitation on the scope of the power as a matter of construction. The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument."

In context, Lord Sumption was probably drawing a distinction between the proper purposes test and the test (which is a matter of construction) of the limit of the relevant power. An exercise of a power can be set aside for an improper purpose although it is within the scope of the power as a matter of construction[82].

However, in my view that is not to say that the extent and scope of the power (ie its context) may be a factor in working out its proper purpose. Lord Sumption just said that the rule does not necessarily depend on the construction of the contract.

9.5 Lord Sumption held later, at [31]:

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79 See eg Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 and Peter Devonshire "*Fraud on a power: a doctrine in retreat*" [2010] NZLR 503, discussing the New Zealand private trust cases: *Kain v Hutton* [2008] NZSC 61 and *Wong v Burt* [2005] 1 NZLR 91, CA.

80 At [30].

81 *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71, [2016] 1 BCLC 1.

82 On the difference between construction and purpose, see Richard Nolan "*Controlling Fiduciary Power*" [2009] CLJ 293 at 300.

> "[31] The purpose of a power conferred by a company's articles is rarely expressed in the instrument itself. It was not expressed in the instrument in any of the leading cases about the application of the proper purpose rule to the powers of directors which I have summarised. But it is usually obvious from its context and effect why a power has been conferred….."

9.6 Similarly Henderson J in *ITS v Hope* looked at the context of the transfer out power to try to determine its purpose (see 13 below).

9.7 It has to be said that the judges are often not very clear on the process by which a proper purpose is identified. This runs the risk of seeming to be rather impressionistic on their part and so difficult to predict[83].

Time to fix purpose

9.8 Henderson J in *ITS v Hope*[84] at [78] also commented on the timing of fixing the purpose:

> "….the proper purposes of any power must be ascertained as at the date when the power was conferred. In support of this submission [counsel] relies on *Stevens v Bell* [2002] EWCA Civ 672, [2002] PLR 247, where Arden LJ said at paragraph 30, in the context of a discussion of the interpretation of pension schemes, that:
>
> > "… as with any other instrument, a provision of a trust deed must be interpreted in the light of the factual situation at the time it was created."

And later at [103]:

> 103. I would add that it makes no difference to my conclusion whether one looks at rule 12.3(b) in its original form, or as it was amended in January 2005. It is, of course, the amended power that the Trustee now wishes to exercise. However, the effect of the amendment was merely to remove the references in rule 12.3(b) to the Principal Employer, which had by then entered into administrative receivership. There is no indication of any intention to extend the scope or basic purpose of the power. In any event, even if it is right to regard the power as freshly conferred in 2005, after the enactment (but before the entry into force) of the relevant parts of the Pensions Act 2004, the result is still the same. The existence of the PPF is one of the changed circumstances in the light of which the power has to be exercised, but as I have tried to explain it is not a relevant circumstance. The power remains one which exists for the sole purpose of enabling the Trustee to apply a fair

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83 Richard Nolan suggests that the courts can supply "default implications", including "reasonable expectations" - Richard Nolan "*Controlling Fiduciary Power*" [2009] CLJ 293 at 302, but suggests that the process may be harder for powers in a company situation - [2009] CLJ 293 at 303. Although not mentioned by Richard Nolan specifically on this point, pension trusts seem to me to fit more in the company category than the private donative trust category.

84 *Independent Trustee Services Ltd v Hope* [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J).

share of the Scheme assets in the purchase of insurance policies providing substitute benefits, no more and no less.

Objective test

9.9 It seems likely that an objective test would be used to work out the relevant proper purpose. This is similar to the use by the courts of objective tests for construing contracts and trusts.

9.10 Thus in *Dalriada Trustees Ltd v Faulds*[85], Bean J was dealing with an issue about whether various loans were properly made out of a pension scheme (see 14.6 below) He held that the loans were not in fact "investments" and went on to hold that they would not be made for a proper purpose either. He held:

> "[68] Thomas [on Powers] goes on to emphasise (para 9–04, p 454) that the scope and purpose of a power must be determined objectively:
>
> > ' … The true intention of the donor of the power as to its scope and purpose must, of course, be ascertained from the instrument creating the power, even where the donor and the donee are the same person … '
>
> [69] The instrument in question in this case is each scheme's trust deed and rules. As drafted, and before any amendment, these are standard form documents permitting 'investments' but saying nothing about the PRP or MPVA loans. The issue between the parties on this aspect of the case is whether other evidence such as Ark's promotional literature can be admitted to demonstrate that the true intention of the donor of the power of investment was to facilitate the PRP and MPVA arrangement.
>
> [70] Both sides cited and relied on the two leading modern decisions of the House of Lords on what may be taken into account in construing a contract or a trust deed. Lord Hoffmann gave the leading speech in each of them and referred back to the first in the second, *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] AC 1101, where he said (at [14]):
>
> > 'There is no dispute that the principles on which a contract (or any other instrument or utterance) should be interpreted are those summarised by the House of Lords in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at 114–115, [1998] 1 WLR 896 at 912–913. They are well known and need not be repeated. It is agreed that the question is what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean.'
>
> [71] The House went on, however, to affirm the long-established exclusionary rule (set out, for example, in *Prenn v Simmonds* [1971] 3 All ER 237, [1971] 1 WLR 1381) prohibiting the use as an aid to construction of 'evidence of what

85 [2011] EWHC 3391 (Ch), [2012] 2 All ER 734 (Bean J).

> was said or done during the course of negotiating the agreement for the purpose of drawing inferences about what the contract meant' (para [42] of the *Chartbrook case*); or, in the wording used in the *Investors Compensation Scheme case* [1998] 1 All ER 98 at 114, [1998] 1 WLR 896 at 913, 'the previous negotiations of the parties and their declarations of subjective intent'.
>
> [72] I consider that the claimant succeeds on this issue essentially for the same reasons as it does on the second issue. The powers of the trustees are to make 'investments' as set out in cl 8.1 of each trust deed. The deed and rules must be objectively construed without reference to external documents showing the subjective intentions of the creators of the PRP. The MPVA loans were beyond the scope of their powers, and made for an ulterior purpose. The fact that everyone involved with the transactions wished to validate MPVA loans does not prevent the loans from being a fraud on the trustees' powers."

9.11 This objective test means that the subjective intentions of the parties at the time that the power was introduced are not relevant. Instead it is what is objectively available.

9.12 But it seems that some statements – eg a letter of wishes from a settlor in a private family trust – can be taken into account (eg *Breakspear v Ackland*[86]).

10. HOW IS THE TRUSTEE'S PURPOSE WORKED OUT?

10.1 The second stage is to work out the decision maker's purpose in exercising the relevant power or discretion. If this is outside the proper purpose (as determined by the court) then the exercise of the power is challengeable.

Subjective test

10.2 The test for the trustee's purpose is subjective. It is necessary for the court to decide what the trustee's actual purpose was in making the relevant decision. Only if this is an improper purpose (compared to the proper purpose of the power) is there a breach.

10.3 This is confirmed by Lord Sumption in *Eclairs* at [15]:

> "The important point for present purposes is that the proper purpose rule is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication. It is concerned with abuse of power, by doing acts which are within its scope but done for an improper reason. It follows that the test is necessarily subjective. 'Where the question is one of abuse of powers,' said Viscount Finlay in *Hindle v John Cotton Ltd* 1919 56 SLR 625 at 630, 'the state of mind of those who acted, and the motive on which they acted, are all important'."

10.4 So the question is a question of fact[87] – what was the actual purpose (or main purpose) of the trustee board. Subsequent conduct can be relied on as evidence of the intention of the parties at the relevant time[88].

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86 [2008] EWHC 220 (Ch), [2009] Ch 32 (Briggs J). Noted in [2008] CLJ 252.

10.5 In practice the court may well seek to draw inferences form the effect of the exercise of the relevant power[89].

Causation/More than one decision maker

10.6 Lord Sumption went on in *Eclairs* to consider, at [17] to [24] the situation where the decision maker or group of decision makers had more than one motive or purpose for the relevant decision[90].

10.7 Lord Sumption ended up at [21] and [22] by considering a "but for" test was appropriate, following the Australian case *Whitehouse v Carlton House Pty*[91]:

> "The question is which considerations led the directors to act as they did. In *Hindle v John Cotton Ltd* 1919 56 SLR 625 at 631 Lord Shaw referred to the 'moving cause' of the decision, a phrase taken up by Latham CJ in *Mills v Mills* (1938) 60 CLR 150 at 165. But this cryptic formula does not help much in a case where the board was concurrently moved by multiple causes, some proper and some improper. One has to focus on the improper purpose and ask whether the decision would have been made if the directors had not been moved by it. If the answer is that without the improper purpose(s) the decision impugned would never have been made, then it would be irrational to allow it to stand simply because the directors had other, proper considerations in mind as well, to which perhaps they attached greater importance. This was the point made by Dixon J in the passage immediately following the one which I have cited from his judgment in *Mills v Mills*:
>
> > 'But if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable.'
>
> Correspondingly, if there were proper reasons for exercising the power and it would still have been exercised for those reasons even in the absence of improper ones, it is difficult to see why justice should require the decision to be set aside.
>
> [22] Dixon J's formulation has proved influential in the courts of Australia. As the majority (Mason, Deane and Dawson JJ) pointed out in the High Court of Australia in *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 294:

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87 Eg Franz Ranero "*Managed Investment Schemes: The Responsible Entity's duty to act for a proper purpose*" (1999) 17 CSLJ 422 at 424.

88 See eg Asplin J in *Labrouche v Frey* [2016] EWHC 268 (Ch) at [144].

89 D M Maclean "*Trusts and Powers*" (1989, Sweet & Maxwell) at p110, citing *D'Abbadie v Bizoin* (1871) 5 IR Eq 205.

90 See also Franz Ranero "*Managed Investment Schemes: The Responsible Entity's duty to act for a proper purpose*" (1999) 17 CSLJ 422 at 429 citing *Darvall v North Sydney Brick & Tile Co Ltd* (1989 15 ACLR 230 (Kirby P dissenting).

91 (1987) 162 CLR 285.

> 'As a matter of logic and principle, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that, but for its presence, "the power would not have been exercised" …'
>
> I think that this is right. It is consistent with the rationale of the proper purpose rule. It also corresponds to the view which courts of equity have always taken about the exercise of powers of appointment by trustees: see *Birley v Birley* (1858) 25 Beav 299 at 307 (Sir John Romilly MR), *Pryor v Pryor* (1864) 2 De GJ & Sm 205 at 210 (Knight Bruce LJ), *Re Turner's Settled Estates* (1884) 28 Ch D 205 at 217, 219, *Roadchef (Employee Benefits Trustees) Ltd v Hill* [2014] EWHC 109 (Ch), para 130 and generally Thomas on Powers (2nd edn, 2012), paras 9.85–9.89."

10.8 Lord Hodge agreed with Lord Sumption, but the other three Supreme Court justices while agreeing in the result reserved the position on this "but for" test – see Lord Mance at [54].

10.9 Paul Matthews comments[92] that if a relevant power is a joint power then an improper purpose of any one decision maker is enough to invalidate the exercise. However this would not seem appropriate to apply as a test where the relevant body has a majority vote applicable (eg where the trust deed so allows, or a company board of directors or a charity or pension trustees). Proudman J in *Roadchef (Employee Benefits Trustees) Ltd v Hill*[93] followed a test of looking at who was really driving the decision:

> "[129] Where a decision is made a by a group such as a board of directors, and a wrongful intention is held by some but not all who supported the decision, then the exercise of the power is only bad if it can be affirmatively shown that the decision would not have been taken without the concurrence of the persons with the bad intentions. In the present case, Mr Ingram Hill was the source of the scheme to transfer the approved shares, he was selective in the information he provided to the other directors and he was the sole driver of the decision."

Applying a public law test?

10.10 Lord Sumption also echoed at [18] the concern about applying "too rigorous an application of the public law test to the decisions of director" made by Dixon J in Australia in *Mills v Mills*[94]. In that case Dixon J pointed out the difficulties associated with too rigorous an application of the public law test to the decisions of directors:

> '… it may be thought that a question arises whether there must be an entire exclusion of all reasons, motives or aims on the part of the directors, and all of them, which are not relevant to the purpose of a particular power. When the

92 Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131at 139.

93 *Roadchef (Employee Benefits Trustees) Ltd v Hill* [2014] EWHC 109 (Ch) at [129]. Cited in support of the "but for" test by Lord Sumption in *Eclairs* at [22].

94 (1938) 60 CLR 150.

> law makes the object, view or purpose of a man, or of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within their powers. The application of the general equitable principle to the acts of directors managing the affairs of a company cannot be as nice as it is in the case of a trustee exercising a special power of appointment. It must, as it seems to me, take the substantial object the accomplishment of which formed the real ground of the board's action. If this is within the scope of the power, then the power has been validly exercised.'

10.11 It seems to me to be appropriate to apply the same test to commercial trusts such a pension schemes.

Purpose vs motive?

10.12 Some distinction is drawn in the cases between the motive or intention of the exercise of a power and its purpose[95]. This can sometimes be quite a difficult line to draw.

10.13 If there is a transaction or agreement to do something – eg to purchase an article, then it seems that the purpose will be both sides of the transaction (ie to pay the money and to acquire the article), even though the trustee's motive may have been one part (eg to acquire the article).

10.14 Knox J dealt with this in *Hillsdown Holdings plc v Pensions Ombudsman*[96]:

> "The person who pays a price for an article out of a fund under his control has inevitably, as part of his purpose, both the acquisition of the article and the payment of its price. No doubt his motive is to secure the article. But motive and purpose are not the same and it is the latter that counts."

10.15 It is helpful to quote the wider context for this statement:

> "Mr Oliver for Hillsdown argued that the reason and purpose why the power was exercised as it was, was in fact to secure the augmentation of benefits to members or, if one looks at the problem on a literal basis, the purpose of the exercise of the power was to transfer the assets to another scheme and thereby achieve the price that was to be paid for the benefit of the beneficiaries of the FMC scheme.

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95 See D M Maclean "*Trusts and Powers*" (1989, Sweet & Maxwell) at 93 to 96 and 99 to 104 (citing *Re Brook's Settlement, Brook v Brook* [1968] 3 All ER 416, [1968] 1 WLR 1661 on the difference between intention and effect) and Richard Nolan "*Controlling Fiduciary Power*" [2009] CLJ 293 at 298 (fn36), suggesting that "motive is essentially about antecedent reasons for action; purposes are essentially about prospective aims", citing *Topham v Duke of Portland* (1869) LR 5 Ch App 40 at 57.

96 [1997] 1 All ER 862 (Knox J) at 881.

….

> In my view the purpose of the FMC trustee in exercising the power in r 21 was to give effect to the bargain which had been struck between Hillsdown and the FMC trustee. That bargain had two essential features, first, the payment of surplus to Hillsdown and, secondly, the augmentation of members' benefits. As Mr Oliver put it in opening the appeal:
>
> 'I squarely confront the position in this case that the purpose of these transactions was to ensure that there could be a return of surplus to Hillsdown in circumstances where the trust deed of the FMC Scheme did not on its terms permit it.'
>
> If it was the purpose of the transactions, it was also in my view one at least of the purposes of the exercise of the r 21 power. No one suggested that there was not a bargain struck between the FMC trustee and Hillsdown and the argument in support of the appeal very properly fully accepted the existence of that bargain.
>
> I accept that if the Pensions Ombudsman intended to define the purpose of the exercise of the power under r 21 in saying that the sole reason for it was to secure the payment of surplus to Hillsdown, he was in error but I am not satisfied that he was doing anything more than identifying why the power under r 21 was used. It was a way, and probably the only way, in which Hillsdown could secure a very large part of the surplus in the FMC scheme. However that may be, I am satisfied that the purpose was as I have stated it. Nor is that conclusion escaped by describing the payment to Hillsdown as the price for securing the desired benefit. The person who pays a price for an article out of a fund under his control has inevitably, as part of his purpose, both the acquisition of the article and the payment of its price. No doubt his motive is to secure the article. But motive and purpose are not the same and it is the latter that counts."

10.16 Knox J referred[97] to what Turner LJ said in *Topham v Duke of Portland*[98]:

> '… it is one thing to examine into the purpose with which an act is done, and another thing to examine into the motives which led to that purpose …'

Knox J summarised that this meant that Turner LJ "declined to examine the propriety of the motive of the appointor in that case, the Duke of Portland, which was that the duke disapproved of the proposed marriage of one of his daughters to Colonel, later Sir William, Topham."

11. EFFECT OF IMPROPER EXERCISE

11.1 The following is a short outline of the position.

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97 [1997] 1 All ER 862 (Knox J) at 882.

98 (1863) 1 De G J & S 517 at 571, 46 ER 205 at 227.

11.2 In practice an exercise of a power for an improper purpose is probably void in equity rather than voidable – see *Cloutte v Storey*[99], but note the doubts expressed on this by Lord Walker in *Pitt v Holt*[100].

11.3 The distinction between a void and voidable exercise is rather obscure. Paul Matthews suggests that a void exercise cannot be ratified[101]. It may also impact on priorities with third parties[102] and who may seek to invalidate the use of the power.

11.4 The Court will usually cancel the exercise of the power and will not seek to exercise it itself[103].

11.5 Sometimes the court may look to sever the good from the bad in a particular exercise of a power[104].

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99 [1911] 1 Ch 18, CA. Not applied in relation to an employer in breach of the implied "Imperial duty" – see Warren J in *IBM UK Holdings Ltd v Dalgleish* [2015] EWHC 389 (Ch), [2015] PLR 99 at [251].

100 [2013] UKSC 26, [2013] 2 AC 108 at [62]. See Michael Ashdown "*Trustee Decision Making*" (OUP, 2015) at 9.20.

101 Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 at 139.

102 See Brian Green QC, section on "The void/voidable issue" in "*The law relating to trustees' mistakes — where are we now?*" (2003) 17 TLI 114 at 122; *Lewin on Trusts* (19th ed, 2014, Thomson Reuters) at 29-132.

103 See Sarah Worthington "*Equity*" (2nd ed, 2006, OUP) at 145.

104 Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 at 140.

B. APPLICATION OF THE PURPOSE TEST TO PENSION SCHEMES

12. AMENDMENT POWERS

12.1 An amendment power is potentially capable of making very wide changes to the pension scheme. The cases indicate that it must be exercised in a way that does not conflict with the accordance with the basic purpose of the scheme.

12.2 In *Courage*[105], Millett J held that it was contrary to the purpose of the power to allow a substitution of principal employer where the change was purported to be made with a view to the retention of surplus by the holding company of the current principal employer (instead of the scheme (with its surplus) remaining with the old principal employer (which was being sold) and remaining attached to the employees[106]).

12.3 Millett J held[107]:

> 'It is trite law that a power can be exercised only for the purpose for which it is conferred, and not for any extraneous or ulterior purpose. The rule-amending power is given for the purpose of promoting the purposes of the scheme, not altering them.'
>
> Before I consider this question, I should make some general observations on the approach which I conceive ought to be adopted by the court to the construction of the trust deed and rules of a pension scheme. First, there are no special rules of construction applicable to a pension scheme; nevertheless, its provisions should wherever possible be construed to give reasonable and practical effect to the scheme, bearing in mind that it has to be operated against a constantly changing commercial background. It is important to avoid unduly fettering the power to amend the provisions of the scheme, thereby preventing the parties from making those changes which may be required by the exigencies of commercial life. This is particularly the case where the scheme is intended to be for the benefit not of the employees of a single company, but of a group of companies. The composition of the group may constantly change as companies are disposed of and new companies are acquired; and such changes need to be reflected by modifications to the scheme.
>
> Secondly, in the case of an institution of long duration and gradually changing membership like a club or pension scheme, each alteration in the rules must be tested by reference to the situation at the time of the proposed alteration, and not by reference to the original rules at its inception. By changes made gradually over a long period, alterations may be made which would not be acceptable if introduced all at once. Even the main purpose may be changed by degrees."

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105 *Re Courage Group's Pension Schemes* [1987] 1 All ER 528, [1987] 1 WLR 495 (Millett J).

106 But see the later gloss by Blackburne J in *Merchant Navy Ratings Pension Fund Trustees Ltd v Chambers* [2002] ICR 359, [2001] OPLR 321.

107 [1987] 1 All ER 528 (Millett J) at 536.

12.4 Millett J then referred to a case, *Thellusson v Viscount Valentia*[108], about the rules of a members' club (Hurlingham) established for sporting activities (originally pigeon shooting) and concluded his general observations (at p506D):

> "So the main purpose of a club or pension scheme may be enlarged by appropriate amendments to the rules; and once it becomes too late to challenge the amendments, the enlarged purposes become the new basis by reference to which any further proposed changes must be considered."

12.5 In *Bank of New Zealand v Bank of New Zealand Officers Provident Fund*[109] amendments were upheld by the Privy Council. Lord Walker held, at [8]:

> "But those rules are capable of being amended, so long as the amendments do not conflict with the basic purpose of the scheme to which they relate (see *Re Courage Group's Pension Schemes …….*). The basic purpose of a scheme may not be entirely apparent from the face of its documentation. In particular, an objects clause containing words or expressions which are specially defined, but may be capable of amendment, is not necessarily a reliable guide to the scheme's basic purpose."

12.6 Lord Walker then set out the comments in *Courage* above and held:

> "21. An illustration of a situation in which the objects clause will not be decisive is where there have been changes in the organisation of an enterprise, through a process of natural development, making it necessary or expedient for the objects to be restated. If the trust deed of a pension scheme declares that its object is to provide pensions and other benefits for employees of X Ltd, and the business of X Ltd is restructured so as to be carried on by several subsidiary companies employing the workforce previously employed by the holding company, there can be no doubt that the scheme's power of amendment (unless exceptionally and specifically restrictive) could be exercised so as to bring in employees of the subsidiaries. The amendment, so far from frustrating the commercial purpose of the scheme, would prevent it being frustrated, since otherwise the group's management would have to choose between the unattractive alternatives of setting up a new pension scheme or abandoning an advantageous restructuring. On the other hand the amendments proposed in the Courage case were not permissible because they were part of an unnatural and manipulative plan which would have severed the pension fund from the workforce for whom it was established (see at pp.509-510).
>
> 22. For these reasons their Lordships do not find it necessary to go far into the detailed submissions which were made about the precise language in which the purposes or objects of the Association have been expressed at different times, either in the preambles to the 1900 Act and the 1971 Act or in the constantly changing rules. That is not the way in which documents establishing and regulating a superannuation scheme ought to be approached:

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108 [1907] 2 Ch 1, CA.

109 [2003] UKPC 58, [2003] OPLR 281.

> see the *UEB Industries* case at p297, approving the observations made by Warner J in *Mettoy Pension Trustees Ltd v Evans and others* [1990] 1 WLR 1587, at p1610 (who was himself following Millett J in *Courage*)."

12.7 In *IBM (2014)*[110], an exclusion rule had been introduced in a new definitive deed, allowing the employer to exclude active members from continuing in pensionable service. The employer used this rule to exclude most active members. This was challenged as being for an improper purpose (only ceasing DB accrual while allowing future Dc accrual or avoiding winding-up the plan), but Warren J rejected this challenge, holding that the power was not exercised for an improper purpose.

13. TRANSFERS OUT: *FLETCHER CHALLENGE* AND *ITS V HOPE*

13.1 In *Hillsdown*[111], Knox J held that it was contrary to the purpose of the transfer-out power to make a transfer to a new scheme with the purpose of allowing a surplus refund to the employer that was prohibited by the old scheme.

13.2 Later, the discretion given to trustees to fix the amount of transfer payments out of the scheme has been considered to have pretty wide bounds.

13.3 In *Wrightson Ltd v Fletcher Challenge Nominees Ltd*[112], the Privy Council held that pension trustees had a wide discretion (when considering the amount of a transfer payment to a new scheme). The issue here involved a New Zealand pension scheme and was how the trustee decided on an appropriate transfer payment to be paid to a new fund following an employer (Wrightson) ceasing to participate (following its demerger from the Fletcher Challenge group)[113]. The deed provided that:

> "there shall be deemed to be a dissolution of such part of the Plan as the Trustee determines to be appropriate to the Participating Company."

13.4 Lord Millett gave the Privy Council's judgment. He upheld the decision of the trustee to agree with the remaining employer and not to pass any share of surplus to the leaving employer's new pension fund. However, he felt the point was finely balanced:

> "The Trustee is not entitled to allocate to the withdrawing company so much of the Fund 'as it thinks fit', but so much 'as is appropriate' to the company in question. This limits the matters of which the Trustee can take account, but in their Lordships' opinion it does not dictate the choice between a share of fund and a benefits based approach. The circumstances attendant on a partial

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110 *IBM UK Holdings Ltd v Dalgleish* [2014] EWHC 1796 (Ch), [2014] PLR 335 (Warren J) at [274] – [293].

111 *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862 (Knox J).

112 [2001] UKPC 23, [2001] OPLR 249, PC. Oddly not mentioned in the later case, *Independent Trustee Services Ltd v Hope* [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J) – see below.

113 Similar facts to that in *Stannard v Fisons Pensions Trust Ltd* [1992] IRLR 27, CA, but in that case the terms of the transfer-out power more clearly spelt out how much a transfer payment could be.

> dissolution are many and various, and their Lordships think that it would have been unwise to fetter the Trustee's discretion to choose between the rival approaches in any way, even by indicating a presumptive 'starting point'. Accordingly, they agree with the Court of Appeal that the Trustee should approach the determination of the part of the Plan attributable to the withdrawing company with an open mind, and without adopting any presumption as to the adoption of one or other of the rival approaches.
>
> 30 Their Lordships have considered the rival arguments in relation to the manner in which the Trustee exercised its discretion, and consider that the Court of Appeal came to the right conclusion. The surplus was relatively small and might well disappear in a short period of time should market conditions deteriorate. The Trustee was entitled to take the view that no part of it should be allocated to the Wrightson scheme. While some of the arguments which the Trustee considered might appear to be irrelevant to the exercise of its discretion, most of them had been raised by Wrightson and the Trustee could not be criticised for responding to them."

ITS v Hope

13.5 The "best interests of the members" test is (in effect) rejected by the rather difficult decision of Henderson J in *Independent Trustee Services Ltd v Hope*[114].

13.6 The case involved a group of members who were concerned that their benefits would be capped if the scheme entered the Pension Protection Fund (PPF). This group presented a plan to the trustees designed to:

(a) get better benefits for them (ie greater than the PPF level) outside the scheme; but

(b) not to reduce the benefits of the remaining members (who would still end up with the PPF protected level).

13.7 The arrangement would involve the trustee making a transfer payment (at a full level) in respect of the capped members. This would reduce the solvency remaining in the scheme (ie it would be more than a "share of fund"), but the remaining members would not be adversely affected as the scheme would enter the PPF and their benefits would be provided up to the same protected level (their protected level of benefits from the PPF would not depend on the level of funding in the scheme, so would not be affected by the transfers-out).

13.8 A simple "best interests of the members" purpose test would clearly be satisfied (the transferring members would be better off, the remaining members would be unaffected). The trustees were still concerned that the PPF would be affected (the scheme would almost certainly have less assets proportional to the benefits transferred

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114 [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J). See the talk by Duncan Buchanan at the White Paper Conference on Pensions (2015) and the note by David Fox [2010] CLJ 240. Before the decision in *ITS v Hope*, on the potential for the interests of the PPF to be considered, see Andrew Simmonds QC "*The Pension Protection Fund – 18 months on*" (2007) 21 TLI 150.

to the PPF) and so applied to court for approval (with the PPF and the Pensions Regulator also being represented).

13.9 Henderson J held that the transfer payments would be invalid as being made for an improper purpose. This is a clear decision that the "best interests" purpose is not an overriding duty, but instead there is a purpose test.

13.10 Unfortunately it is rather tricky when the proper purpose test is applied. Henderson J held, at [96]:

> "96. In this context, it seems clear to me that the purpose of rule 12.3(b) is to enable the trustees, if they think fit, to apply an amount of money which fairly represents the benefits to which a member or beneficiary is entitled under the Scheme (or a specified part of those benefits) in the purchase of an insurance policy which provides benefits in substitution for those benefits (or the relevant part of them). The limitation on the amount which may be so applied to (in short) a fair share of the Scheme assets is in my judgment implicit in the rules, not as a matter of construction, but because it would be contrary to the fundamental purpose of the Scheme as a whole to empower the trustees to apply a disproportionately large share of Scheme assets in the purchase of benefits which are intended to be in substitution for those available under the Scheme."

13.11 But this could result in a rather difficult test. For example:

(a) what is a "fair share" or "disproportionately large share"? Presumably a look at the funding of the scheme compared to the transfer payment on a "share of fund" basis?

(b) Does this involve considering which set of actuarial assumptions to be used (in getting a capital value of the relevant benefits. Does the trustee have a discretion here about which factors to use? (eg a range?).

(c) Does it mean that any use of the relevant power must be capped at the share of fund level? Presumably not if the member is exercising the statutory transfer right to a cash equivalent transfer value (CETV) under PSA 1993?

(d) Trustees often exercise powers that give benefits worth more than a share of fund – for example if agreeing to a pension increase to pensions in payment. This benefits the pensioner members more than the other members. Is this subject to the "share of fund" test, so that the power cannot be exercised if the scheme is in deficit on the relevant measure? This issue may well be considered in the forthcoming *BA case*[115] where a challenge is being made by the employer to the decision of the trustee board to grant a pension increase.

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115 Warren J noted in his decision on a preliminary point, *British Airways v Spencer* [2015] EWHC 2477 (Ch), [2015] PLR 519, that part of the claim was that "The Pension Increase Decisions involved the exercise of the discretionary increase power for an 'improper purpose'".

13.12 An odd aspect of *ITS v Hope* is that the judge did not explain why a different approach to transfers-out was adopted by the Court of Appeal in the earlier case of *Eastearly plc v Headway Ltd*[116] (in the judgment in *ITS v Hope*, Henderson J did not even refer to this case). In *Eastearly*, the Court of Appeal allowed a different "cunning plan" – that is, for the trustees to carry out a partial buy-out that increased the employer's liability to the scheme[117]. Perhaps there may be less public interest in protecting an employer than in protecting the PPF? But it would have been better if the judgment in *ITS v Hope* had at least dealt with this.

13.13 The leading case on transfer payments, the decision of the Privy Council in *Wrightson Ltd v Fletcher Challenge Nominees Ltd*[118] was not cited to Henderson J in *ITS v Hope* and is not mentioned in his judgment. In *Fletcher Challenge*, Lord Millett gave the judgment of the Privy Council holding that a transfer payment out of the scheme did not have to be on a share of fund basis (ie in that case to include a share of the actuarial surplus), but that the trustee's discretion was "an extremely wide one" and there was no "presumptive starting point":

> "29. Their Lordships find the question nicely balanced, but they remind themselves that the discretion conferred on the Trustee by clause 4.2 is an extremely wide one. It is not, of course, completely at large. The Trustee is not entitled to allocate to the withdrawing company so much of the Fund "as it thinks fit", but so much "as is appropriate" to the company in question. This limits the matters of which the Trustee can take account, but in their Lordships' opinion it does not dictate the choice between a share-of-fund and a benefits-based approach. The circumstances attendant on a partial dissolution are many and various, and their Lordships think that it would have been unwise to fetter the Trustee's discretion to choose between the rival approaches in any way, even by indicating a presumptive "starting point". Accordingly, they agree with the Court of Appeal that the Trustee should approach the determination of the part of the Plan attributable to the withdrawing company with an open mind, and without adopting any presumption as to the adoption of one or other of the rival approaches.
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> 30. Their Lordships have considered the rival arguments in relation to the manner in which the Trustee exercised its discretion, and consider that the Court of Appeal came to the right conclusion. The surplus was relatively small and might well disappear in a short period of time should market conditions deteriorate. The Trustee was entitled to take the view that no part of it should be allocated to the Wrightson scheme. While some of the arguments which the Trustee considered might appear to be irrelevant to the exercise of its discretion, most of them had been raised by Wrightson and the Trustee could not be criticised for responding to them."

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116 [2009] EWCA Civ 793, [2010] ICR 153, [2010] 1 BCLC 317, CA. The judgment of the Court of Appeal was given on 23 July 2009, the day before the trial in *ITS* started. The list of cases cited in argument in *ITS* (in the ICR reports at 554) includes the first instance decision in *Easterly v Headway* [2008] EWHC 2573.

117 See also the later case allowing a similar cunning plan: *Sarjeant v Rigid Group Ltd* [2013] EWCA Civ 1714.

118 [2001] UKPC 23, [2001] OPLR 249, PC.

13.14 Standing back on *ITS v Hope*, it seems reasonable (as Henderson J decided) to protect the PPF in the specific circumstances of this case. Having said that, Henderson J was obviously struggling to find a legal way of reaching his decision. The members pointed out that Parliament has enacted a range of protections for the PPF, but did not think it necessary to block this route.

13.15 Henderson J clearly wanted to deter any future attempt to 'take advantage of the existence of the PPF' and held that there was a 'principled basis upon which the court can intervene to nip behaviour of this kind in the bud'. So this decision will have wider relevance. For example, this case may prevent the trustees of a scheme that is funded below the PPF protected level from taking a 'Las Vegas gamble' by making high-risk investments knowing that even if the investments fail, the scheme members will still be protected up to the PPF level.

13.16 If this case has wider application, Henderson J's reliance on the 'public interest' arguments creates some uncertainty. It is not clear when this principle can be invoked in the future. For example, it may not always be clear when trustees are allowed to take the PPF into account when:

(a) buying out benefits with an insurer,

(b) allocating assets during a partial wind-up (eg if only some sections of the scheme are eligible for PPF entry),

(c) during a scheme merger (trustees compare the PPF level before and after the merger),

(d) commuting pensions for cash (eg when considering the commutation rates available) or

(e) investing the scheme's assets. But this decision will probably not affect buy-ins, because a buy-in policy will still be an asset of the scheme that is available to the PPF.

13.17 The safest course of action for trustees will be to ask themselves whether it would be reasonable for them to make a particular decision even if the PPF did not exist. Trustees should carefully minute these decisions so that they can later prove that the PPF's existence was not a factor in their decision. If trustees cannot ignore the PPF's existence, they will need advice based on the specific facts of their situation.

14. INVESTMENT

14.1 In *Cowan v Scargill*[119] an attempt by trustees to veto some investments (eg outside the UK was held to be an improper use of the scheme investment power. Although often quoted as the basis for a "best interest" duty, the judgment is also consistent with a proper purposes test. Megarry V-C noted (at 288):

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119 [1985] Ch 270 (Megarry V-C). There is a good discussion of *Cowan v Scargill* by Margaret Stone J in "*The superannuation trustee: Are fiduciary obligations and standards appropriate?*" (2007) 1 J Eq 167. See also Paul Matthews "*The doctrine of fraud on a power*" [2007] PCB 131 at 136.

> "Powers must be exercised fairly and honestly for the purposes for which they are given and not so as to accomplish any ulterior purpose, whether for the benefit of the trustees or otherwise: see *Duke of Portland v Topham* (1864) 11 HL Cas 32, a case on a power of appointment that must apply a fortiori to a power given to trustees as such."

14.2 In *MNRPF*[120], Aspin J considered *Cowan v Scargill* and held, at [229}:

> "In my judgment, it is clear from *Cowan v Scargill* that the purpose of the trust defines what the best interests are and that they are opposite sides of the same coin, ….."

14.3 But in *Pitmans Trustees Ltd v Telecommunications Group plc*[121] the employer argued that the adoption of a gilts matched investment policy by the trustees took place for an improper purpose, namely to increase the amount payable by the employer under s 75 of the Pensions Act 1995.

14.4 Sir Andrew Morritt V-C held (on other grounds) that a valid gilts matched policy had not been adopted. But he went on to deal with this other argument briefly by saying:

> "the adoption of the revised statement of investment principles was plainly done with the intention that a gilts-matching policy be adopted. The fact, if it be one, that one of the motives for such an adoption was to maximise the Trustees' claim under s.75 would not vitiate the exercise of the power."

14.5 Strictly this was not necessary for his decision. This may be no more than an appreciation that trustees can ask for the increased s75 buy-out debt if a winding-up is likely (eg *Capital Cranfield*[122]).

14.6 In *Dalriada Trustees Ltd v Faulds*[123], Bean J followed a similar proper purpose approach to an investment power (this time to invalidate actions by trustees seemingly designed to get round tax rules). The Pensions Regulator had appointed a new professional trustee to an occupational pension scheme, The new trustee, as claimant, sought to challenge some loans made by the previous trustees with the consent of the relevant member.

14.7 Bean J held that some of the loans made by the scheme[124] did not fall within the investment power as being investments. Even if they had been, he went on to hold that the relevant investments would have been made for an improper purpose. He held at [68]:

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120 *Re Merchant Navy Ratings Pension Fund; Merchant Navy Ratings Pension Trustees Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch), [2015] All ER (D) 298 (Feb) (Asplin J).

121 [2004] EWHC 181 (Ch), [2005] OPLR 1, [2004] PLR 213 (Sir Andrew Morritt V-C).

122 *Capital Cranfield Trustees Ltd v Walsh* [2004] EWHC 2874, [2005] OPLR 365 (Lindsay J).

123 [2011] EWHC 3391 (Ch), [2012] 2 All ER 734 (Bean J).

124 Seemingly a money purchase scheme, with the member agreeing to the loans out of his or her account.

> [68] Thomas [on Powers[125]] goes on to emphasise (para 9–04, p 454) that the scope and purpose of a power must be determined objectively:
>
> ' … The true intention of the donor of the power as to its scope and purpose must, of course, be ascertained from the instrument creating the power, even where the donor and the donee are the same person … '
>
> ……
>
> [72] I consider that the claimant succeeds on this issue essentially for the same reasons as it does on the second issue. The powers of the trustees are to make 'investments' as set out in cl 8.1 of each trust deed. The deed and rules must be objectively construed without reference to external documents showing the subjective intentions of the creators of the PRP. The MPVA loans were beyond the scope of their powers, and made for an ulterior purpose. The fact that everyone involved with the transactions wished to validate MPVA loans does not prevent the loans from being a fraud on the trustees' powers.

14.8 Bean J went on the hold that deeds of amendment purporting to act retrospectively to authorise the loans were ineffective for that purpose[126].

14.9 Overall, the courts seem not to find favour with some attempts to get round limits by using other powers – eg transfer-out (*ITS v Hope*, but contrast *Eastearly* and *Fletcher Challenge*) and investment (*Cowan v Scargill* and *Dalrieda*).

15. EARLY RETIREMENT REDUCTION

15.1 Warren J in *Re IBM Pension Plan*[127], held, at para [504], that a provision requiring an actuarial reduction to be applied on early retirement does not allow the trustee to apply no reduction.

15.2 This could be seen as a matter of construction of the relevant rule, but also fits with a proper purpose test.

15.3 Warren J distinguished (on the wording of the rule) the decision of Lloyd J in *Universities Superannuation Scheme Ltd v Simpson*[128]. Helena Davies described this case (in the commentary to the OPLR report):

> "The essential problem here was that the scheme treated active and deferred members in different ways. The decision was that this amounted to a breach of the preservation legislation.
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> Active members who had a contractual retirement age of between 60 and 65 could take an unreduced pension at that age. Although deferred members could take early retirement from 60, the terms of the early retirement were at

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125 See now *Thomas on Powers*, (2nd ed, 2012, OUP) at 9.35.

126 See discussion in Pollard "*Amendment Powers: Two Myths*" APL Seminar, March 2015.

127 [2012] EWHC 2766 (Ch), [2012] PLR 469 (Warren J).

128 [2004] EWHC 935 (Ch) [2004] ICR 1426, [2004] OPLR 311 (Lloyd J).

> the trustee's discretion. The trustee had decided to apply a blanket policy that the benefits on early retirement of deferred members be subject to actuarial reduction and enforced this even in cases where, under the terms of the deferred members' contracts, they would have been able to retire and receive an unreduced pension before 65 if they had remained active members. The preservation legislation is clear on this; s.71 of the Pension Schemes Act 1993 says that deferred members must be given the benefits calculated in the same way as those they would have received had they remained as active members until normal pension age, defined as the earliest age at which a member is entitled to receive benefits under the scheme. The question was whether that could be decided by reference to the general terms of the scheme or depended on the employment terms of the particular member. The latter interpretation was found to be correct."

15.4 In *IBM*, Warren J held that the *USS* case was one where the early retirement rule was "entirely different" giving a discretion to the trustee, acting on actuarial advice. Warren J considered that the USS rule meant "That gave a discretion to the trustee company which had to be exercised by reference to the Preservation Regulations"

16. COMMUTATION FACTORS

16.1 Some scheme give members a right to convert some or all of their accrued pension into a cash sum at retirement. A simple form of rule could be that

> "the rate at which pension is converted into lump sum shall be decided by the Trustee and confirmed by the Actuary to be reasonable."

16.2 The reference to the Actuary's involvement indicates that the starting point for determining commutation factors should be the actuarial value of the pension being commuted. Note that there is no requirement in this rule for employer consent.

16.3 The valuation basis is not specified and in practice the trustee is likely to wish to consult the Actuary from the outset.

16.4 Where trustees have a discretion, usually a fairly wide margin of appreciation is given by the courts[129]. Subject to the points above, the Courts will often only intervene if it can be shown that the trustees acted for an improper purpose or in a way that no reasonable trustee would act[130]. More recent cases have emphasised that in some powers an approach for no more than "a share of fund" is required[131].

16.5 Acting in the best interests of members does not necessarily mean that trustees must use their powers to maximise payments to some/all members. As a general principle, pension scheme trustees are obliged to act impartially in a manner that they

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129 Eg *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2001] UKPC 23 (a case looking at a bulk transfer value).

130 Eg *Harris v Lord Shuttleworth* [1994] ICR 991 (a case looking at a discretion on an ill health pension).

131 See above: *Independent Trustee Services Ltd v Hope* [2009] EWHC 2810 (Ch) (a case on bulk transfers out of a scheme about to wind up).

believe to be fair and equitable, having regard to the different classes of beneficiary, and also between individuals within those classes. This involves maintaining:

> "a balance between assets and liabilities…so that, as far as can be foreseen, they will be in a position to provide pensions and other benefits in accordance with the rules throughout the life of the scheme."[132]

16.6 Case law indicates that the courts will require trustees to take account of a pension scheme's funding position when exercising administrative powers such as powers to buy-out benefits and effect transfers:

(a) In *Stannard v Fisons Pension Trust Ltd*[133] the Court of Appeal held that the trustees' determination of an amount to be transferred out of the relevant pension scheme following the sale of Fisons' fertilizer division was flawed because the trustees had not considered the current (increased) value of the pension fund at the transfer date and its implications in determining the amount that it would be just and equitable to appropriate in respect of the transferring members.

(b) As already discussed (see 13 above), in *ITS v Hope*[134] the scheme was in deficit and the court considered a proposal to use a buy-out power to purchase annuities which would maximise certain members' benefits in anticipation of entry into the Pension Protection Fund (***PPF***). Henderson J held that there was a limitation, implicit in the relevant scheme rules, that the amount which may properly be applied in purchasing annuities would be no more than a fair share of scheme assets, considered in the light of actuarial advice.[135]

16.7 Useful guidance on commutation factors is given in the report of the "Member Options Working Party" issued by the Pensions Board of the Institute of Actuaries in December 2006[136].

17. PENSION INCREASES

17.1 Some schemes include a power or discretion exercisable by the trustee in relation to the rate of increases paid on pensions in payment (ie indexation) or (less common) on the rate of revaluation in deferment. In both cases a minimum level of increase is provided by statute[137].

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132 *Edge v Pensions Ombudsman* [2000] Ch 602, per Chadwick LJ at 623. An extract from the citation at 6.1 above.

133 [1992] IRLR 27, CA.

134 [2009] EWHC 2810 (Ch), [2010] ICR 553 (Henderson J).

135 *Ibid.* Henderson J at [96] and [99].

136 See https://www.actuaries.org.uk/sites/default/files/documents/pdf/memberoptionsworkingparty2006report.pdf

137 Pensions Act 1995 and Pension Schemes Act 1993. See Chapter 14.8 (Indexation) in Freshfields on Corporate Pensions Law 2015 (Bloomsbury Professional).

17.2 In addition in some cases the trustee has power to choose the relevant index to be used – eg *Danks v Qinetiq Holdings Ltd*[138] and *Arcadia Group Ltd v Arcadia Group Pension Trust Ltd*[139].

17.3 In the forthcoming *BA case* a challenge is being made by the employer to the decision of the trustee board to grant a pension increase. Warren J decided a preliminary point last year, *British Airways v Spencer*[140], and noted that part of the claim was that:

> "The Pension Increase Decisions involved the exercise of the discretionary increase power for an 'improper purpose'".

138 [2012] EWHC 570 (Ch) (Vos J).

139 [2014] EWHC 2683 (Ch) (Newey J).

140 [2015] EWHC 2477 (Ch), [2015] PLR 519 (Warren J).

C. TRUSTEES EXERCISING POWERS FAIRLY

18. FAIR BALANCE

18.1 Trustees acting for a proper purpose and seeking to promote the success of the scheme (not just the interest of the members) means that trustees need to consider the impact of their decisions for the various interested groups: affected member, other members, employer etc.

18.2 Broadly this is similar to an overall fairness requirement, but still giving a discretion to the trustees within a range.

18.3 This fairness approach is supported by the caselaw.

18.4 A leading passage is in the judgment of Chadwick LJ in *Edge v Pensions Ombudsman*[141] discussed above (see 6.1 above). To repeat one section (underlining mine):

> "….the task of the trustees is to maintain a balance between assets and liabilities valued on that actuarial basis; so that, so far as the future can be foreseen, they will be in a position to provide pensions and other benefits in accordance with the rules throughout the life of the scheme. That task is to be performed by setting appropriate levels for employers' and members' contributions. If that task could be performed with perfect foresight there would be no surpluses and no deficits. But, because the task has to be performed in the real world, surpluses and deficits are bound to arise from time to time and prudent trustees will aim to ensure that the likelihood of surplus outweighs the risk of deficit. Nevertheless, it is no part of the trustees' function, in a fund of this nature, to set levels for contributions which will generate surpluses beyond those properly required as a reserve against contingencies."

18.5 Earlier, in Australia, in *Lock v Westpac Banking Corpn*[142], Waddell CJ upheld a scheme amendment allowing trustees to agree to a package involving a surplus refund to the employer and benefit improvements. Waddell CJ held (at 610C):

> "It seems to me that in the present case the Trustees, while they had a duty to act in the interests of the members, were entitled to take into consideration the interests of the Bank in relation to the surplus which had accumulated in the fund in considering whether or not to consent to the proposed amendment to the deed. If they were satisfied on reasonable grounds that the overall package was a resolution of the interests of the parties in the surplus which was fair both to the Bank and to the members, they were, in my opinion, entitled to consent to an amendment enabling part of the surplus to be returned to the Bank."

18.6 In *Smithson v Hamilton*[143], Sir Andrew Park commented on a balanced role of trustees in agreeing to a definitive deed that:

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141 [2000] Ch 603, CA at 623.

142 (1991) 25 NSWLR 593, [1991] PLR 167 (Waddell CJ).

> "[101] That is not to say that, if the trustees had happened to notice a feature of the rules (like r 3.5.2.1) which appeared to be unintentionally onerous upon PFPL, they (the trustees) would have been obliged to keep quiet about it. If they thought that something had gone wrong in the drafting to the detriment of PFPL though not of members of the scheme, they were fully entitled to draw it to PFPL's attention. Mr Newman has said, in his written reply to Mr Stallworthy's submissions that 'no decision of the trustees should be made without the employer's interests being considered and taken into account'. I accept that, but I do not think that it has any impact on this case."

18.7 The "fair balance" approach as between members and the employer is also supported by the Court of Appeal decision in *Foster Wheeler Ltd v Hanley*[144]. That case was mainly concerned with interpreting amendments made to a pension scheme.

18.8 The Court of Appeal held that the relevant amendment should still take effect in relation to future service (and that an unwieldy blue pencil approach should not apply), even though this would result in lower benefits for some members, on the basis that this was a fairer result.

18.9 Arden LJ stated:

> "By conferring a windfall on members with mixed NRDs, the judge's solution did not satisfy the principles which I have identified. It is unfair to the company and potentially unfair to other members of the scheme. I am reinforced in this view by the fact that Mr Spink's submissions did not give any reasons to justify the windfall element as such of the judge's solution. In my judgment, the windfall element constituted a fatal flaw."

18.10 This can be seen as similar to the duty imposed on trustees in a private family settlement to decide on investment strategy, balancing the interests of the life tenant with the ultimate remaindermen.

18.11 A similar balancing exercise is envisaged from local authorities when (say) deciding between transport users and ratepayers when fixing on a transport policy—see Lord Wilberforce in *Bromley v Greater London Council*[145],

> . . . the G.L.C. owes a duty to two different classes. First, under its responsibility for meeting the needs of Greater London, it must provide for transport users: these include not only the residents of London, but persons travelling to and in London from outside (e.g. commuters) and tourists. Most of these will not pay rates to the G.L.C. Secondly, it owes a duty of a fiduciary character to its ratepayers who have to provide the money.

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143 [2007] EWHC 2900 (Ch), [2008] 1 All ER 1216 (Sir Andrew Park).

144 [2009] EWCA Civ 651, [2010] ICR 374, CA at [36].

145 [1983] 1 AC 768 at 815, HL.

19. A CONTRARY VIEW?

19.1 But Asplin J in *Dutton v FDR Limited*[146] (a case involving the effect of an indexation amendment conflicting with a proviso to amendment power) held against any concept of "windfall gain" being relevant as a matter of construction of the deed, commenting, at [45]:

> "[45] I also derive no assistance from terminology such as "windfall" or "contamination". The right which came into existence after the 1991 Deed is just that. It arises from the Rules themselves. The amendment to introduce 5% RPI increases together with the effect of the Proviso which was at all times a part of the then Definitive Deed and Rules, results in a single right to increases, no more, no less. No question of windfall or contamination arises."

The Court of Appeal decision in *Foster Wheeler* was not cited by Asplin J.

146 [2015] EWHC 2946 (Ch) (Asplin J).

D. CONCLUSION

20. OVERVIEW

20.1 The caselaw clearly supports a proper purpose test that requires trustees to seek to exercise their discretionary powers in what they consider:

(a) to be in line with the proper purpose of the individual power /discretion; and

(b) often also to be most likely to promote the success of the scheme.

20.2 They usually need to act fairly and balance the interests of the individual member with the interests of the other members (and secondary beneficiaries) and the interests of the employer.

20.3 Often this may give a wide discretion[147], but broadly means that they need to act "fairly"[148]. An approach solely (say) favouring the members (with their dependants etc) may well be an improper purpose, unless the employer agrees (eg as an exercise of the augmentation power).

20.4 All of this can leave trustees very much up in the air. The amounts at stake are pretty large. On one side will be the employers, anxious not to have to pay too much too soon into a scheme; on the other the Pensions Regulator and the Pension Protection Fund (to say nothing of the members), who will be looking back over the actions of the past trustees—partly with a view to seeing if there is a potential claim.

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147 See eg *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2001] UKPC 23; [2001] OPLR 249, PC.

148 See *Foster Wheeler Ltd v Hanley* [2009] EWCA Civ 651; [2010] ICR 374, CA.