HERBERT SMITH FREEHILLS

PENSIONS DISPUTES QUARTERLY

APRIL 2025

The last three months

Court approves scheme merger in winding-up, notwithstanding dilution of surplus

The High Court approved a proposal to merge pension schemes of failed retailer Arcadia.

Arcadia sponsored two defined benefit schemes: a Staff Scheme and an Executive Scheme. The two had always been run as "sister" schemes, with a view to achieving parity of funding.

In 2020 Arcadia went into administration, subsequently converted to liquidation. The schemes came to be wound up.

For many years the Staff Scheme had been thought to be less well-funded than the Executive Scheme. Therefore, on the basis of the "parity of funding" objective, the Staff Scheme had received the bulk of the available contributions and recoveries.

The position changed unexpectedly in 2022. The Staff Scheme was found to be better funded than its sister. When buy-ins were completed for both schemes in 2023, the Staff Scheme trustee was able to secure 100% of liabilities, but the Executive Scheme trustee was able to secure only 87%.

Although the Executive Scheme was underfunded, the Staff Scheme had a significant surplus, which the trustee could at its discretion use to augment members' benefits. If the schemes were merged, some surplus would remain, even after the Executive underfunding had been made good.

The trustees decided in principle to proceed with a merger, by means of a bulk transfer from the Executive Scheme to the Staff Scheme. As regards the Staff Scheme, two issues arose:

- The Scheme's rules did not permit transfers-in. However, the amendment power said that (where Arcadia was in liquidation) the trustees could amend the rules unilaterally, including during winding-up.
- A merger would reduce the surplus available for distribution to the Scheme's existing members.

On the application of the Staff Scheme trustee (not opposed by the representative beneficiary), the Court held as follows:

- **An amendment to enable the merger was within the scope of the amendment power**. On the face of it the amendment power was sufficiently wide, and there was no basis on which a fetter should be implied.
- **The proposed amendment would be a proper exercise of the trustee's powers**. The amendment did not undermine the main purpose of the Staff Scheme, and there was no overriding principle that all powers must be exercised in members' interests. The Court's conclusions as to purpose were informed by the close relationship between the two schemes; the "parity of funding" objective; and an objects clause in the Staff Scheme. The clause indicated that the main purpose of the Scheme was to provide the benefits specified in the rules, but not additional benefits by way of augmentation.
- **The trustee's in-principle decision as to the merger had been properly reached**. The trustee had managed conflicts of interest appropriately, and had considered relevant factors while ignoring the irrelevant. Relevant factors included the "parity of funding" objective. In the circumstances, there was a strong moral obligation to effect a merger. The trustee could properly take that into account.

Accordingly the Court confirmed that the proposed amendment was within the scope and purpose of the amendment power, and approved the trustee's proposed decisions as to amendment and merger.

FSCS compensation: claim for judicial review dismissed

The High Court dismissed a claim for judicial review in relation to the Financial Services Compensation Scheme (**FSCS**).

The claimants had lost money after transferring funds to self-invested personal pensions with high-risk investments.

In 2021 the FSCS paid the claimants compensation, calculated on a "monies in, monies out" basis in accordance with understanding of the law at the time. But shortly afterwards it became apparent from *Adams v Options UK* that compensation might be payable not only on a "monies in, monies out" basis, but also for other losses arising from transfer decisions. The claimants then lodged appeals against their compensation awards.

Over the following year, the FSCS decided how it should respond to *Adams* and, by stages, formulated and published a policy. In its final form, the policy was that:

- new claims, and claims underway on the date of the *Adams* judgment, would be assessed in the light of *Adams*; but
- claims which had been finally assessed before the judgment date would not be reopened, either proactively or on appeal, except where an appeal was underway on that date.

The claimants' appeals were not underway on the judgment date. In 2023, the FSCS notified the claimants that it would not be deciding the appeals, and that accordingly their claims were closed. The claimants applied for judicial review.

While expressing reservations about the FSCS's policy, the High Court held that:

- Although framed as a challenge to the FSCS's 2023 decisions, the claim in reality sought to challenge the policy on which the decisions were based. The policy had been formulated and communicated in 2022, but had not been challenged within the requisite period. It would be an abuse of process to allow the claim to proceed as an out-of-time collateral challenge to the policy.
- The way in which the FSCS had dealt with the claimants' appeals had not given rise to legitimate expectations of the sort which would confer substantive or procedural benefits. The FSCS had told the claimants that their appeals would be considered in the light of *Adams*, but had not said that any particular outcome would follow.

Virgin Media: ICAEW guidance

The Institute for Chartered Accountants in England and Wales published guidance on accounting considerations relating to the *Virgin Media* case.

The guidance outlines the different approaches which trustees, employers and auditors may adopt in the light of the case. It acknowledges the legal uncertainties and practical challenges.

Whilst the appropriate approach for a given party will depend on the circumstances, the guidance suggests that, where there is a potential *Virgin Media* issue, the following will commonly apply:

- The trustees will be information-gathering or may be taking a wait-and-see approach (based on legal advice); they will not necessarily have carried out detailed analysis.
- The employer will disclose the potential issue via the pensions note in its accounts.
- Provided that the employer makes an adequate disclosure, there is likely to be no impact on the auditors' report.

Other *Virgin Media* developments

An industry working group published an update on discussions with the Department for Work and Pensions about the *Virgin Media* case. The group has been lobbying the DWP for regulations to validate amendments which would otherwise be void on *Virgin Media* principles.

The Pensions Minister stated that the Government was "actively considering" its response to *Virgin Media*, but that no final decisions had been made.

Mirror-image promise: Ombudsman orders specific performance

The Pensions Ombudsman ruled in favour of a member who was persuaded by his employer to transfer from one scheme to another in 1998.

Rule 8.2 of the old scheme said that pensions in payment were to increase at such rate as the employer determined from time to time. The applicable rate in 1998 was RPI capped at 5% (**RPI 5**).

The employer told the member that benefits under the new scheme would be mirror-image. However, the rules of the new scheme did not provide for pension increases. The employer had unilateral power to amend the rules, but an amendment as to pension increases was never made.

The member left service shortly after the transfer, and retired in 2014. He was quoted, and initially received, a pension with increases of RPI 5.

In 2017 the trustees, noting that there was no pension increase provision in the rules and after obtaining counsel's opinion, told the member that he was not entitled to RPI 5, and embarked upon "correction". The member complained to the Ombudsman.

The Ombudsman ruled as follows:

- A contract had been formed between the member and the employer in relation to the transfer. Under the contract, the employer was obliged to procure mirror-image benefits, and to amend the rules of the new scheme accordingly. This was a continuing obligation.
- Although the transfer had taken place more than 25 years previously, the employer did not have a limitation defence. Time for these purposes did not start to run until 2017, when (via "correction") the employer had breached its continuing obligation. In any case, the appropriate remedy was specific performance (ie an order that the employer perform its contractual obligations), to which the Limitation Act does not apply.
- The trustees were themselves obliged to provide mirror-image increases on the transferred pension, by virtue of the transfer-in rule. There was extrinsic evidence that the trustees had exercised power under the rule, such that mirror-image increases applied.

- In practice "mirror-image increases" would be RPI 5, unless and until the employer amended the rules to include a counterpart to the old scheme's rule 8.2, and used that provision to determine an alternative basis for subsequent increases.
- The employer should amend the scheme's rules and/or augment the member's benefits, to give effect to its obligations.

Ombudsman's new operating model

The Pensions Ombudsman published an update on the new operating model outlined in previous editions of PDQ.

The update discusses the "lead case" approach, which the Ombudsman may adopt where an issue affects multiple members. The update also provides an example of a short-form expedited determination.

Elsewhere in the Courts

Class actions. The Court of Appeal refused to allow a securities claim, brought on behalf of pension schemes and others, to proceed as a representative action. We covered the case in a blog post. We also reported another case, in which the High Court refused to allow a representative action on the basis that that the "same interest" test was not met.

Mitigation and damages. The Court of Appeal considered the assessment of damages in a case involving negligence and breach of fiduciary duty. As explained in our commentary, the judgment discusses the circumstances in which benefits attained by a claimant following a breach are to be taken into account.

"Without prejudice" rule. The High Court rejected a claim that an audit report, produced for the purpose of settlement negotiations, was protected by the "without prejudice" rule. Our blog post provides details.

Privilege. Privilege was held to attach to a valuation report, produced with a view to mediation. We noted the flexible approach which the High Court adopted when applying the "dominant purpose" test.

Dispute resolution provisions. In a blog post, we discussed two cases in which the Courts considered conflicting dispute resolution provisions in reinsurance contracts.

Evidence of settlement. We discussed a High Court decision which suggests that evidence of a settlement with other parties will only be admitted if closely connected with the issues which the court needs to decide.

ADR. The High Court ordered the parties to a commercial dispute to mediate ahead of a proposed trial, even though the defendant felt there was no real prospect of settlement. The Court also ordered inspection of a document listed in a witness statement. Our summary can be found here.

Looking forwards

Validity of amendments – *Verity Trustees v Wood*

A case as to the validity of historic amendments to TPT (an industry-wide pension scheme) was heard by the High Court in February and March 2025. Among other things, the hearing covered questions arising from the *Virgin Media* case, including whether actuarial confirmation was required for "closure" amendments; whether an initially void amendment became valid when the actuary next recertified the scheme; and whether the Court can in principle assume that actuarial confirmation was obtained, in circumstances where evidence is lacking. Given the scale and complexity of the case, we expect that there will be a significant delay before judgment is handed down.

Pension Schemes Bill

The Government plans to publish the Pension Schemes Bill in May 2025.

Proposed measures, announced alongside the King's Speech, include provision for the Pensions Ombudsman to be a "competent court" for the purpose of recoupment of overpaid benefits.

Litigation funding

The Civil Justice Council is expected to complete its review of litigation funding by summer 2025, following publication of an interim report. The previous Government had proposed legislation as to litigation funding, following the Supreme Court's *PACCAR* decision. The current Government has said that it does not intend to re-introduce legislation until the Council's review is complete.

Key contacts

Samantha Brown
Managing Partner EPI (West)
London
T +44 20 7466 2249
samantha.brown@hsf.com

Antonia Pegden
Partner
London
T +44 20 7466 2530
antonia.pegden@hsf.com

Dan Saunders
Of Counsel
London
T +44 20 7466 2036
dan.saunders@hsf.com

Richard Evans
Knowledge Lawyer
London
T +44 20 7466 6320
richard.evans@hsf.com

For a full list of our global offices visit **HERBERTSMITHFREEHILLS.COM**