Pension-fund trusts are an area which is of great importance but is not covered in all Equity and Trust modules. We include three questions here as an additional resource for those students who wish to pursue the study of this topic.

Introduction

For trusts lawyers, both professional and academic, pension funds are an area of increasing importance and interest, not to mention their high profile in the political and economic arenas. Most pension-fund trusts are created by an employer (which it is here convenient to call 'the company') with separate trustees who hold the fund upon trust to pay pensions to retired employees in accordance with each employee's contractual entitlement. Under some schemes (non-contributory schemes) the whole fund is provided by the company alone; but many schemes are contributory in that the employees also make contributions of a specified amount.

Most of these funds take the form of a trust, and there are two principal reasons for this. First, the trust enables the assets of the pension fund to be distinguished from those of the company. This offers some safeguards against an unscrupulous company and makes it more difficult (though, as the Robert Maxwell saga revealed, not impossible) for the company to treat the pension fund as its own property. Secondly, very important tax exemptions are available to pension funds, but only to those which exist in the form of an irrevocable trust. The Maxwell scandal led to a review of the law relating to pension funds, and to the introduction of special rules to regulate them in the **Pensions Act 1995**. This Act set up a regulatory authority with supervisory powers over trustees of pension funds, it introduced minimum funding requirements and restrictions on a company's receipt of surplus while a scheme is ongoing and it requires one-third of the trustees to be member-nominated trustees. The **Pensions Act 2004** further strengthened the legislative protection by replacing the minimum funding rules with a more flexible scheme, by setting up the Pensions Protection Fund and by creating the office of the Pensions Regulator. It also permits the proportion of member-trustees to be increased, by regulation, to one-half: **Pensions Act 2004**, **s. 243**.

Pension funds increasingly feature in courses on equity and trusts. In the context of trusts law, it is possible to identify three important areas: the extent to which the law of trusts is developing special rules for pension funds; the beneficial ownership of a surplus; and the control of the exercise of powers under a pension fund. Each of these areas is covered by one of the three questions and answers in this chapter.

Useful discussions of pension funds generally are to be found in the following books: Parker and Mellows, *The Modern Law of Trusts* (A. J. Oakley, ed.) 9th edn, Sweet & Maxwell, 2008; Hayton and Mitchell, *Hayton and Marshall: Cases and Commentary on the Law of Trusts and Equitable Remedies*, 13th edn, Sweet & Maxwell, 2010.

Question 1

To what extent is the law of trusts developing a distinct set of principles for pension-fund trusts?

Commentary

The question raises interesting issues and admits of no definite answer. As with many essay-style questions, it is for the candidates to create their own structures for their answers. The suggested answer examines three ways in which pension-fund trusts tend to differ from the traditional family trust (the number of beneficiaries, the large size of their investments and their contractual nature). It then considers the question in relation to each of them in turn.

Answer plan

- Large number of beneficiaries
  - potential problem: uncertainty of objects
  - judicial response: ***McPhail* v *Doulton***

- Large size of many pension funds: cf. large charitable trusts
  - potential problem: unduly restrictive investment clause
  - judicial response: ***Mason* v *Farbrother***
- Essential contractual nature
  - potential problem: adequate control of powers
  - judicial response: ***Mettoy*** case; ***Imperial Group Pension Trust***; ***Wilson* v *Law Debenture Trust***

Suggested answer

Although pension funds normally adopt the trust form, they differ in a number of ways from family trusts. One important difference is in the sheer number of beneficiaries: a family trust is likely to have a small range of beneficiaries, whereas under a pension fund the beneficiaries may be reckoned in the hundreds of thousands. The House of Lords in ***McPhail* v *Doulton* [1971] AC 424** recognised the need for trust law (which was largely developed in the context of family trusts) to adapt to take account of the modern large-scale trusts for the benefit of employees. This it did by discarding the 'complete list' test for discretionary trusts. It appears that the House of Lords intended its decision to be of general application, and not to be restricted to pension-fund trusts.

It is therefore evident that the growth in pension-fund trusts has had an impact upon the general law of trusts. What is more difficult to ascertain is the extent to which the law of trusts is developing, or ought to develop. rules of special application to these pension-fund trusts. In addition to the large number of beneficiaries, there are other elements which distinguish such trusts from family trusts. Thus some pension-fund trusts contain many millions of pounds—far larger than the majority of family trusts. In the context of trustees' investment policy, Megarry V-C in ***Cowan* v *Scargill* [1985] Ch 270** saw no reason to hold that different principles should be applied to pension-fund trusts from those which apply to other trusts. In contrast to this, in ***Mason* v *Farbrother* [1983] 2 All ER 1078**, the judge considered that the very size of the pension fund involved (£127 million) meant that it had 'something of a public element in it'. He treated this as a special circumstance justifying the court's sanctioning an extension of the trustees' investment powers under the **Trustee Act 1925**, **s. 57**, beyond that permitted under the general law at that time. (The courts showed a similar willingness to permit a widening of the investment powers of trustees of very large charitable trusts: see ***Trustees of the British Museum* v *A-G* [1984] 1 WLR 418** and ***Steel* v *Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167**.) The **Pensions Act 1995**, **s. 34(1)**, gave trustees of an occupational pension scheme the same powers of investment as if they were entitled to the assets absolutely; and similarly wide powers were conferred on trustees of other trusts by the **Trustee Act 2000**, **s. 3(1)**. Future applications to the court are therefore more likely to comprise attempts to have restrictions on investment imposed by the trust instrument removed. It remains to be seen if the courts will adopt a different approach for pension-fund trusts in these circumstances.

Most important of all, perhaps, is the fact that the beneficiaries of pension-fund trusts (unlike the majority of beneficiaries under family trusts) are not volunteers but provide consideration for their benefits. This was first acknowledged judicially in ***Kerr* v *British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071** and has been accepted in subsequent cases, notably ***Mettoy Pension Trustees* v *Evans* [1990] 1 WLR 1587** and ***Davis* v *Richards & Wallington Industries Ltd* [1990] 1 WLR 1511**. The consideration may take the form of direct contributions to the fund; but even if the fund is non-contributory, the employees can be treated as furnishing consideration by working for the company in the expectation that they will eventually receive a pension from the fund. Indeed, pensions are sometimes considered to be a form of deferred remuneration. Since the employees in a pension fund provide commercial consideration for their benefits, a pension-fund trust is therefore an example of a commercial (or at least a quasi-commercial) trust, in contradistinction to the traditional family trust, which is essentially a creature of the settlor's bounty. It appears, however, that the underlying contractual basis of a pension fund does not itself preclude the employees from being entitled to any surplus by way of resulting trust: ***Davis* v *Richards & Wallington Industries Ltd***.

It was the contractual nature of the employees' rights that impressed Warner J in the ***Mettoy*** case that the power to appoint the surplus, although vested in the company rather than the trustees, was a fiduciary power rather than a personal power. Furthermore, as the company was in liquidation and there was nobody who could exercise that power (a position since modified by the **Pensions Act 1995**, **s. 25**), it was appropriate for the court to exercise it in the most appropriate manner. There is no comparable instance of the court's executing a fiduciary power in the context of a family trust. At first sight, ***Klug* v *Klug* [1918] 2 Ch 67**, may appear to run counter to this view. In that case, which involved a family trust, one of two trustees (the Public Trustee) wished to exercise the power of advancement in favour of the beneficiary in remainder, but the other trustee objected on grounds which indicated that she had taken improper considerations into account. The court ordered the advancement to be made. It is arguable, however, that the court was not exercising the discretion itself, but was merely giving effect to the wishes of the untainted trustee. The remedy in the ***Mettoy*** case may therefore, in practice, be available only in the peculiar circumstances of a pension-fund trust.

There is now implicit judicial recognition that established principles of trust law are inadequate to control the exercise of all powers under a pension fund. Thus it is evident that not all powers exercisable under a trust can be fiduciary powers, so that equity is powerless to intervene. New duties in relation to the exercise of powers under a pension-fund trust are therefore being imported from the law of contract. Thus, the employee's right to have the pension fund properly managed, and the correlative duties imposed on those with powers in relation to the fund, are being treated as derived from the employee's contract of employment: see particularly ***Imperial Group Pension Trust Ltd* v *Imperial Tobacco Ltd* [1991] 1 WLR 589**. Since it is equity which traditionally fills the gaps left in the common law, this might be considered a reversal of roles! It appears, however, that the courts are unwilling to permit the commercial nature of a pension-fund trust to justify a departure from the general rule of trust law, that a beneficiary is not entitled to see documents which reveal the reasons for the exercise of the trustees' discretion: see ***Wilson* v *Law Debenture Trust Corp.* [1995] 2 All ER 337**.

Question 2

In the absence of an express indication in the trust deed establishing a pension fund or the exercise of any power to deal with surplus funds, it is difficult to ascertain who is beneficially entitled to any surplus that arises. This is largely the fault of trust law itself.

Discuss.

Commentary

The question deals with an important aspect of pension-fund trusts: the ownership, subject to any appointment, of any surplus. 'Surplus' means the amount by which the value of the trust's assets exceed its actuarial liabilities. The liabilities are the payments which the fund needs to make to satisfy the contractual entitlements of its pensioner-beneficiaries, these being retired employees currently receiving a pension, and present employees when they eventually retire. So long as the pension-fund trust continues, the surplus is merely actuarial. There is no actual surplus until the trust is wound up, which may occur if the company which created it is taken over or is dissolved on insolvency.

Surpluses began to be amassed in the 1980s, largely owing to higher than expected interest rates and redundancies, which reduced the anticipated demands on the funds. To combat this, the **Finance Act 1986** imposed a ceiling on the permitted size of surpluses, so that schemes which operated with excessive surpluses lost the tax advantages. If the company which set up and (at least partly) funded the scheme was beneficially entitled to a large surplus, it could become a target of a 'corporate raid', i.e., an attempted takeover by another company seeking to get its hands on the surplus funds. For primarily these reasons, the issue of the application of surplus funds came to prominence in the 1990s, and, in view of the recession and insolvencies of that period and beyond, seems likely to remain important.

Answer plan

- Introduction
  - significance of determining beneficial ownership
- Theories
  - overfunding by company
  - resulting trust
- Conclusion
  - more meaningful to consider how surplus is applied

Suggested answer

The need to identify the beneficial ownership in a pension-fund surplus can arise in two sets of circumstances: where the pension fund is continuing, and where it is wound up (which may occur when the company which established it is dissolved or taken over). The trust instrument may specify how, in either event, any surplus is to be applied. Most instruments, however, in order to retain flexibility, do not. Instead, most confer a variety of powers (either on the trustees or the company) to enable them to deal with the surplus. Since, however, the exercise of a power is necessarily discretionary, it is important to ascertain who is entitled to the surplus should there be no exercise of the power, i.e., to ascertain who has a beneficial interest subject to defeasance.

Identifying such beneficial ownership can be difficult, and the **Pensions Act 1995** does not provide a solution. Superficially, it might appear that the law of trusts is to blame, since most pension funds (in order both to create funds distinct from the company's own assets and to take advantage of various tax exemptions) are created as trusts; and, on the recent occasions when the courts have applied principles of trust law, there has been no consistency of result. A deeper analysis, however, suggests that the uncertainties are not wholly a result of trust law, but arise also from the nature of pension funds themselves.

In ***Re Courage Group Pension Schemes* [1987] 1 WLR 495**, Millett J noted that, under most pension schemes, the employees cannot be asked to increase their contributions, even if the fund is in deficit, and it will be the company which must make good any shortfall. Any surplus is therefore to be treated as the result of overfunding by the company alone, and so would appear to belong (so far as not appointed) to the company beneficially.

A different view, however, was taken in ***Mettoy Pension Trustees Ltd* v *Evans* [1990] 1 WLR 1587**. There, Warner J thought that, if the company were effectively at liberty to apply the surplus in any way it wished, it was difficult to appreciate why the trust instrument should expressly give it a power to do something it was in any event entitled to do: namely, to apply the surplus to the benefit of the employee-objects. Warner J's judgment seems, therefore, to proceed on the basis that, subject to the exercise of any power of appointment, the surplus belonged beneficially to the employees.

Only a few weeks after judgment was delivered in ***Mettoy***, the court was again asked to rule on the application of a surplus in ***Davis* v *Richards & Wallington Industries Ltd* [1990] 1 WLR 1511**. It is therefore not surprising that ***Mettoy*** was not cited in the later case, where Scott J adopted a different approach. Here, the pension scheme had been wound up with a surplus of £3 million. Contributions to it were derived from three sources: the company, the employees and other companies' pension schemes which had joined and whose assets had been transferred (the transferred funds). The scheme had in fact been amended to enable the surplus to be applied to the employees; but the court was asked to decide (*inter alia*) how, in the absence of the valid exercise of such power, the surplus should be held.

Scott J decided that, in the absence of any indication in the trust instrument, there was a presumption that the surplus was held on a resulting trust for those who had contributed to it. He did not think that the fact that the contributions from all sources had a contractual origin under the pension scheme was itself sufficient to exclude any claim under a resulting trust. Under this particular scheme, the company had been required to contribute whatever sums were necessary to enable the trustees to maintain the benefits. The benefits should therefore be treated as having been funded first by the employees' contributions and by the transferred funds, and only secondly by the company's contributions. It was therefore logical to treat the surplus as being provided first by the company's contributions. In effect, the company had made an overpayment, and thereby acquired an equitable right to its repayment; and the device whereby such repayment was effected was the resulting trust. The practical result of this approach (which was similar to that adopted in ***Re Courage***) was that the company was entitled to the entire surplus.

Scott J also rejected any claim under a resulting trust by the employees or the trustees of the transferred funds. He gave two reasons. First, the value of the benefits would be different for each employee, depending upon when he joined and how old he was when he left. A resulting trust was unworkable as between the employees, and the court would not impute to the employees an intention that would lead to such a result. Secondly, the scheme was established to take advantage of various tax exemptions, and the relevant legislation placed a ceiling on the amounts that could be returned to employees. A resulting trust for the employees would have breached these requirements, and equity would not therefore impute an intention to the employees that any part of the surplus derived from their contributions should be returned to them under a resulting trust. A resulting trust of the transferred funds was rejected on similar grounds. Scott J therefore held that any part of the surplus derived from either of these two sources was to devolve as *bona vacantia*.

In ***Air Jamaica Ltd* v *Charlton* [1999] 1 WLR 1399**, at p. 1412, however, Lord Millett, giving the advice of the Privy Council, expressed the view that Scott J's reasoning in the ***Davis*** case was erroneous. Lord Millett said that evidence that the employees did not intend to retain a beneficial interest could not prevent them having an interest under a resulting trust.

There is, therefore, a conflict of authority as to where, subject to the exercise of any power of appointment, the beneficial interest in any surplus in fact lies. Where the pension fund is wound up, the allocation of a surplus will usually be determined by the exercise of a power, and it has been held that the mere fact that a surplus on winding up might be attributable to overpayments by the company is not a sufficient reason for the trustees to refuse to exercise the power so as to allow the surplus to go to the company: ***Thrells Ltd (1974) Pension Scheme* v *Peter Lomas* [1992] PLR 1**.

Where the pension fund is still continuing, any surplus is merely actuarial: the extent of the surplus depends upon which of a variety of methods of calculation the actuary employs, and there can be no certainty that the surplus will continue or that it will not, in a future year, turn into a loss. It may therefore be inappropriate to seek to identify the ownership of a surplus in a continuing fund. There is much to be said for Knox J's observation in ***Re London Regional Transport Pension Fund Trust Co. Ltd* (1993) *The Times*, 20 May** that 'the question of whether a continuing fund is in surplus or in deficit cannot be answered with any precision, … and the concept of ownership of a surplus is even more uncertain than that of ownership of the fund as a whole.'

In practice, the issue before the court tends not to be the abstract question of who owns a surplus, but the rather more concrete problem of construction of the trust instrument consistently with the **Pensions Act 1995** and other statutory provisions. The issue then resolves itself into determining whether the trust instrument authorises, or can be amended to authorise, the application of the surplus in the way proposed. As was said by the Court of Appeal in ***National Grid Co.* v *Mayes* [1999] PLR 37**, 'The solution lies within the terms of the scheme itself, and not within a world populated by competing philosophies as to the true nature and ownership of actuarial surplus.'

Question 3

Consider the extent to which the court can control the exercise of a power to appoint a surplus under a pension-fund trust.

Commentary

Most pension-fund trusts confer a variety of powers upon the trustees or the company (or the trustees with the consent of the company) to enable them to deal with any surplus. Examples of commonly found powers are: a power to amend the trust deed or the rules made under it in order to increase pensions or other benefits to the employees and pensioners beyond their contractual entitlements; a power to enable the company (and, more rarely, the employees) to take a 'contributions holiday' (i.e., to reduce or suspend its contributions to the fund in the event of there being an excessive surplus); and a power to make a payment out of the pension fund to the company. The power of the court to control the exercise of the power derives originally from equity, which means that the manner of the exercise of the power can be controlled only if it is a fiduciary power. Recent case law, however, has revealed the existence of duties derived from the law of contract. The suggested answer deals with duties of both types.

Answer plan

- Fiduciary power (power conferred on trustees)
  - relevant duties
- Trustees need not disclose reasons for decisions
- No-conflicts rule
  - effect of **Pensions Acts 1995** and **2004**
- Contractual duties
  - good faith

Suggested answer

If the power to appoint a surplus is vested in the trustees of the pension fund, it is inevitably a fiduciary power. In equity, the trustees of such a power must actively consider its exercise, must exercise it for its proper purpose, must consider fairly the respective claims of the objects of the power and must exclude any improper considerations.

The appointment of a surplus may be effected by the exercise of a power of amendment contained in the scheme itself. In ***Edge* v *Pensions Ombudsman* [2000] Ch 602**, the trustees had dealt with an actuarial surplus by exercising a power of amendment so as to reduce the contributions of employees and companies, to give additional service credit for members in service. Benefits for existing pensioners were not, however, increased, and some of these pensioners argued that, in exercising their discretion, the trustees had not acted impartially as between the different classes of beneficiaries. The Court of Appeal rejected this argument. The power to amend was a discretionary power, so that the decision of the trustees to prefer one class of beneficiaries to another could not be criticised. There being no evidence that the trustees had not exercised the power for its proper purpose, or that they had failed to give proper consideration to relevant matters or had not excluded from consideration irrelevant matters, there was nothing to indicate a breach of trust.

Even if the trustees of a pension fund have acted in breach of trust, as where they have taken improper considerations into account, it may be difficult for the beneficiaries to obtain evidence of such breach of trust. The problem is that it has been held that, like the beneficiaries under a family trust, the employee-beneficiaries cannot, in the absence of evidence of bad faith, compel the trustees to disclose the reasons for their decisions: ***Wilson* v *Law Debenture Corp.* [1995] 2 All ER 337**. In the view of Rattee J, the fact that the employees were not volunteers did not justify a departure from the general principles established in ***Re Londonderry's Settlement* [1965] Ch 918**. Sir Robert Walker, writing extra-judicially, has expressed cautious criticism of the decision in ***Wilson***, both because the rationale for the ***Londonderry*** principles may not apply to commercial trusts such as pension funds, and also because it runs counter to the trend in administrative law towards a general duty to give reasons for decisions: Walker, chapter 5 in *Trends in Contemporary Trust Law* (A. J. Oakley, ed.), Oxford University Press, 1996, at p. 131.

Trustees are under a duty to prevent putting themselves in a position where their duties as trustees conflicts with their personal interests. The no-conflicts rule would have the potential to prevent trustees of pension funds who are also members of the fund from benefiting from decisions they make as trustees, e.g., through a decision to increase pensions. The **Pensions Act 1995**, **s. 39**, however, has restricted the application of the rule, so that trustees are not subject to the rule merely because they exercise their powers as trustees in a manner that benefits, or might benefit, them as members of the scheme.

Generally, a power conferred, not on the trustees, but on a third party, would be construed as a non-fiduciary (i.e., a personal) power, with the result that the manner of its exercise (or non-exercise) would not be subject to equity's scrutiny. Were this construction to be applied to pension funds, then, where (as happened in the past) a power to apply surplus assets was conferred on the company that was not itself a trustee of the fund, equity would not be able to prevent the company from exercising (or from refraining from exercising) the power solely in order to benefit itself. In ***Mettoy Pension Trustees* v *Evans* [1990] 1 WLR 1587**, in rather special circumstances, Warner J treated the power vested in the company (which was not itself a trustee) as a fiduciary power. His Lordship was influenced by the fact that the beneficiaries under a pension fund are not volunteers, but provide consideration for their pensions, and they might be thought to have earned a right to have the company properly consider the exercise of the power in their favour. He also took into account the desirability of preventing a company's pension-fund surplus from being raided by another company in a takeover bid.

The specific problem considered (but circumvented) by the decision in ***Mettoy*** was addressed by the **Pensions Act 1995** (as amended by the **Pensions Act 2004**): where the company is insolvent (as it was in ***Mettoy***), any fiduciary powers vested in it are exercisable only by an independent trustee: **Pensions Act 1995** (as amended), **s. 25**. The same Act also dealt with the more general problem (highlighted by ***Mettoy***) of the company being in a position of conflict in relation to the exercise of a power. Thus, where there is an ongoing scheme, a power conferred on any person (including the company) to make payments to the company is exercisable only by the trustees: **Pensions Act 1995** (as amended), **s. 37(2)**, and only in compliance with proposals approved by the Revenue and designed to protect the members: **Pensions Act 1995** (as amended), **s. 37(4)**. A power vested in the company to take a contributions holiday, however, is not a power to make payments to the company, and so is not subject to these statutory safeguards.

The donee of a power under a pension scheme (whether himself a trustee of the fund or a third party) may owe duties to the employee-beneficiaries of the fund in relation to the exercise of that power which derive, not from equity (and so are not dependent upon the power's being construed as fiduciary), but rather from the common law: namely, the implied duties which arise by virtue of the contract of employment. These other duties (such as to act in good faith, and to exercise the power for its proper purpose and not for a collateral purpose) are similar to the particular duties which are imposed by equity on the donee of a fiduciary power. Provided these duties are fulfilled, there is no conflict in the exercise of the power resulting in a benefit to the donee of the power.

Thus in ***Imperial Group Pension Trust Ltd* v *Imperial Tobacco Ltd* [1991] 1 WLR 589**, Browne-Wilkinson V-C held that, as the employee-beneficiaries were not volunteers, the company's power to withhold consent to an amendment to a pension scheme had to be exercised in good faith. The company was not entitled to use its power to induce members to transfer to a new scheme. The duty of good faith implied into the contract of employment itself was therefore to be implied into the contract underlying the pension-fund trust. Similarly, in ***British Coal Corporation* v *British Coal Superannuation Scheme Trustees Ltd* [1995] 1 All ER 912**, Vinelott J stated that a company with a power to amend its pension scheme must exercise the power so as to fulfil the legitimate expectations of the members and pensioners; but, provided it does so, it may exercise the power so as to reduce or suspend its own contributions.

The emergence of these duties is not, however, without problems: since the duties are necessarily expressed in general terms, there may be practical difficulties for the company to know whether it is doing what is necessary to comply with them, particularly where the fund is still continuing so that the surplus is purely actuarial.

Further reading

Hayton, D., ‘Pension trusts and traditional trusts: drastically different species of trusts’ [2005] Conv 229.

Moffatt, G., ‘Pension funds: a fragmentation of trust law?’ (1993) 56 MLR 471.

Nobles, R., ‘Don’t trust the trustee’ (1990) 53 MLR 377.

Nobles, R., ‘The exercise of trustees’ discretion under a pension scheme’ [1992] Journal of Business Law 261.

Pittaway I., ‘Pension funds: is a separate branch of trust law evolving?’ (1990) 4 Trust Law & Practice 156.

Scott of Foscote, Lord ‘The fetters in trustees’ discretions’ (2002) 16 TLI 214.

Walker, Sir Robert, ‘Some trust principles in the pensions context’, in *Trends in Contemporary Trust Law* (A. J. Oakley, ed.), Oxford University Press, 1996, chapter 5.