Good faith and then some? British Airways wins landmark case over trustees’ unilateral increase.

Those of you who have been doing your homework on trustees’ duties will note with interest the judgement handed down by the Court of Appeal earlier this month.

The ruling, for those who aren’t aware, was a final determination in the case of British Airways PLC (BA) versus Airways Pension Scheme Trustee Ltd. As is often the case with pension trustee matters, this one should be noted by AF1 and J02 students as well as those taking AF7, AF8, PETR or PTPA.

To paint the picture, BA closed the Airways Pension Scheme (APS) to new members as far back as 1984, when it was replaced by the New Airways Pension Scheme (NAPS). However, the scheme remained open for future accrual by existing members. The whole can of worms was opened in 2010, when then-Chancellor George Osborne, in his infinite wisdom, took the decision to switch statutory escalation, as determined by annual Pension Increase (Review) Orders, from RPI to CPI.

Whilst Pension Increase (Review) Orders apply specifically to public sector schemes, it is common practice for private sector defined benefit funds to mirror them and this one was no exception.As any level 6 pension student will know, this impacts scheme members in two ways. Firstly, the revaluation of benefits held by deferred members will be impacted. Secondly, the annual rate of escalation applied to pensioner members will also change. The move was opposed vigorously at the time by scheme members, who argued that CPI was not a realistic reflection of the increase in the cost of living.

Most of those reading this will be aware that CPI usually results in a lower figure for inflation. Whilst the oft-quoted line of RPI including housing costs, which CPI does not take into account, is correct, it is also something of a red herring. The real issue with CPI is that it is calculated as a geometric, as opposed to arithmetic, mean. This probably isn’t the place to go into the mechanics of geometric and arithmetic calculations. I mean, I’m sure you’ve all got work to do and I’d rather not send you all to sleep. Because let’s face it, maths is so boring, right? But the upshot is that in the words of the treasury:

*“The CPI annual rate would typically have been about 0.5 percentage points higher if the elementary aggregates had been calculated using arithmetic means as in the RPI”.*

In other words, using the geometrical as opposed to arithmetic method results in an average annual increase of 0.5% less. To put that into context, let’s assume a constant RPI of 2.5% and CPI of 2%. Picture a 40-year-old with preserved benefits of £25,000 per annum and a scheme NRD of 65. By the time our jolly approaching-middle-age chap or chapess comes to retire, his benefits would be worth £41,015.15 per annum under CPI revaluation, as opposed to an RPI figure of £46,348.60. A difference of approximately 13%. Worth getting all hot and bothered above, right? Plus, this is before taking into account that some observers estimate the CPI/RPI discrepancy to be more like a whole 1%.

Whilst I somewhat digress, to get back to the matter at hand, in 2011, the Airways Pension Scheme trustees took it upon themselves to use the scheme’s power of amendment and amend the scheme rules. Unusually in this instance, the power did not require the consent of BA as a sponsoring employer. The rule change conferred on the trustees the power to grant discretionary increases. As with most boring administrative matters, the change went largely unnoticed until the 2013/14 tax year when the trustees actually decided to make use of it. Said use involved the award of a discretionary increase of 0.2% above CPI. This covered approximately half of the gap between CPI and RPI for that particular year.

The court case concerned a challenge by BA to the trustee’s right to make such a decision. Figures, right? Much as most of us would love for our employer to be forced to give us a pay risk without their consent, a lot of companies would be fairly swiftly out of business. BA, somewhat unsurprisingly, were unhappy at the decision, stating that it was inappropriate at a time when the company had agreed to make deficit repair contributions in lieu of paying dividends.

Perhaps the most interesting thing about this case is that the wigs can’t even seem to agree amongst themselves. In the original challenge, Justice Paul Morgan refused BA’s claim that the trustees had acted improperly. Essentially, the honourable Mr Morgan stated that if it was intended that trustees could not use the power to award discretionary increases to members then this would have been written into the trust. It was noted that the burden of proof fell on BA to show that the trustees had not acted properly and considered all relevant factors and advice when making their decision. It was considered that they could not prove such.

In the latest instalment, Lord Justice Kim Lewison and Lord Justice Peter Jackson, against the dissenting Lord Justice Nicholas Patten, took the opposite view. BA was originally granted leave to appeal Mr Morgan’s judgement on two grounds. Firstly that the 2013 discretionary increase breached the prohibition in clause 2 of the Scheme trust deed on making “benevolent or compassionate” payments. Secondly that the Trustees, by arrogating to themselves the role of setting the amount of the pensions to be paid, had acted for an improper purpose.

Whilst the Court of Appeal dismissed the first contention, in summary, heavy emphasis was placed on clause 4 of the trust deed, which stated that the trustees “shall manage and administer the Scheme and shall have power to perform all acts incidental or conducive to such management and administration”. This persuaded Messrs Lewison and Jackson that “the function of the trustees is to manage and administer the scheme; not to design it”. In essence, that the trustees are supposed to be the policemen and not the politicians.

The amount at stake is a drop in the ocean to the likes of BA, a mere £12m, though the legal costs are likely to add a substantial chunk to that. The contested power to award discretionary increases has not been used again since the legal proceedings began. Nonetheless, the ramifications of the ruling, for BA and other sponsoring employers, in terms of future risk management and profitability could be huge. That said, the trustees have been granted leave to appeal to the Supreme Court. We may not have heard the last of this one.