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## RELEVANCE OF AVAILABILITY OF PENSION PROTECTION FUND ENTRY TO PENSION FUND TRUSTEES – THE “ILFORD” CASE

By Devi Shah, Richard Evans and Catherine Pedler

The High Court has ruled in *Independent Trustee Services Limited v Hope & others*<sup>1</sup> that a proposed arrangement which would have “selected against” the Pension Protection Fund would not be a proper exercise of pension trustee’s powers.

### Background

The Ilford pension scheme had a substantial deficit and an employer which was effectively insolvent. The scheme was likely in due course to enter a PPF assessment period after the employer had suffered a qualifying insolvency event. If the scheme fell into the PPF, the compensation which members would receive would be lower than their entitlements under the scheme. The members hardest-hit would be those below normal pension age at the start of the assessment period, who would receive only 90% of their entitlements and would be subject to the PPF annual cap, which, as at April 2009, equates to £28,742.69 per annum at age 65.

In a bid to minimise the adverse impact on members, the trustee came up with a creative proposal. Prior to the start of the PPF assessment period, the trustee would arrange a substantial buy-out of benefits, using a power in the scheme’s rules to effect the following arrangement:

- all benefits would be bought out for those members who were below normal pension age (and so would be hardest-hit under PPF rules); and

- there would be a partial buy-out for those members over normal pension age, to cover the expected shortfall between PPF compensation and their scheme entitlements.

The buy-out would improve the position of members, but would worsen the position of the PPF. The PPF would have to take on significant liabilities but almost all of the scheme’s assets would have been consumed by the buy-out.

The trustee was advised by a QC that it could not properly implement the proposal. However, certain members in the “hardest-hit” category (backed by a different QC) argued otherwise. The trustee therefore asked the Court for directions on the exercise of the buy-out power.

### The Court’s decision

In summary, the Court ruled that the proposed buy-out went beyond the purposes for which the buy-out power was intended, and therefore could not properly be effected.

The purpose of the buy-out power was to enable the trustee to buy an annuity using an amount of money “which fairly represented the benefits to which the member [was] entitled under the “scheme”, in other words a “fair share of the scheme assets”. The fair share limit was implicit in the rules, not as a matter of construction, but because it would be contrary



**Devi Shah** is a partner and **Catherine Pedler** is a senior associate in the Restructuring, Bankruptcy & Insolvency group and **Richard Evans** is a partner in the Pensions group at Mayer Brown International LLP.

<sup>1</sup> [2009] EWHC 2810 (Ch)

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to the purpose of the scheme to empower the trustee to apply a disproportionately large share of the assets in the purchase of benefits which were intended to be in substitution for those available under the scheme. The application of a disproportionately large share of assets for a partial buy-out would “in all normal circumstances” prejudice the remaining members who were not bought out.

The trustee had submitted that the purpose of the proposed buy-out was to “secure for members as high a proportion as is possible of the benefits that they were promised under the scheme”. The judge said that this might have been the reason behind the proposal, but it was not the purpose. The purpose was to apply a disproportionately large, and therefore unfair, share of the scheme assets in the purchase of buy-out policies. Therefore, the proposed buy-out would have breached the implicit “fair share” limit.

Of particular interest to the restructuring community, the Court further ruled that the availability of compensation under the PPF was not a relevant factor for the trustee to take into account when exercising the buy-out power. The judge did however acknowledge that, in certain contexts, it might be appropriate (or even necessary) for trustees to have regard to the safety net, depending on the context and purpose of the power which the trustees were proposing to exercise and the particular way in which the trustees wished to take the PPF into account.

In this case, the Court was satisfied that the trustee’s proposal represented a blatant attempt to undermine or circumvent the policy of the PPF legislation. Further, there was a strong public interest issue (with respect to funding of both the PPF and pension schemes generally) that mitigated against the proposal being upheld in this case. Accordingly, the court held that prospective PPF compensation was not a relevant factor for the trustee to take into account when exercising the buy-out power, because to take it into account would

be contrary to the clear legislative policy of the Pensions Act 2004 and, therefore, contrary to public policy. It followed that scheme rules could not properly be amended to permit or oblige the trustee to take account of PPF compensation when exercising its buy-out powers.

The judge made some non-binding comments about whether the PPF compensation rules could be squared with the EU Insolvency Directive, which requires member states to provide protection for pensions where an employer becomes insolvent. The judge said that a cap on compensation was not inherently inconsistent with the Directive. There was however a question as to whether the level at which the PPF cap had been pitched would, in all circumstances, comply with the Directive.

### Comment

The judge indicated with some force that it will not normally be appropriate for trustees to make decisions in reliance upon the existence of the PPF safety net. This may well influence trustees’ approach in their dealings with sponsoring employers where there is a prospect of the employer’s insolvency. However, the judgment did leave room for argument as to when it would be appropriate to take into account the existence of the PPF safety net, depending on the relevant context. The Court also rejected the idea that the PPF could be classed as a beneficiary or quasi-beneficiary of a pension scheme. Accordingly it would seem that trustees do not have a positive duty to consider the interests of the PPF – and the same must be true of employers.