Recent Development of Trust Law on Occupational Pension Scheme in U.K.

Yukizawa, Kazuhito

(Citation)
Kobe University law review,28:31-40

(Issue Date)
1994

(Resource Type)
departmental bulletin paper

(Version)
Version of Record

(JaLCDOI)
https://doi.org/10.24546/00166954

(URL)
https://hdl.handle.net/20.500.14094/00166954

RECENT DEVELOPMENT OF TRUST LAW ON OCCUPATIONAL PENSION SCHEME IN U. K.

KAZUHITO YUKIZAWA

1 THEORETICAL STRUCTURE OF THE PROBLEM background

In Nov. 1991, after the death of Robert Maxwell, the president of Mirror group, big financial scandal around him was made public. The outline is as follows: He managed not a few individual companies, and got into great debt as their business performance got so much worse. In order to compensate the financial loss, he bore huge loan from the banks. Then, besides the assets of Maxwell Communication Co. and Mirror Group Newspaper Co., both of which were actually governed by Mr. Maxwell, occupational pension fund settled for the employees of these companies were offered to the banks as securities in misappropriating way. The fact that the money unlawfully removed from the occupational pension fund amounted to about 420 million pounds shocked the British people, many of whom particiapte the occupational pension schemes settled by their employers and expect their lives after retirement on the pension to be paid under those schemes.

Maxwell case is indeed the tip of the iceberg.

During 1980's, under the booming economy in U. K., occupational pension funds rapidly grew as big institutional investors and the funds bore tremendous amount of surplus[1] because of big return from the investment to bonds, stocks and real estates. This huge surplus of the fund stimulated the greed of the business elite and triggered their fraudlent manipulation or ingenious impropriety of the pension fund.

trust law

To whom the surplus of the fund belongs and who is responsible for managing the surplus? Occupational pension schemes have to be settled in the form of irrevocable trust if they want to receive tax-reliefs (which has been provided under Finance Act 1921 and all subsequent legislations; now is provided in Income and Corporation Taxes Act 1988, §592 (1) (a)).

(1) 'At first blush it (the word of surplus) carries connotations of real assets that are available for distribution because they exceed actual liabilities. In fact this position could only be reached in an ongoing scheme once all the beneficiaries had died. Until then, a "surplus" is an abstraction derived from an actuarial valuation of the assets and liabilities of a pension scheme. It simply represents the excess of the actuarial value of assets over the actuarial value of liabilities on the basis of the valuation method used.'Graham Moffat, 'Pension Funds: A Fragmentation of Trust Law?', Vol. 56 The Modern Law Review (July 1993) at 471, 473.

Under trust law, once pension fund trust is settled by the company (employer) for the employees, the fund is entrusted to the trustee who is responsible for managing the fund for the best interests of the beneficiaries (ex-employees after retirement and dependents on them or their successors, employees participating in the schemes, etc) and acting in the manner of fairness among the beneficiaries (fiduciary duty).

So, it seems natural to think that the trustee decides how to treat the surplus of the fund especially in liquidation of the pension schemes, considering what is the best interest for the participants in the concerned factual background. But, this is not necessary the case. In fact, company controls the surplus of the fund and sometimes benefits itself at the cost of beneficiaries' interest.

Then, why is such a thing possible? First, it ascribes to Finance Act 1970. Before the Act 1970 was enacted, in order to give tax-reliefs to the occupational pension scheme, Inland Revenue had requested the trust deed or shceme rule to include the provision that prohibited return of the pension fund to the company as settlor or any change of rule which in effect came to the same result as this. But, in turn, the Act 1970, for the tax-reliefs of the occupational pension schemes settled after 1970, requests that the trust deed or scheme rule includes the provision which orders return of any surplus of the fund to the company in liquidation of the scheme. Although the reason of changing the policy is not clear, it is said that Inland Revenue is concerned about losing taxable money as it be paid to pensioners out of surplus. However, becase of this new rule, many of the occupational pension schemes have been under threat of liquidation by the companies' managements who desire to take the surplus for themselves.

Second, a doctrine is crucially significant. It's 'freedom of trust' doctrine. Indeed, a trustee is expected to exercise comprehensive or discretionary power on the management of the entrusted fund (trust power). However, the trust deed, which defines the content of the trust, can be written in any way the settlor and trustee may agree. So, if the company as a settlor chooses its employees as trustees of the pension fund trust, actually the company can design any trust conditions in favour of its own benefit as it likes. Yes, trust law is said as the last fortress of the 'Laissez-faire' doctrine in the days of 'welfare state.' Under this doctrine, the company may reserve in the trust deed a certain power to finally decide whether to re-distribute the surplus of the fund among the pensioners in the form of increase of the pension or to have it return to itself. Or, the company may hold the exclusive discretion to amend any provision or rule in the trust deed so as to gain the surplus of the fund later in any time it wants.

In this way, the company has now free-handed power to control the surplus of the occupational pension fund. Then, what is the characteristics of such power in jurisprudential significance? If a trustee has such discretionary power, it is characterized as fiduciary power or trust power and he is obliged to act according to fiduciary duty. However, the power reserved for the company as a settlor in such a way is considered to be not fiduciary but rather personal power the holder of which may act considering primarily his own interest, even though it is deeply concerned with interests of the trust beneficiaries.

Today, not a few jurists criticize that the system of trust law itself is absolutely unsuitable for furthering the purpose of the pension scheme to secure the pensioners' lives after their retirement and it deters the potential conflict of interests between pensioners and company from being realized under the guise of 'co-operation and reliance.' In fact, recently we see some propositions to insist comprehensive and statutory system should take place for the old 'medieval' system of trust law(2). But, others say that trust law is basically useful for the framework of the pension scheme in the view of the flexibility and the fiduciary concept, however a certain statutory supplementation must be done to supervise effectively the opportunistic or abusive behavior of the company(3).

In any way, the extent being different, it is widely recognized that some reformation must be done especially to restrain the reserved power of the company on the pension fund management. Recent cases also indicate a certain clear inclination to limit the function of freedom of trust doctrine and to further the certainty of the right of pensioners in the fund.

2 CASES AND ANALYSIS

As said above, the courts do not hesitate to intervene the content of trust deed or shceme rule when they find some unilateral behaviour of the campany, and to impose more heightened standard of duty than that of mere 'personal power' to the reserved power for the company on the management of the pension fund. Among those, especially important are the followings ;

(1) Re Courage Group's Pension Schemes, [1987] 1 All ER 528, which employs the doctrine of 'ultra vires'

(2) Mettoy Pension Trustees Ltd. v. Evans, [1991] 2 All ER 512, which imposes 'fiduciary duty' on the power of the company

(3) Imperial Group Pension Trust v. Imperial Tabacco Ltd., [1991] 2 All ER 597, which imposes 'good faith obligation' on the power of the company.

(1) Re Courage Group case

factual outline

So-called 'Imperial Group,' which had Imperial Brewing and Leisure Ltd. (IBL) as a core subsidiary, had settled occupational pension schemes for the

(2) 'the Field Report' House of Commons, Session 1991-1992, Social Security Committee, Scond Report, The operation of Pension Funds, March 4, 1992, HC 61-11.

(3) This idea seems to be majority in the academic or legal practicioners' field. Latest governmental report [Pension Law Reform-The Report of the Pension Law Review Committee (chaired by prof. Roy Goode; Sep. 1993)] stands on this idea. see also, David Hayton, 'Trust Law and Occupational Pension Schemes', the Conveyancer and Propertv Lawyer (July-August, 1993), at 283-285.

employees of the companies belonging to the group. In the schemes, IBL had been described as a 'company' that could 'at any time' add, delete or vary the rules of the deed 'unless it alters the main purpose of the Fund,' while it was provided that the 'committee of management' 'shall concur' in the execution of the changed deed.

And the deed provided that in case that the 'company', i. e. IBL, 'shall be wound up for the purpose of reconstruction or amalgamation with any other company, the committee of management may make such arrangements and enter into such deeds and agreements as they may in their discretion think requisite for the substitution for the Company of such reconstructed or amalgamated company'.

In Feb. 1986, IBL changed the deed to close the scheme to new members in order to cope with the hostile tender offer Hanson Trust plc had then declared. However, in April of the year Hanson gained the controling ownership of Imperial Group. The surplus of the Imperial Group pension fund amounted to 80 million pounds at that time.

In Sep. of the year, Hanson agreed with Elders to sell the controling ownership of Imperial Group provided that Hanson should substitute for IBL as 'the company' and retain all the rights concerning the Imperial Group pension fund; amend the deed to transfer about 10 million pounds out of the surplus to new retirement pesion shceme to be created by Elders into which member-employees of the Imperial Group pension were to be encouraged to move; for member-employees who would stay in the old scheme, the fund enough to secure for pension payment to them would be left, however about 70 million pounds of surplus should be removed to use for Hanson/or reopen the then-closed scheme for employees of Hanson Group as new memebers.

According to this agreement, IBL management amended the substitution clause in the deed as following, in order to make it possible that Hanson could substitute for IBL even in this situation; 'If a Company holds directly or indirectly a controling interest in Imperial Group and decides that it should be 'the company' for the purposes of the Fund then the existing Company (IBL), the holding company and the Committee of Management shall enter into a Deed'.

And Hanson proposed the committee of management to execute this amendment of substitution clause.

Then the committee of management asked to the court whether it was obliged to execute this amendment or had discretion to do so or not.

[holding by Millett J.]

'In my judgment, the validity of a power of substitution depends on the circumstances in which it is capable of being exercised and the characteristics which must be posessed by the company capable of being substituted; while the validity of any purported exercise of such a power depends on the purpose for which the substitution is made. The circumstances must be such that substitution is necessary or at least expedient in order to preserve the scheme for those for whose benefit it was established; and the substituted company must be recognisably the successor to the business and workforce of the company for which it is to be substituted. It is not enough that it is a member of the same group as, or even that it is the holding company of, the company for which it is substituted. *It must have succeeded to all or much of the business of the former company and have taken over the employment of all or most of the former company's employees.*

In my judgment, the proposed power to substitute IBL's ultimate holding company for IBL *in undefined cicumstances* is far too wide, alters and is capable of defeating the main purpose of the schemes, and is *ultra vires.*

Even if this were not the case, I would not uphold the proposed exercise of the power. (between omitted) The whole object in substituting Hanson for IBL was to bring about a dissolution or partial dissolution of the schemes on the completion of the sale to Elders which would otherwise not occur.

The purpose of the amending deeds were frankly acknowledged by counsel for IBL to be "to retain within the control of Hanson a surplus which has been contributed by companies which Hanson has bought, and for which surplus Hanson has paid, rather than allow it to be transferred to Elders." That purpose is foreign to the purpose for which the power to amend the trust deeds and rules is confered, and invalidates any exercise of that power.

Accordingly, *I hold that the committee of management is not at liberty to execute the amending deeds by which Hanson is to be substituted for IBL.*' ([1987] 1 All ER 542, e-j. Italics in the sentense by the writer)

[comment]

In this case, trust deed didn't permit substitution of Hanson for IBL as the 'company', because even after take-over by Hanson IBL was not 'wound up' and IBL was not authorized the power to decide to substitute or not. So, Hanson, who desired to gain huge surplus of the pension fund, had IBL as 'the company' amend the subsitution clause itself in order to be 'the company' and then tried to amend further the deed by itself as 'the company'. But, the court held such amendment motivated by the ambition of such a temporary holding company just to take away the surplus of the fund didn't meet the requirement of the general amemdment clause not to infringe the main purpose of the scheme, and explained that this requirement meant to be the limitation of the capacity to amend the deed by the company, not just the standard of lawfulness. In that sense, too general and ill-motivated substitution clause was judged as beyond the capacity to amend of the company, i. e. ultra vires.

Indeed theory of 'ultra vires' seems to be very strong doctrine to keep the pensioner's right from such an opportunistic behavior of the company. This may represent the willingness of the court to recover legal justice and to give warning to those who indulge their own benefit under the name of trust.

However, under the ultra vires theory, while the effect is very drastic, i. e. absolutely invalid, the requisite depends upon the broad interpretation of the words of 'purpose' which is not necessarily clear. In another word, the requisite is unproportionate vague to the gravity of the effect. So, generally speaking, this theory may not be suitable for judging the actions of business organization in which not a few interested parties are involved. And although occupational pension scheme is in a sense an organization for furthering social interests, at the same time it plays very important role in the capital market as an institutional investor i. e. business organization. Further, it is deeply involved in the interests of the company because it is a private pension settled by the company. So, generally, especially in the time when the company's performance is very good, interests of both are likely to be coincide.

Considering all said above, I think this case can be hardly precedent.

(2) Mettoy case
factual outline

In 1969, Mettoy Co. plc, settled the pesion scheme for its employees, and in the trust deed was included a general amendment clause as following ; 'The principal Company and the Trustees may jointly from time to time without the consent of the members by Deed alter, cancel, modify or add to any of the provisions of this Deed' provided that this amendment shall not change the purpose of the Pension Fund. And it also included a clause that provided when the Mettoy would come into liquidation and no successor of the business would substitute, this pension scheme should be wound up; and in winding up, in case of existenece of surplus, the trustee should decide whether and how much to rise up the pension to be paid out of the surplus or to return it to the company.

However, in 1980, the Mettoy Pension Trustees Ltd. was substituted for the former individual trustees, and Mettoy and Mettoy Pension Trustees jointly amended the trust deed, especially the winding-up clause as following ; 'Any surplus of the trust fund remaining after securing all the aforesaid liabilities in full may *at the absolute discretion of the Employer* (Mettoy) be applied to secure further benefits within the limits stated in the Rules, and any further balance thereafter remaining shall be properly apportioned amongst the Principal Employer (Mettoy) and each Participating Employer and shall be paid to them in cash.'

During 1983, Mettoy fell into severe financial crisis, and in Jan. of the next year compulsory winding up order was made by the court. At the same time, the pension shceme came into winding—up process, then the fund had about 9 million pounds of surplus.

Mettoy Pension Trustees applied originating summons seeking the determination of the court as to how the surplus of the fund ought to be administered. The questions were (a) is the discretion conferred on the Mettoy company to rise up the pension or not in the new amended deed (1980) a fiduciary power? (b) if so, can the liquidator of the insolvent company exercise this discretional power or not?

[holding by Warner J.]

concerning (a)

'I have come to the conclusion that the discretion conferred on the employer by the new amended deed is *a fiduciary power in the full sense.*

The considerations that have led me to that conclusion are these. If that discretion is not such a fiduciary power it is, from the point of view of the beneficiaries under the scheme, illusory. As I have pointed out, the words conferring the power mean no more, on that construction of them, than that the employer is free to make gifts to those beneficiaries out of property of which it is the absolute beneficial owner, so that at best those words amount to "a true but pointless assertion". If the employer were acquired by a "take over raider", there would be nothing whatever to prevent that raider from rendering itself entitled to the entire surplus.'

concerning (b)

'It (discretional power to decide of surplus) cannot in my opinion become exercisable by a liquidator of the company. (between omitted) However, *the liquidator in this case would be precluded from exercising the power because, if he did so, he would be in a position where his duties conflicted.* As trustee of the power he would be under a duty to hold the balance between the interests of the beneficiaries under the pension scheme and the interests of the persons entitled to share in the assets of the company, namely its creditors and possibly contributories. As liquidator his duty would be to have regard primarily, if not exclusively, to the interests of the creditors and contributories.'

Who is to exercise that power?

'I was referred to a number of authorities on the circumstances in which the court may interfere with or give directions as to the exercise of discretions vested in trustees.' ([1991] 2 All ER 547-548/Italics in the sentense by writer)

[comment]

This case is especially marked that the power traditionally considered to be personal could be trust power so as to be subject to fiduciary duty. Based on this Mettoy approach, all the retained power for the company might be thought to be fiduciary as long as it is concerned with the management of trust fund. However, as the range of this case, a commentator says; 'One should not interpret Mettoy as an indication that all employer powers will now be interpreted as fiduciary in nature. The reasoning which underlay the decision was Warner J.'s view that the members' rights to benefit from discretionary powers should not be "illusory". His interpretation was designed to ensure that these rights had some substance.'(4) This analysis seems to be persuasive.

And this case explained that because liquidator who succeeded the whole company stood in conflicts of interests both for creditors and for beneficiaries he could not exercise the trust power. But this case also says the substance of "fiduciary power in full sense" is that "the donee of it owes a duty to the objects of the power to consider, as and when may be appropriate, whether and if so how he ought to exercise it; and he is to some extent subject to the control of the courts in relation to its exercise." ([1991] 2 All ER 545, para. j) If the content of fiduciary duty is just 'to consider' like this, it is possible that at first the liquidator considers as a trustee in good faith, and as the result of deliberation he takes the surplus of the pension fund into the company assets liable for creditors. If so, the liquidator does not need to be always excluded from exercising trust power. In fact, in Icarus (Hertford) Limited v. Driscoll (4 Dec. 1989, [1990] 1 PLR 1), 'which is the case of almost identical facts as this Mettoy case, Aldous J. saw nothing wrong with fiduciary powers being exercised by the employer's receiver, provided the receiver acted in good faith. Good faith was no more than a procedual requirement.'(5)

In this way, the Mettoy case proposed that some drastic change was necessary in traditional perception of fiduciary duty, but it seems to have not succeeded as far.

(3) Imperial Group case
factual outline

Imperial Tabacco Ltd had an occupational pension scheme for the employees of the group companies (Imperial Group Pension Scheme). The management and control of the pension fund were committed to Committee of Management. And the trust deed included a general amendment clause, which read 'Committee of Management may at any time with the consent in the writing of the Company (Imperial Tabacco) alter or modify all or any of the trust or provisions of the Deed or of the Rules.'

In 1985, in defense against the harsh action of take-over by Hanson Trust, Imperial Tabacco and Committee of Management jointly amended the deed as following; first, this scheme should be closed to new members in the event of any person or company acquiring control of the company. second, a new rule of annual augmentation of the pension by the lessor of 5% or Index of Retail Prices (IRP) of the year was introduced.

In 1986, Hanson succeeded in taking over the Imperial Group and the pension scheme was closed. The surplus of the fund was counted to about 130 million pounds at that time.

Then Imperial Tabacco management taken by Hanson began to negotiate

(4) R. Nobles, 'Pensions, Employments, and the Law' (1993 Oxford) at p.89. He points out that if the Mettoy case be followed, 'it could change the balance of power in schmes. Those drafting schemes might have supposed that giving a power to the employer gave it greater powers than sharing the power between trustees and the employer or giving the power to the trustees alone. The interpretation in Mettoy collapses the differnece between trsutee and employer powers, and leaves the employer with greater control when it shares power with the trustees than when it seeks to exercise that power alone.'
(5) Id. at p.88

with Committee of Management about reopening the scheme to the new members. The Committee insisted to amend the annual augmentation rule to rise the up-rate, but the company refused to agree with that and the negotiation failed.

After that, the company settled a new retirement pension scheme for new employees and ruled that annual augmentation of pension to be paid after retirement by the lessor of 15% or IRP of the year was secured. And members of Imperial Group Pension were encouraged to move to the new scheme with their own shares of the fund.

At last, Committee of Management applied originating summons to the court asking for the judgement on whether a certain limitation should be imposed on the power of the company to reserve the consent to amendment proposition by the Committee of Management or not.

[holding by Sir Browne-Wilkinson]

'Pension benefits are part of the consideration which an employee receives in return for the rendering of his sevices. So, in my judgment, the scheme is established against the background of such employment and falls to be interpreted against that background.

In every contract of employment there is an implied term; that the employers will not, without reasonable and proper cause, conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee, i. e. implied obligation of good faith.

Construed against the background of the contract of employment, in my judgment *the pension trust deed and rules themselves are to be taken as being impliedly subject to the limitation that the rights and powers of the company can only be exercised in accordance with the implied obligation of good faith.*

In my judgment the obligation of good faith does require that the company should exercise its rights (a) with a view to the efficient running of the scheme established by the fund and (b) not for the collateral purpose of forcing the members to give up their accrued rights in the existing fund subject to this shceme.' ([1991] 2 All ER 605-607/Italics in the sentence by the writer)

Although the judge said that the facts have not been explored, he recognized, in the abscence of further explanation, the inference that only reason why Hanson refused the proposition by the Management Committee of the old pension scheme was the company's desire to transfer the surplus of the fund to the new scheme was fair. He held, if so, withholding consent to benefits-increasing out of the fund by the company was to breach the implied good faith obligation. ([1991] 2 All ER 608)

[comment]

The autstanding significance of this case is to recognize that the reserved power for the company should be subject to good faith obligation. The content of the obligation is actually the same as that of employment contract, but the judge emphasizes it is not of the contractual relationship but of the scheme rule or trust deed itself. And the motivation behind the exercise of the power by the company must be efficient running of the scheme, and reasons other than that make the action of the company breach of good faith obligation.

A commentator criticize the vagueness of this test; 'The Vice-Chancellor was clear that some entitlement was being undermined by the employer's use of powers, and that a general duty of good faith would prevent this, but never identified exactly what that entitlement was. As such, the case itself provides little guide as to how this duty will operate in future. (between omitted) The duty of good faith will allow the courts to articulate further restrictions of purpose, or to adopt a more ad hoc process, and simply intervene whenever the actions of an employer are considered so outrageous that they breach the duty of trust and confidence.'[6]

Indeed, because of this fault of vagueness, good faith approach could not be general standard for future cases.

3 CONCLUSION

As is clear in the analysis of the cases above, there is no clear theory to influence decisively the followings. It may be because of the focus to the duty theory by the courts. What is required as an urgent task is to make clear what are the pensioner's or deferred pensioner's rights clearly distinguished from the power of the company. However, the courts' approaches concentrating their efforts into considering how to interpret the deed or what kind of duty to control the company power seem to be destined to be ad hoc or, at best, vague. Of course, it may be the limitaion of the judiciary function ifself rather than failure of each court's decision.

So, from now on, the legislature should bear this burden of reforming and restructuring the system of occupational pension law comprehensively, taking some different aspects of legal policies on it into account. Indeed, as said above, the governmental report (R. Goode committee) points out the way toward the very direction. Though it is not yet clear when the task is fulfilled, we can expect to learn the integrated and unique 'occupational pension law' in the near future in U. K.

---

(6) Id. at p.94-95