UK Court of Appeal calms pension equalisation fears - the Foster Wheeler decision

Introduction

As we explained in our client alert of 9 July, the Court of Appeal issued its decision in the *Foster Wheeler* case about equalisation of pension benefits on 8 July 2009. The Court of Appeal overturned the original decision of the High Court.

The purpose of this fuller briefing on the case is to summarise in more detail the background to the Court of Appeal's decision and the key points arising from it.

Background

The case concerned the Foster Wheeler pension scheme – a defined benefit scheme which prior to the 1990 decision in *Barber v Guardian Royal Exchange* had a normal retirement age (**"NRA"**) of 60 for women and 65 for men. The *Barber* decision meant that, from 17 May 1990 onwards, men automatically started to accrue benefits which would be payable, as of right and without any actuarial reduction, from an NRA of 60.

The rules of the scheme were subsequently amended on 16 August 1993 so that a single NRA of 65 was imposed on both sexes for future service from that date. In other words, the scheme's "*Barber* window", which opened on 17 May 1990, was closed on 16 August 1993. This means that some members had built up pension entitlements, from different periods of pensionable service, by reference to NRAs of both 60 and 65. These members are referred to in the Court of Appeal's decision as "mixed NRA members".

The key question in the *Foster Wheeler* case was whether a mixed NRA member could, without employer consent, take the whole of his or her pension unreduced from age 60 (including the elements which had been earned by reference to an NRA of 65).

High Court decision

When the rules of the scheme were amended in 1993, a new early retirement rule (Rule 8(1)) was introduced for members retiring immediately on leaving pensionable service. It said:

> "*If a Member is not entitled to a pension under sub-Rule 7(1), he may, with the consent of the Company before Normal Retirement Date* [which was now 65] *and after his 50th birthday, elect to retire from Service and to receive an immediate pension of an annual amount calculated as in sub-Rule 17(3)(a) but then reduced by 0.5% for each complete month in the period from the Member's date of retirement to the Member's 60th birthday (Normal Retirement Date prior to 1st April 1990) or on such other basis as the Actuary certifies to the Trustees as being reasonable or the Trustees may from time to time introduce.*"

The High Court originally decided that:

- Mixed NRA members could not split their pension into two tranches (i.e. one tranche payable from 60 and the rest from 65).
- Mixed NRA members could take their whole pensions at 60, without employer consent.
- Rule 8(1) did not allow any part of a mixed NRA member's pension to be reduced for early receipt if it was paid at 60 or later.

The High Court's rationale was that *Barber* required the employer to consent to mixed NRA members drawing part of their benefits at 60, and that in practice this required the employer to consent to members drawing all their benefits on retirement at 60.

For reasons which were explained in its judgement, the High Court also concluded that the wording at the end of Rule 8(1) was not flexible enough to allow any part of the pension to be actuarially reduced by reference to an NRA of 65. (Although these reasons were not expressly overruled by the Court of Appeal, they now seem questionable in light of the Court of Appeal's ruling on how the courts should approach *Barber* issues in future).

The High Court decision would have given substantial windfalls to mixed NRA members and it would have had serious funding implications for the scheme and the sponsoring employer. The sponsoring employer therefore appealed to the Court of Appeal.

Court of Appeal decision

The Court of Appeal found in favour of the sponsoring employer, overturning the High Court decision. It said that, in giving substantial windfalls to mixed NRA members, the High Court had reached a conclusion which was unfair to the sponsoring employer and potentially unfair to other members. The Court of Appeal described the windfall element as a "fatal flaw" in the High Court decision.

The Court of Appeal decided that the right answer in the context of this particular scheme was to deal with early retirements by applying the deferred pension rule (Rule 17 - which had also been adopted in 1993), rather than Rule 8(1). In particular, Rule 17(5)(a) states that:

> *"A Member entitled to a deferred pension under sub-Rules 17(2) or 17 (3) may with the agreement of the Company, at any time ... after his 50th birthday and before Normal Retirement Date ... elect that, instead of that deferred pension, he shall be paid an immediate pension equal in amount to the deferred pension reduced by such amount (if any) as the Trustees shall determine being no more than the Actuary certifies to be reasonable to take into account of the earlier date on which the pension comes into payment."*

The Court of Appeal decided that, applying the *Barber* decision, the requirement for the company's agreement in Rule 17(5)(a) could be disapplied, so that a mixed NRA member aged 60 would be entitled to draw a single pension representing all his/her accrued benefits – but (crucially) with the benefits earned by reference to an NRA of 65 being subject to actuarial reduction for early payment.

Points of wider application

The Court of Appeal's decision in the *Foster Wheeler* case turned on the specific circumstances of the scheme, including some extremely unusual rules. But the following points can be taken from the decision as regards the approach a court is likely to adopt when faced with future cases about interpreting equalisation amendments:

- The only effect of European law on benefits is to impose an NRA of 60 for pension entitlements accrued during the "*Barber* window". A scheme should in general be treated as amended only to the extent necessary to make those rights effective. This principle of minimum interference with the scheme's provisions should be applied on the basis that minimum interference takes account of the substance and not simply the form of any notional amendment to the rules.
- When addressing these issues, it is right to compare possible options and consider in relation to any particular option whether the *Barber* rights can be given effect in some other way involving less interference with the rights of any party (again looking at the substance, not just the form). Whether a particular solution is appropriate in any given case will depend on the circumstances of the scheme in question.
- An option which involves members receiving a windfall benefit over and above what *Barber* itself requires is unlikely to satisfy the principle of "minimum interference".
- There was clear support from the Court of Appeal for the way many pension schemes dealt with equalisation in the 1990s – i.e. by introducing a single NRA for all members for future service, while allowing a mixed NRA member to draw their pension early as of right at the old (earlier) retirement age but actuarially reducing any part of the pension which was not earned by reference to the earlier retirement age.

- The concept of a scheme paying split pensions (i.e. separate pensions payable from each NRA respectively) is a possible alternative to paying the entire pension at once (but with an actuarial reduction for part). There is clearly nothing in tax law to prevent this split pension approach going forwards. However, in the context of the Foster Wheeler scheme's approach to equalisation, the Court of Appeal decided that proceeding on a split pension basis would have been inconsistent with the principle of "minimum interference".
- Now that the relevant principles have been fully explored, the Court of Appeal has said it expects that trustees and sponsoring employers should – except in rare cases – be able to address and resolve any residual equalisation issues without recourse to the courts.

Comment

A number of High Court judgements since 2006 hadconcluded, for a variety of reasons, that a pension scheme which thought it had closed the *Barber* window had actually failed to do so.

The Court of Appeal's decision in *Foster Wheeler* has effectively told the High Court not to reach that conclusion if there is a reasonable alternative which avoids giving a windfall to members. Of course there may be no alternative in some cases – for example if the scheme's rules have not been validly amended at all, or where the rule change was clearly intended to enhance members' benefits for the future.

But where there is a good case that a scheme's rules (as amended) have closed the *Barber* window, and where they were clearly meant to close it, the lower courts have now been told that that is the conclusion they should try to reach. The Court of Appeal's decision is a firm statement that it wants to see the recently-escaped equalisation genie put back in its bottle.

If you have any questions or require specific advice on any matter discussed in this briefing, please speak to your regular contact in the Pensions Group or contact:

Jonathan Moody
Partner
+44 20 3130 3042
jmoody@mayerbrown.com

Ian Wright
Partner
+44 20 3130 3417
iwright@mayerbrown.com

Mayer Brown is a leading global law firm with approximately 1,000 lawyers in the Americas, 300 in Asia and 500 in Europe. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest investment banks. We provide legal services in areas such as Supreme Court and appellate; litigation; corporate and securities; finance; real estate; tax; intellectual property; government and global trade; restructuring, bankruptcy and insolvency; and environmental.

OFFICE LOCATIONS AMERICAS: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, São Paulo, Washington
ASIA: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai
EUROPE: Berlin, Brussels, Cologne, Frankfurt, London, Paris

ALLIANCE LAW FIRMS Mexico, Jáuregui, Navarrete y Nader; Spain, Ramón & Cajal; Italy and Eastern Europe, Tonucci & Partners
Please visit our web site for comprehensive contact information for all Mayer Brown offices.
www.mayerbrown.com

0216pen
August 2009