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Case No: A3/2017/1684

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
MORGAN J
[2017] EWHC 1191 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 5 July 2018

Before :

LORD JUSTICE PATTEN
LORD JUSTICE LEWISON
and
LORD JUSTICE PETER JACKSON

Between :

BRITISH AIRWAYS PLC

**Appellant/
Claimant**

- and -

AIRWAYS PENSION SCHEME TRUSTEE LIMITED

**Respondent/
Defendant**

Michael Tennet QC, Sebastian Allen and Michael Ashdown (Instructed by **Linklaters LLP**) for the **Appellant**
Keith Rowley QC, Jonathan Hilliard QC and Henry Day (Instructed by **Eversheds Sutherland International LLP**) for the **Respondent**

Hearing dates : 1 to 2 May 2018

Approved Judgment

Lord Justice Patten :

1. There are two principal issues on this appeal. The first is whether the Trustees of the Airways Pension Scheme (“APS”) validly exercised the power of amendment contained in clause 18 of the APS Trust Deed of 8 October 1948 (“the Trust Deed”) when they conferred on themselves a power to review and at their discretion increase the annual rate of pension payable under the APS beyond what would otherwise be permitted under Rule 15 of the APS Rules. The second issue is whether, assuming that the change in the Rules was validly made, the power created by the amendment to Rule 15 was validly exercised in November 2013 when it was used to grant an additional pension increase of 0.2% over and above the increase stipulated by the application of the Consumer Price Index (“CPI”). British Airways Plc (“BA”) which is the employer for the purposes of the APS and is required to fund the additional pension increase challenges both decisions as unlawful. Morgan J (see [2017] EWHC 1191 (Ch)) held that both the clause 18 power to amend and the Rule 15 power to increase the pensions payable had been validly exercised.
2. The APS is a balance of cost defined benefit scheme which was established in 1948 as the pension scheme for the employees of BA and its predecessors including British Overseas Airways Corporation, British European Airways Corporation and British South American Airways Corporation (together “the Corporations”) all of which were established as state owned corporations under the provisions of the Civil Aviation Act 1946 (“CAA 1946”). The Minister was required by s.20 CAA 1946 to make regulations setting up one or more pension schemes to provide “pensions and similar benefits” in respect of the service of employees of the Corporations including benefits in the case of injury or death and the public ownership of the Corporations was reflected in the requirement in clause 18 of the Trust Deed as originally executed that the power of the Management Trustees to amend the provisions of the Trust Deed should take effect subject to regulations made by the Minister under s.20 CAA 1946. Regulation 7 of the Airways Corporations (General Staff Pensions) Regulations 1948 (“the 1948 Regulations”) provided that no amendment of or addition to the Trust Deed should have effect unless confirmed by Regulations made under s.20. The consent of the Minister (by regulation) to any rule change was therefore mandatory.
3. The 1948 Regulations and CAA 1946 were subsequently amended so that the reference in regulation 7 to s.20 CAA 1946 had by 1971 become a reference to s.24 of the Air Corporations Act 1967 (“ACA 1967”). But in 1971 a significant change occurred when the Secretary of State (in exercise of the powers contained in s.24 ACA 1967) made the Air Corporations (General Staff, Pilots and Officers Pensions) (Amendment) (No. 2) Regulations which by regulation 3(1) removed the requirement under regulation 7 of the 1948 Regulations that any amendment or addition to the provisions of the Trust Deed was required to be confirmed by regulations made under s.24 ACA 1967. The only exception to this was in respect of an amendment which provided for the admission to the APS of the employees of a corporation whose employees had not previously been admitted as members: see regulation 3(2).
4. There have been a number of amendments to the Trust Deed and to the APS Rules including by the introduction in 1973 of what is now Part VI of the Rules which contain the provisions in Rule 15 for the adjustment of pensions and allowances. Rules 9-14 of the original Rules which were contained in the schedule to the Trust Deed set out by reference to the First Table to the Rules the pensions payable to

members based on their salary and contributions. Rule 28 provided that the Rules might be amended or added to in accordance with the provisions of the Trust Deed but there was no express provision in the original Rules for any pension increases and the evidence before the judge was that increases were occasionally granted on an *ex gratia* basis presumably by an *ad hoc* amendment to the APS under clause 18.

5. In April 2008 the Trustees prepared and approved a consolidated trust deed which contained the provisions of the original Trust Deed as amended up to 1 April 2008 together with Part VI of the Rules also as amended up to that date. Clause 23 of the consolidated Trust Deed (which I will continue to refer to as “the Trust Deed”) recorded the fact that the APS was closed to new members with effect from 31 March 1984 in advance of the privatisation of BA in 1987. The April 2008 version of the Trust Deed and the Rules remained current until the amendment to Rule 15 made on 25 March 2011 and the proceedings have been conducted on the basis that there were no material amendments to the APS between 1 April 2008 and that date.
6. As of 1 April 2008 the following were the most important and relevant provisions of the Trust Deed for the purposes of what we have to decide. The main object of the APS is set out in clause 2:

“The main object of the scheme is to provide pension benefits on retirement and a subsidiary object is to provide benefits in cases of injury or death for the staff of the Employers in accordance with the Rules. The scheme is not in any sense a benevolent scheme and no benevolent or compassionate payments can be made therefrom.”

7. In clause 3 each “Employer” covenants with the Trustees to pay “all contributions to be contributed by it and by members in its employment in accordance with the Rules”. By 1987 BA was the sole sponsoring employer under the APS.
8. The administration of the APS is carried out by the Trustees. At the time when the Rule 15 power was amended in March 2011 and subsequently exercised in 2013 the Management Trustees referred to in the Trust Deed were all individuals but they have subsequently been replaced by a corporate trustee which is the defendant and respondent to this appeal. Clause 4(a) provides:

“The Management Trustees shall manage and administer the scheme and shall have power to perform all acts incidental or conducive to such management and administration and the Custodian Trustees shall concur in and perform all acts necessary or expedient to enable the Management Trustees to exercise their powers of management or any other power or discretion vested in them accordingly for which purpose the Custodian Trustees shall have vested in them the power for and on behalf of and (if necessary) in the name of the Management Trustees to execute any deed or other instrument giving effect to the exercise by the Management Trustees of any power vested in them and the Custodian Trustees shall deal with the Fund and the income thereof as the Management Trustees shall from time to time direct and the Custodian Trustees shall be

under no liability otherwise than by recourse to the trust property vested in them for making any sale or investment of or otherwise dealing with the trust property and/or the income thereof as directed by the Management Trustees.”

9. The Management Trustees are given (under clause 4(b)) the usual powers to raise money together with the power (in clause 4(b)(ix)) to do all such other things as are “incidental or conducive to the attainment of the objects of the scheme or any of them”. Their powers of investment are set out in clause 6. Under clause 10 they must produce accounts made up to 31 March in each year and supply them to the auditor.
10. Clause 11 sets out the duties of the scheme actuary. He is appointed and removed by the Management Trustees with the consent of BA: see clause 8. The actuary is required to carry out actuarial calculations of the assets and liabilities of the APS fund at least every three years and to provide a report and recommendations to the Management Trustees: see clause 11(a). As part of this exercise he must certify the amount of any deficiency or disposable surplus:

“(b) if the Actuary certifies that a deficiency or disposable surplus as the case may be is attributable to an Employer he shall certify the amount thereof and the Management Trustees shall within three months after receiving such certificate make a scheme for making good the deficiency or as the case may require disposing of the disposable surplus PROVIDED THAT any such scheme shall be subject to the agreement of the Employer to which it applies or in default of agreement shall be referred to a Fellow of the Institute of Actuaries to be appointed in default of agreement on the application of either the Employer or the Management Trustees by the President for the time being of the Institute of Actuaries and shall come into force subject to such amendments (if any) as that Actuary may direct.

(c) If the Actuary certifies that there is a deficiency attributable to an Employer the scheme referred to in paragraph (b) above shall provide that the Employer shall contribute to the Fund in addition to any existing deficiency contribution payable under this clause and to the contributions prescribed by the Rules an equal annual deficiency contribution calculated to make good the deficiency over a period not exceeding forty years from the date of the valuation PROVIDED THAT an Employer may at any time or times pay to the fund such monies as the Employer shall think fit in or towards satisfaction of any deficiency contributions which it would otherwise have been liable to provide on any subsequent date or dates.

- (d) If the Actuary certifies that there is a disposable surplus attributable to an Employer the scheme referred to in paragraph (b) above shall provide that:-
 - (i) the amount or outstanding term of any existing annual deficiency contribution shall be reduced to such extent as the disposable surplus will permit
 - (ii) if after having extinguished as aforesaid all outstanding annual deficiency contributions of an Employer a balance of disposable surplus still remains the contributions of the Employer shall be reduced to an extent required to dispose of such balance by annual amounts over such a period not exceeding 30 years from the date of the valuation as the Actuary shall advise.”
- 11. Under clause 13 the Management Trustees have full power to determine the entitlement of any person to any pension benefit from the fund and all matters, questions and disputes touching or in connection with the affairs of the APS. There is an arbitration clause in relation to disputes about pension entitlement.
- 12. Clause 18 contains the power of amendment. Following the privatisation of BA and the changes in the regulations this has been amended from the version which appeared in the original Trust Deed so as to exclude references to the Corporations and the Minister. It now reads:

“The provisions of the Trust Deed may be amended or added to in any way by means of a supplemental deed executed by such two Management Trustees as may be appointed by the Management Trustees to execute the same. Furthermore the Rules may be amended or added to in any way and in particular by the addition of rules relating to specific occupational categories of staff. No such amendment or addition to the provisions of the Trust Deed or to the Rules shall take effect unless the same has been approved by a resolution of the Management Trustees in favour of which at least two thirds of the Management Trustees for the time being shall have voted PROVIDED THAT no amendment or addition shall be made which -

 - (i) would have the effect of changing the purposes of the scheme or
 - (ii) would result in the return to an Employer of their contributions or any part thereof or
 - (iii) would operate in any way to diminish or prejudicially affect the present or future rights of any then existing member or pensioner or

- (iv) would be contrary to the principle embodied in Clause 12 of these presents that the Management Trustees shall consist of an equal number of representatives of the employers and the members respectively.”

13. Although, as I have said, neither the Trust Deed nor the Rules originally contained express power to increase pensions, clause 24 does give the Employer the ability to increase benefits:

“(a) Subject to the payment to the Fund by the Employer of such sum or sums, if any, as may be advised by the Actuary to be necessary, the Employer may by notice in writing to the Management Trustees specify that there shall be provided under the scheme:

- (i) increased or additional benefits to or in respect of any Member, Pensioner or category of Member or Pensioner; and
- (ii) benefits on different terms and conditions from usual for or in respect of any Member, Pensioner or category of Member or Pensioner

and the Management Trustees shall thereupon provide the same accordingly.

(b) Subject to the payment to the Fund by the Employer of such sum or sums, as may be advised by the Actuary as the costs of the benefits, the Employer may, with the consent of the Management Trustees, specify that there shall be provided under the scheme benefits in respect of any employee, or former employee, of the Employer, or category thereof (other than Members or Pensioners), and the Management Trustees shall thereupon provide the same accordingly. The Employer shall make the payment to the Fund, as set out above, within four weeks of the commencement of the payment of benefits.”

14. I should also mention, because they feature in some of the arguments presented on this appeal, the provisions of clauses 18A and 18B. Clause 18A empowers the Management Trustees in conjunction with BA to “make or concur in arrangements for the constitution of separate pension schemes” for members of the APS. This includes the power to transfer such part of the fund to the new scheme as the actuary considers appropriate in respect of any members who become members of the new scheme. This power was exercised in 1984 when a new pension scheme (“the NAPS”) was set up for new employees of BA and some 17,007 members of the APS transferred to the NAPS. The NAPS was also closed to new members in 2003 and since then the only form of pension provision for new employees of BA was a defined contribution occupational pension scheme known as the BA Retirement Plan.

15. Clause 18B deals with members of the APS who cease to be employees of a participating employer either because their employer ceases to be associated in business with BA or because it disposes of part of its business. Clause 18B(d) requires the employer in such circumstances to ensure that members' contributions continue to be paid to the Management Trustees up to the date when the employer ceases to be a participating employer and prohibits that employer from exercising after the date of the disposal of its business any power or discretion (for example under clause 24) which:

“might in the opinion of British Airways Plc or of the Management Trustees have the effect of increasing the amount or value of any benefit to which any person is or may become entitled under the scheme without the consent of British Airways Plc.”

16. Part VI of the Rules contain the provisions which govern pension entitlement including matters such as normal retirement age, contributions, deferment of pension and provision for dependants. Rule 13A gave the Employer in its absolute discretion the right to request the augmentation of the pension of certain members who retired before normal retirement age. The power had to be exercised by notice in writing given before 26 March 1986. After that date Rule 34 also allowed the Employer to give notice to the Management Trustees (up to 15 November 1989) requiring them to provide increased or additional pension benefits to any member or pensioner. From 1990 this provision was replaced by clause 24 of the Trust Deed. In the case of both Rules, as under clause 24 of the Trust Deed, the corollary was an obligation on the part of the Employer to fund the increases.

17. The only provision in the Rules which allows for the automatic adjustment of benefits is Rule 15. In the consolidated Rules prior to the amendment in 2011 it provided as follows:

“The annual rate of all pensions and allowances payable or prospectively payable under Rules 8, 9, 10, 11, 12, 13 and 34 hereof shall be adjusted as if the rates of increase as specified in the Annual Review Orders issued in accordance with section 59 of the Social Security Pensions Act 1975 were applicable thereto PROVIDED ALWAYS that if the said Act is repealed and not replaced or should it become necessary to review the basis of such annual adjustments steps shall be taken to ensure that the annual adjustments of pensions and allowances continue to be made based upon an appropriate national index or indices reflecting fluctuations in the cost of living PROVIDED FURTHER that without prejudice to compliance with the requirements of section 51 of the Pension Act 1995, any adjustment under the provisions of this Rule shall not apply

—

(A) during the period of postponement, to pensions postponed under the provisions of Rules 8(a) or 13(c);

(B) in respect of the period from the date of cessation of contributions until the date of commencement of payment, to pensions deferred under the provisions of Rules 5(e), 20(e) or (subject to Rule 34(d)) 20(l);

(C) when the relevant pension or allowance is in payment, to any actuarial increase under Rule 5(e)(iii); nor shall such adjustment apply (subject to section 51 aforesaid) to any crystallisation uplift as described in Rule 5(e)(iv) (or to any part of a pension or allowance attributable to any such actuarial increase or crystallisation uplift), where in any such case an election to this effect has been duly made in accordance with the provisions of paragraph (iv) or (v) of Rule 5(e) as applicable.”

18. Rule 30 states:

“These Rules may be amended or added to in accordance with the provisions of the Trust Deed”.

19. As balance of cost defined benefit schemes both the APS and the NAPS impose on BA as sponsoring employer the obligation to fund the excess of cost of benefits over the amount provided by the employees’ contributions. The provisions of both schemes are supplemented by the provisions of ss.221-233 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005 which contain detailed provisions for ensuring that what is described as the statutory funding objective is achieved and that there are sufficient assets of a suitable kind to make provision for the liabilities under the scheme. This will include taking into account on an actuarial basis any likely increases in benefits attributable to the exercise of a discretionary power under the APS.

20. Historically there have been surpluses identified under the actuarial valuations carried out in accordance with clause 11 of the Trust Deed. A significant surplus was identified as a result of the 1989 valuation which led to BA receiving a contribution holiday up to 2003. But both the APS and the NAPS are now operating in deficit. As of 31 March 2012 the APS has a deficit of £680m on a technical provisions basis and £1,583m on a solvency basis. The comparable figures for the NAPS are £2,660m and £9,125m respectively. Various measures have been taken to remedy the shortfall and BA is continuing to make deficit repair contributions of £55m per annum to the APS and £300m per annum (fixed until 2027) to the NAPS. These are on any view significant liabilities.

21. The provisions of Rule 15 for annual increases in the rate of pensions in line with Annual Review Orders issued in accordance with s.59 of the Social Security Pensions Act 1975 (“SSPA 1975”) are a feature of most public service pensions and of course reflect the historical origins of the present scheme. The provisions of the Pensions (Increase) Act 1971 link public service pensions to certain state benefits. The Secretary of State for Work and Pensions is required under s.150 of the Social Security Administration Act 1992 to review the general level of prices and following such review to make an order increasing (as necessary) certain specified social security benefits. In that event the Treasury is required by s.59(1) SSPA 1975 to

make an order applying the same percentage increase to what are referred to as official pensions.

22. Annual increases of this kind by reference to rises in prices as a measure of inflation were until 2011 based on RPI. This is calculated by reference to a basket of goods and services designed to measure increases in expenditure of an average household in the UK. But it was replaced by CPI which has been used by the Government since 2003 to set the inflation target for the Bank of England and which over the long-term tends to produce a lower rate of inflation than RPI although there may be fluctuations between the two on a month by month basis. A paper published by the Office for Budget Responsibility in November 2015 estimated that the long-term gap between the two measures was likely to be in the range of one percentage point per annum.
23. The two main reasons for the difference in rates produced by RPI and CPI is that RPI (unlike CPI) uses an arithmetic mean known as the Carli formula and also includes in its basket of consumer prices a figure for owner-occupied housing costs. The CPI by contrast uses a geometric mean which assumes that customers will react to price increases in a particular commodity by selecting a suitable but cheaper alternative of the same type when available. It therefore provides what has been described as a more elastic economic model. On 22 June 2010 the Government announced that public sector pensions and certain other state benefits would in the future be increased by reference to CPI under Pensions Increase (Review) Orders with effect from April 2011. The Pensions Increase (Review) Order 2011 increased the pensions to which it applied by 3.1% based on CPI and took effect on 11 April 2011.
24. The change to CPI was controversial for obvious reasons and led to a challenge in the form of proceedings for judicial review brought by a number of unions representing public service employees: see *R (FDA) v Work and Pensions Secretary* [2013] 1 WLR 444. The proceedings challenged both the way in which CPI is compiled and the circumstances in which it was adopted as the Government's chosen measure of inflation. The challenge failed both in the Divisional Court and in the Court of Appeal. The Court of Appeal held that the adoption of CPI was *intra vires* the powers contained in s.150 of the Social Security Administration Act 1992 and that the Secretary of State had not acted unlawfully in taking into account the effect on the national economy of adopting CPI in place of RPI. The cost to the public purse would be a relevant consideration provided that it did not lead the Secretary of State to select an index of inflation that was demonstrably less reliable or appropriate. The Master of the Rolls said:

“61. Viewing the matter more broadly, the applicants' contention that, whatever the circumstances, the Secretary of State should, as a matter of course, be required wholly to put out of his mind the effect on the national economic situation when carrying out his functions under section 150(1) and (2)(a), seems to me unreal. The exercise required by section 150 is macro-economic in nature, unlike the micro-economic exercise involved in *Chetnik Developments* [1988] AC 858, and it has the obvious potential of having a significant effect on the country's finances. It therefore seems to me unrealistic to say that the Secretary of State is required to ignore the wider

economic realities, irrespective of the circumstances, when carrying out his functions under section 150.

62. I cannot, however, accept Mr Eadie's argument without qualification. Thus, I do not consider that the Secretary of State could opt for an index which was clearly less good, and more detrimental to the recipients of pensions, than another index, simply because the former index was beneficial to the national exchequer. Indeed, if the Secretary of State thought that one index was significantly less reliable or less accurate than another, I find it very hard to conceive of any circumstances where he could select the former index merely because he thought it was just about acceptable for the estimating exercise required by section 150(1).

63. While I am not seeking to lay down a firm standard, it seems to me that, before the Secretary of State could invoke the benefit to the national exchequer by selecting an index he considered less good, three requirements would normally have to be met. Those requirements are (i) there would, in the Secretary of State's view have to be little to choose between the indices in terms of reliability and aptness, (ii) the benefit to the national exchequer of choosing the less good index would have to be significant, and (iii) the need to benefit the national exchequer, in terms of the national economy and demands on the public purse, would have to be clear.

64. In other words, the Secretary of State could only select the less good index if it was proportionate to do so, and, bearing in mind the purpose of the up-rating exercise, the circumstances would normally have to be unusual before it could be proportionate to select an index, or other method, which the Secretary of State considered was less good than another.

.....

75. In all these circumstances, it seems to me that, irrespective of whether I am right about the Secretary's right to take into account the effect of his selection of an index on the national economy, the Secretary of State's decision to select CPI as the index by reference to which to up-rate under section 150 was valid.

76. As mentioned above, it was, in my view, open to him to take into account the effect on the national economy, provided that, in his rational view, (i) the index which he selected was not significantly less suitable for section 150 purposes than the alternative, (ii) the choice of index would have a significant effect on the national economy, and (iii) the state of the national economy justified it being taken into account. It seems to me that those three requirements were plainly satisfied here.

The fact that the factor which initially drove the selection of CPI was the effect on the national economy does not alter the fact that CPI was considered on its merits to be an appropriate index for making the section 150(1) estimate for 2011.

77. As for the three requirements, the position appears to have been this in April 2011. (i) To put the point at its lowest, CPI was thought by the Secretary of State, by Lord Freud and Mr Webb, as well as by Mr Cunniffe and Dr Richardson, to be no worse than RPI. (ii) So far as the effect on the national economy was concerned, the effect of choosing CPI rather than RPI was significant. (iii) The Government clearly believed that the state of the national economy was grave, and that any savings which could properly be made should be made – and made as soon as possible; if that were not well known, it is obvious from the Chancellor's statement of 22 June 2010.”

25. In the light of this decision the change from RPI to CPI was lawfully made and had the consequence for the members of the APS of limiting their legal entitlement under the terms of the scheme to CPI based increases in future years. For the same reason, whatever their personal expectations may have been, they had no expectation of continued increases in pension by reference to RPI which the Trustees of the APS had any legal obligation to fulfil.

26. Notwithstanding this the Trustees resolved on 3 February 2011, subject to consultation with BA, to insert a power in the Rules:

“to permit discretionary pension increases on top of those granted by the Annual Review Orders, on a two-thirds majority basis, and that the use of the power would be reviewed on at least an annual basis and take account of relevant professional advice.”

27. The decision was confirmed at a further meeting of the Trustees held on 1 March 2011 and on 25 March the Trustees approved a supplemental deed under which they purported to exercise the power contained in clause 18 of the Trust Deed so as to amend Rule 15 by adding a proviso in the following terms:

“PROVIDED FURTHER THAT the Management Trustees may at their discretion, and shall in any event at least once in any one year period, review the annual rate of pension payable or prospectively payable under Rules 8, 9, 10, 11, 12, 13 and 34 and shall have the power, following such a review, by resolution to apply discretionary increases in addition to those set out in this Rule, subject to taking such professional advice as appropriate. This discretion cannot be exercised unless at least two thirds of the Management Trustees for the time being vote in favour of the resolution.”

28. The supplemental deed was executed on 25 March 2011. On the same day the Trustees voted on whether to exercise the power but were split on the issue (as

between member and employer nominated trustees) so that there was not a two-thirds majority for the proposal as required under the amended Rule 15. A further inconclusive ballot of the Trustees took place in February 2012 but on 28 February 2013 the Trustees agreed in principle to exercise the Rule 15 power so as to award an additional increase of 0.2% over CPI. The minutes of the meeting record:

“After discussion the Trustees present, being ten of the twelve currently in office, agreed unanimously that a discretionary increase of 50% (subject to decisions on treatment of specific groups of members) of the difference between RPI and CPI as at 30 September 2012 (RPI being 2.6% and CPI 2.2%) would be appropriate. The additional increase of 0.2% would be paid after completion of the valuation, with the amount of the increase to be reviewed before the increase was finalised but with at least two thirds of the Trustees then in office being required to vote in favour of any change to the amount to be paid. It was further agreed that:

- no announcement of the decision to award a discretionary increase would be made until the valuation had been finalised
- in the event that the valuation is not finalised by the end of June, the Trustees would consider whether to proceed with a discretionary increase without the valuation being finalised with at least two thirds of the Trustees then in office being required to vote in favour for an increase to be paid in those circumstances
- the payment date to be finalised once the valuation had been finalised taking into account that BA Pensions would require a minimum of six weeks to implement the increase.”

29. On 26 June 2013 the Trustees agreed that the amount of the discretionary increase should remain at 0.2% and on 19 November 2013 they voted to exercise their Rule 15 powers so as to grant an increase in that amount with effect from 1 December 2013.
30. Before the judge BA challenged the 2013 decisions on a number of grounds. It sought a declaration that the amendment of Rule 15 so as to introduce the power to make discretionary pension increases was outside the power of amendment contained in clause 18 of the Trust Deed or involved the exercise of that power for an improper purpose. It also challenged the exercise of the clause 15 power both as carried out for an improper purpose and unlawful either because the Trustees had taken into account irrelevant factors or failed to take into account relevant factors when exercising the discretion or alternatively because the decision was in all the circumstances perverse or irrational. But at the trial BA applied and were given permission to amend their points of claim to allege that both the exercise of the clause 18 power to amend and the subsequent exercise of the amended Rule 15 power were *ultra vires* because they were carried out for a purpose not permitted by clause 2 of the Trust Deed and further that the exercise of the clause 18 power was also contrary to and therefore not permitted by proviso (i) to clause 18 itself. All those grounds turn on whether the amendment to Rule 15 or the subsequent exercise of the Rule 15 power resulted in the

making of “benevolent or compassionate payments” to members of the APS in the form of the additional pension increases.

31. The width of BA’s challenge to both the 2011 amendment and the 2013 exercise of the amended Rule 15 power meant that the judge was forced to conduct a detailed examination of the history of the Trustees’ deliberations over this period and the reasons for the decisions which they made. He was satisfied that if and so far as they had validly conferred on themselves a power under Rule 15 to make discretionary increases in the amount of the pensions payable under the APS, they had not exercised that power without taking all relevant matters into account or in a manner which could properly be described as irrational or perverse and there is no challenge to that part of his decision on this appeal. We are concerned, broadly speaking, with two issues only: whether either the exercise of the clause 18 power of amendment in 2011 or alternatively the exercise of the Rule 15 power in 2013 was *ultra vires* the Scheme because it was for a purpose not permitted by clause 2 of the Trust Deed (what Mr Rowley QC for the Trustees described as a scope of power challenge) and secondly whether, even if the amendment of Rule 15 was within the Trustees’ power as properly construed, it nevertheless was unlawful because the Trustees acted for an improper purpose by setting rather than delivering the remuneration (in the form of pension) which BA pays to its former employees. The response of the Trustees to this ground of appeal is that it is in substance (even if not in form) a challenge to the scope of the Trustees’ powers and therefore stands or falls with the first ground of appeal.
32. For the purpose of considering these two grounds of appeal it is unnecessary to summarise in detail the judge’s findings about what motivated or informed the decision of the Trustees to amend Rule 15 and consequently to exercise the amended Rule 15 power. We are not, as I have explained, concerned with a challenge based on a failure to take relevant matters into account or on the rationality of the decision. In particular the judge accepted that sufficient regard had been had to the financial impact on BA of any discretionary increase and BA’s stated opposition to any attempt to increase pensions over what was already provided for under Rule 15 particularly in the light of the current funding deficit in respect of both the APS and the NAPS.
33. The judge’s finding was that in March 2011 there was such a serious division of opinion about whether in effect to restore RPI as the measure of any inflation-based increase in pensions that the Trustees simply postponed a decision on the issue by agreeing to amend the Rules but deferring any decision on whether to exercise the power. The judge summarises the position at [199]-[200]:

“199. Based on the above evidence, I make the following findings as to the wishes of the MNTs in the period up to the end of March 2011. In general terms, all of the MNTs wished to see the reinstatement of RPI as the basis for pension increases. This view was strongly expressed at trustee meetings and elsewhere. However, the possible reinstatement of RPI was never put to the vote and so the question whether the MNTs would actually have voted to restore RPI was never answered. It is far from clear that they would have voted to restore RPI if there had to be a CPI underpin. Further, all the trustees decided on 3 February 2011 to take counsel's opinion as to their options. They had not obtained counsel's opinion by 25 March

2011. The trustees (including the MNTs) could not have committed themselves to any particular position in relation to RPI whilst they were waiting to obtain counsel's opinion. What they did instead, leaving matters open, was to vote to amend the rules to confer on themselves a discretionary increase power.

200. The MNTs appreciated that they would not secure a two-thirds majority for the reinstatement of RPI. They voted for an amendment to the rules to confer on the trustees a discretionary increase power. They regarded this power as less good than the reinstatement of RPI but nonetheless a power worth having. They understood that the availability of the discretionary increase power did not mean that it would be exercised in any particular way in the future. They understood that there needed to be a two-thirds majority in favour of any such exercise. They understood that the power referred to the trustees taking professional advice before exercising the power.”

34. The Trustees then sought advice from Mr Christopher Nugee QC (as he then was) about a possible future exercise of the Rule 15 power. There were at least two consultations with counsel and the judge set out the tenor of Mr Nugee’s advice in some detail. Many of the issues he was asked to consider do not bear on the grounds of appeal. This includes questions such as whether the members of the APS could argue that they had a contractual right to pension increases by reference to RPI or could rely on some kind of estoppel by convention to that effect. Mr Nugee rejected both possibilities. But more relevantly reference was also made to the purpose for which the clause 18 power had been conferred:

“212. Mr Nugee then considered the factors which should be considered by the trustees if they were considering amending the rules to reinstate RPI as the basis for pension increases. Subject to one matter, he generally agreed with the factors which had been identified in his instructions. However, those factors had referred to the trustees owing a duty to act in the best financial interests of the beneficiaries. Mr Nugee explained that that proposition was taken from a case concerning the investment powers of trustees. With the power to amend conferred by clause 18, one had to examine the purpose for which that power had been conferred. In this case, the power to amend was not for the purpose of giving members the best possible benefits so that the trustees should not exercise this power just to benefit members. The note of the consultation then recorded:

“However, Leading Counsel considered it was a legitimate consideration for the Trustees to take into account that members had an expectation, that had been shared by the Trustees and the company, that pension increases would be in line with RPI.”

213. Mr Nugee was then asked about possible challenges to a decision by the trustees to reinstate RPI as the basis for pension increases, alternatively, a decision not to do so. As to the former, the note of the consultation records:

“If the scheme were well funded with a strong employer covenant then Leading Counsel would not have an issue with the Trustees making an amendment to establish RPI into the Rules. In those circumstances, the Trustees could take into consideration the reasonable expectations of members, and that the change to CPI would cause a reduction in members' pensions. However, Leading Counsel stated that the situation was very different where the scheme was in a significant deficit position with a weak employer covenant. In such a circumstance, Leading Counsel considered it would be a very difficult decision for the Trustees to establish RPI into the Rules.

...

Leading Counsel noted that the move from RPI to CPI as the relevant index will mean that members are likely to receive less money in their retirement. The fact that there is a deficit position does not completely rule out using the amendment power in order to try to deal with this. However, as funding improves Leading Counsel thought that there was a lot to be said for de-risking the scheme rather than incurring added liabilities, in circumstances where there was no entitlement to increases based on RPI.

When considering the discretionary power Leading Counsel thought it would be sensible to see RPI increases as an aspiration. However there were no black and white rules as to when the discretionary power can be used in a deficit position.

A move to RPI would be intended to satisfy the members' reasonable expectations. If the scheme were better funded with a stronger employer covenant, this would be entirely proper. However the less well funded the scheme is, the more difficult the decision becomes.

Leading Counsel opined that the only core legal principle was that the Trustees must take into

account relevant factors and ignore irrelevant factors. The Court would only interfere if the Trustees had failed to take account of a relevant factor or taken into account an irrelevant factor or if the decision were perverse or irrational. A successful challenge on this basis would be very unlikely.””

35. When the issue of a discretionary increase was considered in 2012 BA made it clear to the Trustees that it was strongly opposed to any increase over CPI. The Trustees were split on the issue and again no decision was made. On 20 March 2012 the Court of Appeal dismissed the appeal in *FDA* so that it was clear that RPI would not be used in the future to determine the rate of the annual increases under the Annual Review Orders and therefore under the formula in Rule 15.
36. The judge was asked to determine whether the decision to exercise the Rule 15 power so as to grant the 0.2% increase in pensions was made at the June or the November 2013 meeting. This was relevant to an argument about the matter being pre-determined which does not concern us. The gist of the reasons for the Trustees’ decision to exercise the power was set out in the evidence of Mr Douglas, one of the Trustees, which the judge summarised in the following paragraphs of his judgment:

“505. Mr Douglas gave detailed evidence as to his reasons for the conclusions he reached at the meeting on 19 November 2013. I will summarise that evidence as follows:

(1) there had been throughout an unequivocal expectation among the members of the APS that future pension increases would be based on RPI; secure protection against inflation would have been one of the reasons that approximately 50% of eligible APS members did not transfer to the NAPS in 1984 and until 2010 there had been nothing to change this view;

(2) the decision to award a discretionary increase was based on an understanding that it would only be paid from funds that BA had already pledged; as at November 2013, BA had signed up to the 2013 funding agreement so it could be presumed that BA was content that the contributions were affordable; PwC expressly advised the trustees that it was reasonable to expect that those contributions would be made; further, PwC advised that even if the discretionary increase cost an extra £24 million, this would still be immaterial to BA's covenant; further still, PwC had previously advised the trustees that the Iberia merger, the British Midland acquisition, the agreement with American Airlines and the funding arrangements for the new fleet were all positive developments for its business; as far as the February 2013 decision was concerned, PwC had advised that the covenant was not significantly different to where it had been at the time of the 2010 funding agreement, and in fact there had been positive developments in BA's business; Mr Douglas

considered that it was clear from this that BA was as able to pay the recovery plan contributions as it had been in 2010;

(3) the DIF [Discretionary Increase Framework] and the actuarial advice were comprehensive and addressed all the points raised by tPR [the Pensions Regulator]; Mr Douglas considered that the DIF was a sensible way to consider the award of a discretionary increase especially as this would require annual review, thus allowing the trustees to respond to down-side events and exposure to risk as well as funding or covenant improvements;

(4) the trustees had adequately considered BA's interests;

(5) the APS trustees had to have regard to the NAPS as a large creditor of BA but Mr Douglas considered that the NAPS had its own funding agreement in place for the interests of the NAPS members; and

(6) he considered that he could reasonably assume a value of at least £125 million from the total £250 million contingent payment as a source of funding.

.....

510. What emerges from Mr Douglas' evidence is that matters were not static between the Budget announcement in June 2010 and the decision on 19 November 2013. The documents show that, initially, the MNTs saw matters in stark terms. The Budget announcement came as a shock, in particular, to the APS pensioners. The APS pensioners had, up to that point, expected that pension increases would continue to be based on RPI. The MNTs (not including Mr Douglas at this stage) had the immediate reaction that they should use whatever powers they had to restore RPI. The MNTs were sympathetic to the position of the pensioners and were not sympathetic to the position of BA. The MNTs were persuaded by their advisers not to hardwire RPI in the Spring of 2011. Instead they chose to introduce a discretionary power to increase pensions.”

37. Against this background I can now turn to consider the two main issues which arise on this appeal.
38. BA's challenge to the *vires* of the amendment to Rule 15 and the subsequent exercise of that amended power is based, as I have mentioned, on clause 2 of the APS and, in particular, the requirement that it should not be used to make “benevolent or compassionate payments”. It is common ground that this is an immutable condition which is re-inforced by the proviso in clause 18(i) of the Trust Deed that no amendment should be made which would have the effect of changing the purposes of the Scheme. It is also all-embracing in the sense that it must govern any aspect by the

Trustees of their administration of the APS including most obviously the payment of pensions. It follows that any exercise of the Rule 15 power even in its amended form must be compliant with clause 2 of the Trust Deed. The insertion of the new proviso in 2011 cannot therefore be said to be *ultra vires* on the ground that it would permit the making of benevolent or compassionate payments. The judge was therefore right in my view to say that the focus of any *vires* challenge by reference to clause 2 has to be on the subsequent exercise of the Rule 15 power.

39. A similar but different issue exists in relation to whether the creation of the amended Rule 15 power or its subsequent exercise can be said to have been carried out by the Trustees for an improper purpose. Putting aside for the moment the contention of the Trustees that this is in substance another argument based on the scope of the Trust Deed and therefore the *vires* of what was done, it is clear that the catalyst for the Rule change was the statutory switch from RPI to CPI and the likely consequent reduction in the amount of future index-linked pension increases under Rule 15. But the new proviso is framed in general terms and is subject to certain safeguards such as the requirement to take appropriate professional advice and for there to be a two-thirds majority in favour of a resolution to make a discretionary increase.
40. The 2011 decision to make the rule change was, on the judge's findings, due in part to the inability of the MNTs to secure a majority for an immediate increase above CPI or even to re-instate RPI as the basis for any future annual increases. There was also a perceived need to take advice. All the Trustees therefore supported the rule change on the basis that it left all the options open. It could be exercised so as to restore the loss of pension due to the change to CPI. But that would depend on the circumstances then prevailing and any professional advice given to the Trustees at that time. Future pension increases by reference to RPI were in no sense a given. On the other hand, when the new Rule 15 power was in fact exercised in November 2013 it had only one objective purpose which was to go some way towards restoring the difference between CPI and RPI.
41. The general terms in which the new proviso to Rule 15 is formulated and the findings of the judge make it difficult to contend that the 2011 Rule change was made for the purpose of ensuring that any annual increases in benefits would reflect what the application of RPI would have required. BA's argument on improper purpose therefore focuses (at least in relation to clause 18) not so much on whether the amended power was intended to be used to make good the gaps between RPI and CPI but more fundamentally on whether the Trustees stepped outside their legitimate role of managing and administering the APS and took it upon themselves to assume, as Mr Tennet put it, the rôle of paymaster in BA's business with a wide power to determine increases in pensions or in theory other changes to benefits entitlement for which BA had never contracted with its employees but for which it would be the significant funder with no power of veto.
42. The question of improper purpose does therefore have to be considered both in relation to the Rule change made in 2011 and in relation to the subsequent exercise of the amended power in 2013. Because BA's submissions challenge the legality of what was done by reference to the proper rôle of the Trustees in the structure of the APS both stages in the Rule change process need to be looked at. I propose therefore to start with the issue of improper purpose and then to consider the subsidiary

argument that the payments authorised in 2013 also breached the terms of clause 2 of the Trust Deed.

43. It is a long-established principle in trust law that a discretionary power conferred on Trustees, however widely expressed, must not be exercised for an improper purpose. Although the rule has an obvious application where the trustee acts for what is traditionally described as a corrupt purpose (for example, in order to benefit himself) the scope of the rule is much wider. It also encompasses cases where there is no personal benefit or bad faith involved but where the trustee has exercised, for example, a power of appointment in order either directly or indirectly to benefit a non-object of the power. Closer to the present case, the Trustees of a pension fund have been held to have acted for an improper purpose when, in the absence of any power to return a surplus to the employer, they transferred funds to another scheme so as to enable the return of capital to be made: see *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862.
44. Cases of improper purpose therefore include circumstances where the appointee (under, for example, an appointment of capital) is literally outside the class of permitted objects of the power. But the rule is not limited to excessive exercises of this kind. As the decision in *Hillsdown Holdings* illustrates, the rule can equally apply where the Trustees act within the letter of their powers but do so for a purpose which is not permitted by or provided for under the trust instrument and is therefore beyond the scope and purpose of the power which was granted.
45. The problem which arises in the present appeal is to identify the circumstances in which the exercise of a widely drafted power of amendment may nonetheless be curtailed by resort to what can be identified as the purpose or purposes of the Scheme and in particular whether the purposes relied on in this case are in substance synonymous with and limited by the terms of the Trust Deed itself so that any challenge to the exercise of the power depends upon the construction of the Trust Deed (including any implied terms) and so becomes essentially a question of *vires*. Allied to this is the fact that a power of amendment is by its very nature designed to allow the Trustees to effect changes in the existing terms of the Trust Deed or the Rules. The objection that the Trustees are seeking to achieve an outcome not so far provided for under the Scheme is not therefore sufficient in itself. It must be possible to identify some other features or provisions in the Scheme which render the use of the clause 18 power so as to create the new Rule 15 proviso improper and invalid in this case.
46. It is important to observe at the outset that BA do not contend that by some process of construction it is possible to read the clause 18 power of amendment as qualified by a requirement to obtain the employer's consent to any rule change or at least any rule change with financial implications for BA as the funding employer. Nor does BA suggest that as a matter purely of construction the scope of the clause 18 power does not extend to making rule changes which would enable increased benefits to be payable to members of the APS. Their case is that the 2011 exercise of the clause 18 power and the subsequent exercise of the amended Rule 15 power were carried out for an improper purpose because they had the effect of setting rather than delivering the remuneration which BA pays to its employees or former employees in the form of pensions. To have acted in this way is said to come within the principles referred to earlier because it involved the exercise of the relevant powers "for purposes contrary

to those of the instrument” by which those powers were conferred. This is a familiar formulation of the relevant principle which one can see in the judgment of Lord Cooke in *Equitable Life v Hyman* [2002] 1 AC 408 at page 460F and more recently in the judgment of Lord Sumption in *Eclairs Group Ltd v JKK Oil and Gas plc* [2015] UKSC 71.

47. The latter was a case where the board of JKK served disclosure notices pursuant to s.793 of the Companies Act 2006 on the claimant companies (which were shareholders in JKK) requiring them to disclose, *inter alia*, any arrangements concerning their JKK shares. The board considered that JKK was the possible target of a takeover bid by the claimants which the board opposed. When the claimants failed to provide what were considered to be adequate particulars of the arrangements requested, the board proceeded to exercise the power contained in Article 42 of JKK’s articles of association to suspend the claimants’ rights as shareholders to vote at general meetings or to transfer their shares. This was challenged by the claimant companies as the exercise of the Article 42 power for an improper purpose on the basis that the board’s purpose in exercising the power was not to enforce the requests for information made under s.793 but rather to enable the board to block the claimants’ opposition to pending resolutions at the forthcoming AGM for the re-appointment of directors and the purchase of the company’s shares.

48. Lord Sumption’s judgment contains the following statement of the basic rule:

“14. Part 10, Chapter 2 of the Companies Act 2006 codified for the first time the general duties of directors. The proper purpose rule is stated in section 171(b) of the 2006 Act, which provides that a director of a company must “only exercise powers for the purposes for which they are conferred”. The rule thus stated substantially corresponds to the equitable rule which had for many years been applied to the exercise of discretionary powers by trustees. “It is a principle in this court”, Sir James Wigram V-C had observed in *Balls v Strutt* (1841) 1 Hare 146, “that a trustee shall not be permitted to use the powers which the trust may confer upon him at law, except for the legitimate purposes of the trust.” Like other general duties laid down in the Companies Act 2006, this one was declared to be “based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director”: section 170(3). Section 170(4) accordingly provides that the general duties are to be “interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding rules and equitable principles in interpreting and applying the general duties”.

15. The proper purpose rule has its origin in the equitable doctrine which is known, rather inappropriately, as the doctrine of “fraud on a power”. For a number of purposes, the early Court of Chancery attached the consequences of fraud to acts which were honest and unexceptionable at common law but unconscionable according to equitable principles. In particular,

it set aside dispositions under powers conferred by trust deeds if, although within the language conferring the power, they were outside the purpose for which it was conferred. So far as the reported cases show the doctrine dates back to *Lane v Page* (1754) Amb 233 and *Aleyn v Belchier* (1758) 1 Eden 132, 138, but it was clearly already familiar to equity lawyers by the time that those cases were decided. In *Aleyn's Case*, Lord Northington could say in the emphatic way of 18th century judges that "no point was better established". In *Duke of Portland v Topham* (1864) 11 HLC 32, 54 Lord Westbury LC stated the rule in these terms:

"that the donee, the appointor under the power, shall, at the time of the exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view to the real purpose and object of the power, and not for the purpose of accomplishing or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power."

The principle has nothing to do with fraud. As Lord Parker of Waddington observed in delivering the advice of the Privy Council in *Vatcher v Paull* [1915] AC 372, 378, it

"does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power."

The important point for present purposes is that the proper purpose rule is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication. It is concerned with abuse of power, by doing acts which are within its scope but done for an improper reason. It follows that the test is necessarily subjective. "Where the question is one of abuse of powers," said Viscount Finlay in *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625, 630, "the state of mind of those who acted, and the motive on which they acted, are all important".

49. Some of this is controversial and did not command the support of the whole court. But there was unanimity about the Article 42 power being inserted in the Articles only for the purpose of re-enforcing a statutory request for information and not being

intended to enable the board to frustrate any other exercise of a shareholder's rights. Applying that to the case in point, Lord Sumption said:

“30. The submission of Mr Swainston QC, who appeared for the company, was that where the purpose of a power was not expressed by the instrument creating it, there was no limitation on its exercise save such as could be implied on the principles which would justify the implication of a term. In particular, the implication would have to be necessary to its efficacy. In my view, this submission misunderstands the way in which purpose comes into questions of this kind. It is true that a company's articles are part of the contract of association, to which successive shareholders accede on becoming members of the company. I do not doubt that a term limiting the exercise of powers conferred on the directors to their proper purpose may sometimes be implied on the ordinary principles of the law of contract governing the implication of terms. But that is not the basis of the proper purpose rule. The rule is not a term of the contract and does not necessarily depend on any limitation on the scope of the power as a matter of construction. The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument. Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context.”

50. The proper purpose principle or restriction has been applied in at least two reported cases to exercises of a power of amendment contained in the trusts of a pension scheme. In *Re Courage Group's Pension Schemes* [1987] 1 WLR 495, Millet J (as he then was) held that it would be *ultra vires* and unlawful for a power of amendment to be used in order to substitute for the existing employer under the scheme a new company (Hanson Trust plc) which had recently taken over the group and had never therefore employed the members of the scheme. The proposed substitution was designed to enable Hanson Trust to sell the existing employer company and its subsidiaries without including a transfer of the pension scheme and its assets and to be able thereby to open the scheme to new entrants and to remove an existing surplus from the scheme for its own benefit. The judge accepted that it was desirable for a group pension scheme to include some provision for substitution in order to cater for events such as the liquidation or replacement of the employer company in the event of a group re-organisation. But this did not justify the introduction by amendment of an unlimited power of substitution designed to enable Hanson to gain access to the scheme surplus. The judge said (at pages 505 and 511):

“It is trite law that a power can be exercised only for the purpose for which it is conferred, and not for any extraneous or ulterior purpose. The rule-amending power is given for the

purpose of promoting the purposes of the scheme, not altering them.

.....

In my judgment, the validity of a power of substitution depends on the circumstances in which it is capable of being exercised and the characteristics which must be possessed by the company capable of being substituted; while the validity of any purported exercise of such a power depends on the purpose for which the substitution is made. The circumstances must be such that substitution is necessary or at least expedient in order to preserve the scheme for those for whose benefit it was established; and the substituted company must be recognisably the successor to the business and workforce of the company for which it is to be substituted. It is not enough that it is a member of the same group as, or even that it is the holding company of, the company for which it is substituted. It must have succeeded to all or much of the business of the former company and have taken over the employment of all or most of the former company's employees. In my judgment, the proposed power to substitute I.B.L.'s ultimate holding company for I.B.L. in undefined circumstances is far too wide, alters and is capable of defeating the main purpose of the schemes, and is ultra vires.

Even if this were not the case, I would not uphold the proposed exercise of the power. The amending deeds are not an academic exercise designed to improve the constitution of the schemes for the future. They were occasioned by, and prepared in contemplation of, the impending sale to Elders. The whole object in substituting Hanson for I.B.L. was to bring about a dissolution or partial dissolution of the schemes on the completion of the sale to Elders which would otherwise not occur. The purpose of the amending deeds was frankly acknowledged by Mr. Inglis-Jones to be

“to retain within the control of Hanson a surplus which has been contributed by companies which Hanson has bought, and for which surplus Hanson has paid, rather than allow it to be transferred to Elders.”

That purpose is foreign to the purpose for which the power to amend the trust deeds and rules is conferred, and invalidates any exercise of that power.”

51. In *Bank of New Zealand v Bank of New Zealand Officers Provident Association Management Board* [2003] UKPC 58 the Privy Council was also concerned with a pension fund in surplus and with whether the trustees could exercise a power of amendment so as to distribute the surplus not only to current members but also to former members who had received lump sums under the scheme on retirement rather

than pensions as such and were not therefore “pensioners” within the terms of the scheme. Membership of the Scheme was confined to existing employees of the bank and pensioners. The exercise of the power of amendment so as to include non-pensioners on a distribution of the surplus was challenged on the basis that it was an attempt to confer benefit on persons who were not members of the scheme. But the Privy Council held that the critical question was whether the proposed amendment was within the powers of the Trustees when it was intended to be made.

52. The rules of the scheme defined its object as the maintenance of a provident fund “for the benefit of Members and Pensioners of the Association and their dependants”. As in the present appeal, there was no real dispute about the power of amendment being unrestricted and therefore wide enough to enable the proposed distribution of the surplus to be carried out. Lord Walker of Gestingthorpe identified the relevant question as being whether its exercise could nonetheless be restricted on the basis that what was proposed would involve the power being used for purposes outside those for which it was intended. The application of the proper purposes rule required, he said, an examination of the objects of the scheme as the first port of call. But the objects clause will not necessarily be decisive:

“21. An illustration of a situation in which the objects clause will not be decisive is where there have been changes in the organisation of an enterprise, through a process of natural development, making it necessary or expedient for the objects to be restated. If the trust deed of a pension scheme declares that its object is to provide pensions and other benefits for employees of X Ltd, and the business of X Ltd is restructured so as to be carried on by several subsidiary companies employing the workforce previously employed by the holding company, there can be no doubt that the scheme's power of amendment (unless exceptionally and specifically restrictive) could be exercised so as to bring in employees of the subsidiaries. The amendment, so far from frustrating the commercial purpose of the scheme, would prevent it being frustrated, since otherwise the group's management would have to choose between the unattractive alternatives of setting up a new pension scheme or abandoning an advantageous restructuring. On the other hand the amendments proposed in the *Courage* case were not permissible because they were part of an unnatural and manipulative plan which would have severed the pension fund from the workforce for whom it was established (see [1987] 1 WLR at pp 509–510).”

53. The reference to “members and pensioners” in the objects clause was held not to exclude former employees who had received lump-sum payments rather than pensions under the scheme. The detail of this does not matter for present purposes. But what the decision does indicate is that the identification of the purposes of the scheme and therefore of the powers it confers on the Trustees was at least in these two cases conducted at a fairly high level of generality by reference to the stated objects of the scheme.

54. *Courage* was on any view an extreme case because the amendment of the scheme to facilitate the substitution of Hanson Trust for the existing employer had no purpose other than to liberate the surplus from the fund by the dissolution of the scheme. It was not therefore difficult to conclude that this lay outside the purposes for which the power of amendment was granted. *Bank of New Zealand* by contrast is a case where the stated objects of the scheme were given a flexible rather than a narrow construction and were held not to impinge on the scope of the otherwise widely drafted powers of amendment.
55. In the present case a resort to the objects clause contained in clause 2 of the Trust Deed does not assist BA. Neither the creation of the new Rule 15 power nor its subsequent exercise were inconsistent with the APS as a scheme “to provide pension benefits on retirement”. Clause 18(i) also expressly provides that no amendment is to be made which would have the effect of changing the purposes of the Scheme so it is difficult to see (at least in relation to clause 18) what real scope there is for the operation of the proper purposes rule if its proper focus is on compliance with the stated objects or purposes of the APS. An amendment which would change the purposes of the APS is simply *ultra vires*.
56. Although the interests of the members of the APS and those of BA differ in relation to any increase in the amount of benefits payable under the scheme, the purpose of the rule change was in no sense inimical to the continuation of the scheme or inconsistent with its purpose as the provision of deferred remuneration to employees. It undoubtedly involved a re-adjustment of benefits against liabilities but that is a tension which the Trustees are called upon to resolve under any scheme which permits the Trustees to increase benefits without affording the employer a corresponding veto. The Trustees must of course balance the interests of the employer against those of the employees or former employees and must take the funding implications into account. But the judge has found that the Trustees properly carried out this exercise and there is no appeal from his decision on that issue. BA’s case therefore depends, as I have said, upon identifying in the terms and structure of the scheme as it existed in March 2011 a prior limitation on the circumstances in which the power of amendment may be used to effect an increase in benefits even though that power is in terms unlimited. To do this it is necessary, it seems to me, to descend to a level of particularity not seen in the authorities I have so far referred to. What on one view might be regarded as details of the structure of the APS: for example, the absence of an express power for the Trustees to increase benefits beyond the Rule 15 statutory formula; the power of the employer to sanction such increases; the function of the Trustees to manage and administer the scheme; and the rôle of the actuary to identify surpluses or deficiencies in the APS with a corresponding obligation on the part of BA or the Trustees to make provision for it; all these features of the existing scheme have on BA’s case to be treated as defining the purpose for which the power of amendment exists and the circumstances in which it can properly be exercised.
57. Having regard to clause 18(i) Morgan J held that the relevant purposes of the scheme in relation to the exercise of the power of amendment were, as I have said, the provision of pension benefits on retirement and negatively that the scheme should not be used to make benevolent or compassionate payments: see [411]. He accepted Mr Rowley QC’s submission that the ascertainment of the purposes of a scheme is

normally conducted at this high level of generality. Mr Tennet submits that this is too wide an approach and that the fundamental purpose of any occupational pension scheme is to deliver to employees the pension benefits which their employer is willing to fund. If right, this formulation allows one to bring into account the particular structure of the scheme under consideration and the balance which it strikes between the function of BA as employer and the functions of the Trustees whose primary task is to administer the scheme and to deliver to members the benefits which the employer has committed itself to. Mr Tennet submits that the Trustees' powers are not conferred to enable them to determine the appropriate remuneration package for BA's employees and former employees and should not be exercised for that purpose. He says that it would be unprecedented for trustees of an occupational pension scheme to increase the funding burden on an employer by increasing the benefits payable under a scheme which is in deficit.

58. It is important to note at this stage that BA does not contend that clause 18 can never be used so as to increase benefits. Mr Tennet accepts that it would be open to the Trustees, for example, to increase benefits in order to remove an actual or potential surplus from the Scheme. The employer's obligation to make contributions is limited to what is necessary to meet the liabilities under the Scheme: nothing more. The identification of a surplus by the actuary could lead to a contributions holiday for BA as part of a scheme under clause 11(d) of the Trust Deed which expressly provides for that event. But Mr Tennet accepts that it would also be open to the Trustees to use the power of amendment to increase benefits so as to eliminate what is referred to as a "trapped" surplus even though that is not catered for under clause 11. Such exercise would not be conditional on the consent of BA unlike a scheme under clause 11 which requires the employer's consent: see clause 11(b). The only limitation on the use of clause 18 to remove a surplus is the bar (in clause 18(ii)) on the return of contributions to the employer.
59. This limited concession is consistent with the position taken by all counsel on the last occasion when the APS was considered by the Court. In *Stevens v Bell* [2001] Pens LR 99 Lloyd J was asked to consider the scope of clause 11 and its relationship with clause 18 in connection with a surplus which then existed in the scheme. Most of the questions raised in the proceedings are not relevant to this appeal but it is interesting to note that all counsel were agreed that if and so far as the clause 11(d) power was not wide enough to dispose entirely of the surplus, it would be possible for it to be amended and expanded under clause 18. The Court of Appeal (see [2002] Pens LR 247) affirmed the view of the judge that clause 11(b) of the Trust Deed operated independently of clause 18 but rejected the submission that clause 11(b) contained an implied power of amendment. It was not therefore possible to devise a scheme providing for the return of contributions to BA except by amendment under clause 18 but that was prohibited by clause 18(ii).
60. For present purposes the only significance of this earlier litigation about the APS and the scope of the Trustees' powers in relation to a surplus is that it proceeded entirely as an exercise in construction of the relevant provisions of the Trust Deed. It was not suggested (perhaps because in relation to a surplus the point did not arise) that there was any other relevant limitation on the exercise of the power of amendment.
61. As part of his argument Mr Tennet made reference to some academic commentaries including observations by the late Mr Edward Nugee QC and Mr David Pollard in his

book, the *Law of Pension Trusts* (2013). Mr Nugee is quoted for having said that “since it is the employer who has decided to set up the scheme, it is his purposes that are to be achieved. And those purposes can be summarised as the provision to the members of the benefits promised by the scheme”. Mr Pollard speaks of the purpose of a defined benefit occupational scheme being to provide the stated benefits to members “at a cost acceptable to the employer”. For my own part I do not find general statements of this kind, shorn of the context of a particular scheme, to be of much assistance. Although it is clearly right that the purpose of the scheme and therefore the duty imposed on the trustees is to deliver the benefits provided under the scheme, any consideration of what those benefits are or may be must take into account all the provisions of the relevant trust deed including any power of amendment. This is a point I will need to return to later in this judgment.

62. Turning then to the provisions of the Trust Deed, Mr Tennet accepts that the starting point must be clause 2 although he prays in aid Lord Walker’s caveat in *Bank of New Zealand* that the purpose of a scheme may not be entirely apparent from the face of the documentation. The stated object of the scheme as set out in clause 2 is of course relied on as making the increase in pensions *ultra vires* as “benevolent or compassionate payments”. But BA contend that the terms of clause 2 (“the main object of the scheme is to provide pension benefits on retirement”) also provides confirmation that the APS is designed to provide deferred remuneration earned by the members’ service and must be looked at having a business rather than a benevolent objective.
63. An important provision is clause 4(a) which assigns to the Trustees the duty of managing and administering the scheme. This is relied on as indicating that their rôle does not include the design of the benefits structure. Similarly, it is said that the balance of funding obligations imposed by clause 11 depending on whether the scheme is in deficit or surplus will be distorted if the Trustees are entitled to re-write the benefits provided so that a surplus can never arise.
64. In relation to clause 18 itself, Mr Tennet accepts that the power of amendment is widely drafted but does not at least in terms extend to the improvement of benefits. The exercise of the power is of course subject to a number of express restraints including that it should not be used to change “the purposes of the scheme”: see clause 18(i). The second ground of appeal (the *ultra vires* argument) relies on this. But Mr Tennet says that the question of improper purpose is a slightly different question which requires a wider consideration of the scheme than simply clause 2.
65. The other provision in the Trust Deed which featured in the argument is clause 19(d) which deals with the disposal of any remaining balance in the fund in the event of a winding-up of the scheme. Clause 19(c) provides for the purchase of annuities and a remaining balance then falls to be distributed in accordance with clause 19(d) which provides:

“In the event of there being any balance in the Fund upon the expiry of the scheme or remaining after application under the provisions of sub-clause (c) of this Clause the Rules of the scheme shall be amended in consultation with the Actuary, subject to paragraph (e) below, to provide additional benefits (in the form of pensions and/or allowances) for Members or

pensioners by way of non-commutable annuities PROVIDED HOWEVER that the aggregate of the actuarial values of such additional benefits shall not be in excess either of such balance or of the actuarial equivalent of such additional pensions or allowances. Such annuities to be purchased in manner provided under the said sub-clause (c) of this Clause. Any balance then remaining being paid to the Employers in proportions determined by the Actuary.”

66. Mr Tennet emphasises that this is the only express power conferred on the Trustees to increase benefits but it applies only in the event of a winding-up and if there is a balance which requires to be disposed of. It cannot therefore be regarded as a power to set the levels of remuneration which BA must fund. It is given to the Trustees simply as a matter of good administration. The overall purpose of the Trustees’ powers remains one of delivering rather than setting the benefits to which the employees are entitled.
67. The deployment of the proper purposes rule in the way it has been relied on in this case is novel. Although it is not necessary to refer to them, we were shown a whole series of decisions (mostly at first instance) which Lewison LJ has referred to in his judgment in which judges have had to consider the legality of particular exercises of the powers conferred on trustees sometimes in relation to the disposal of a surplus or the alteration of benefits but in other cases more generally. Although the argument in these cases (such as *Stevens v Bell* supra) has involved a detailed examination of the provisions of the particular schemes, the legality of the trustees’ actions has been considered largely in terms of *vires* having regard to the proper construction of the terms of the trust deed and any rules. Where the proper purposes argument has been used it has been confined either to bolstering what would otherwise be a claim of *ultra vires* or where the action in question ran contrary to the fundamental purposes of the scheme as in *Courage*. There are no cases where on the proper construction of the trust provisions the trustees have had power to do what is proposed but that power has been held nonetheless to be limited not by reference to the overall purpose or object of the scheme but by reference to the existing scope of those very powers.
68. Although novelty is not a bar to principle, I have come to the conclusion that there are really insuperable difficulties in trying to construct out of the provisions I have referred to a purpose-based limitation on the proper exercise of the clause 18 power. In cases like *Courage* and *Eclairs* the courts were able to identify a governing purpose for the scheme or (in the case of *Eclairs*) the power conferred by the articles of association which was enough to invalidate what was proposed. The power to substitute a new employer in *Courage* could not properly be used to allow Hanson to dissolve the scheme and lay hold of the surplus. In *Eclairs* a power given to reinforce a request for information could not be used to block opposition to the re-appointment of directors. But this high-level approach does not produce the result for which BA contends in the present case. The overall object and purpose of the APS is expressly identified in clause 2 as the provision of pension benefits on retirement in contrast to a benevolent scheme. The pension benefits are those provided for under the terms of the Trust Deed and the Rules.
69. Although neither the Trust Deed nor the Rules in their original form provided for increases in the benefits payable, both included a power of amendment which, as the

judge found, was exercised from time to time to provide for pension increases. Rule 15 which provided for annual increases by reference to increases in other public-sector pensions was a later addition which must again have been introduced by the exercise of the power of amendment. Even if one ignores the history of these changes and starts with a consideration of the scheme and its Rules as of 1 April 2008, the structure of the APS was that it provided index-linked benefits to members and contained a power of amendment that was widely drawn. A consideration of the structure of the scheme and the derivation from it of an object or purpose must take into account not only the existing benefits structure but also the ability of the Trustees which has always existed to make amendments to it.

70. The equitable overlay embodied in the proper purposes rule can have no application in my view unless it is clear that the Trustees intend to use the powers they were granted to achieve something which can be characterised as improper. Even if one puts aside Lord Sumption's suggestion in *Eclairs* that this involves a subjective test of intention, it clearly requires regard to be had to the terms of the trust instrument and any other relevant background material in order to construct the limits of the discretion. This means that the starting point in this case must be clause 18 itself and, in particular, clause 18(i) which expressly forbids an amendment that would change the purposes of the scheme. It must be highly debateable whether, in the light of this provision, there is any or very much room for the operation of the proper purposes rule in relation to clause 18. But even if it is not excluded, its content must equally depend on what the Trust Deed itself identifies as the purpose of the scheme. This is spelt out in clause 2 which I need not repeat.
71. The irony of this case is that although the amendment to Rule 15 is not limited in terms to adjusting the rate of annual increases, the exercise of that power which has precipitated this litigation did no more than in part to re-instate the application of RPI which had operated as the measure of inflation for the purposes of the scheme for a number of years. The change in government policy which led to the adoption of CPI operated to the benefit of BA but did not alter the principle of an annual index-linked increase as part of the benefits structure. The November 2013 increase to some extent reversed this change and undoubtedly imposed on BA additional financial obligations which it had not provided for and which it naturally objected to. But it did not confer on the members of the scheme a benefit that was different in kind from what they had always enjoyed.
72. Taking simply the amended rule 15 power, it is not possible in my view to treat the grant to the Trustees of a power to review the annual rate payable and to apply discretionary increases as something falling outside the provision of pension benefits in accordance with clause 2 so that unless one can construct from the other provisions of the Trust Deed a further qualification to the effect that the pension benefits should be only those which BA is willing to fund or can be provided for out of an available surplus, the proper purpose rule can have no application in this case.
73. If one drills down, so to speak, into the other provisions of the deed which Mr Tennyson has relied upon it is undoubtedly the case that BA as the employer is the funder, that the Trustees or new Trustee are given the primary task of administering the scheme rather than setting the level of benefits, and that apart from Rule 15, there is no express provision for the increase of benefits. But none of these provisions nor anything in the relevant contextual background is relied upon as supporting a

construction of clause 18 which excludes changes to benefits unless consented to by BA and if the amendment under consideration was not *ultra vires* then it is difficult in my view to see what purpose of the scheme it infringed. The amendment made was within the scope of clause 2 as drawn for the reasons I have given. BA's argument seems to me to be an attempt to elevate particular provisions of the scheme which construed together do not impose a relevant restriction on the Trustees into a purpose of the scheme best expressed as a principle that there should be no increase in or alteration to the benefits structure which would impose on BA as employer a funding obligation it was not prepared to consent to.

74. In my view this is not a purpose or object of the scheme but a matter of detail which will differ from scheme to scheme depending on how they were originally constructed or have developed over time. It is not and cannot be part of BA's argument that a power for trustees to increase benefits without the employers' consent is by its very nature inimical to any occupational pension scheme and unless it can be regarded as fundamental in that kind of way I do not see how the equitable principles we are concerned with come to be engaged. The question becomes one of *vires* alone and, as to that, the parties are agreed that the amendment was lawful unless it resulted in the making of benevolent or compassionate payments to the members. The absence of any requirement for the employer to consent to an increase or change in benefits may be unusual but in the present case that is largely the product of the scheme's history which I have set out in the earlier part of this judgment. I also agree with Mr Rowley's submissions that the various qualifications which BA has accepted in its formulation of this principle, in particular its non-application when the scheme is in surplus, are likely to make it difficult in practice for the Trustees to know with any certainty what are the precise limits to the exercise of the power. With respect to Peter Jackson LJ, the formulation of the purpose of clause 18 suggested at [126] would in my view place the Trustees in a position of complete uncertainty about the scope of their powers. This is in sharp contrast to the express terms of clause 18 itself.
75. As the judge observed, the clause 18 power of amendment does embody a number of safeguards including the requirement for a two-thirds majority of the Trustees in favour of its exercise which will enable the employer-appointed trustees to exert a significant influence in any discussion about whether to increase benefits as they did in the present case. But more important is that it is to be exercised in good faith in a proper trustee-like manner which requires the Trustees to take into account and give proper weight to the obligations of the employer and issues such as the deficit in the scheme and the affordability of the increases. These do not of course give the employer the same level of protection as a veto but they do require the Trustees to carry out a rigorous and realistic assessment of the position which can be subject to review by the Court as it was in this case. Those are the control mechanisms to guard against any aberrant or excessive exercise of the power.
76. In my view there has been no breach of the proper purposes rule either in relation to amendment of the Rule 15 power or its subsequent exercise.
77. That takes me to the second issue which is whether the exercise of the amended Rule 15 power resulted in the making of benevolent or compassionate payments. This is a pure question of construction.

78. On the judge's findings the Rule 15 power was exercised in order to give effect to an expectation among members of the scheme that any increase in pensions under Rule 15 would be based on RPI. BA's case was that this amounted to an act of sympathy or generosity towards members of the APS which infringed the provisions of clause 2.
79. The judge had no difficulty in rejecting the argument that the increase amounted to a compassionate payment. He accepted Mr Rowley's submission that this description could not be applied to a pension increase which had been awarded across the board to all pensioners regardless of their personal circumstances:

"476. It is easy to hold that the award of a 0.2% discretionary increase did not involve a compassionate payment. The trustees were not moved by compassion in making their decision. The increase was to be available to all pensioners whatever their personal circumstances, whether or not they were suffering hardship and whether or not their circumstances deserved compassion."

80. But he found the question whether the award involved or amounted to the making of a benevolent payment more difficult. The Oxford English Dictionary definition of "benevolent" is "desirous of the good of others, of a kindly disposition, charitable, generous" and in one sense the Trustees' decision to award an additional increase above the members' strict legal entitlement could be described as generous or even charitable in its non-technical sense. But the judge took the view that the effect of clause 2 could not be determined simply by an application of these dictionary meanings but had to be considered in the context of the scheme as a whole. At [478] he said:

"478. I will not attempt a comprehensive definition of "benevolent payments" for the purposes of this scheme. However, the above arguments taken together powerfully suggest that the prohibition in clause 2 of the trust deed on the making of benevolent payments was not intended to prevent the trustees conferring on themselves, and then exercising, a power to make discretionary payments which would be available to all of the pensioners irrespective of their personal circumstances. I therefore conclude that the decision of 19 November 2013 to award a discretionary increase was not contrary to clause 2 of the trust deed."

81. The evidence before the judge was that the reference in clause 2 to the scheme not being a benevolent scheme can be traced back to two earlier pensions schemes, the 1936 Imperial Airways Limited Pension Scheme and the 1942 British Overseas Airways Corporation Pension Fund. The researches of the parties did not indicate much more than that clause 2 was probably inserted into the APS to ensure that it obtained Revenue approval. Benevolent schemes had existed for a long time in order to provide financial assistance on the basis of need. But tax concessions for pension schemes were introduced by the 1921 Finance Act and the draftsman of the APS is likely to have wanted to emphasise that the scheme was one which provided only pension benefits to members entitled to them and did not make benevolent or compassionate payments.

82. It seems to me that clause 2 is designed to draw a distinction between the provision of pension benefits on retirement in accordance with the provisions of the scheme and purely gratuitous payments of a benevolent or compassionate kind which are not pension payments. The fact that the motivation for a general increase in the pensions payable may include an element of generosity does not make the payment a benevolent one for the purposes of clause 2. The judge was right in my view to reject BA's contention that the 2013 pension increases were *ultra vires* clause 2 of the Trust Deed.
83. I would therefore dismiss this appeal.

Lord Justice Lewison:

84. I have had the privilege of reading the judgment of Patten LJ in draft. I adopt with gratitude his exposition of the relevant facts and the relevant instruments. I agree entirely on the question whether the increases in pension were "compassionate" or "benevolent" and thus prohibited by clause 2 of the Trust Deed. For the reasons he has given they were not. Where I have more difficulty is in relation to the "proper purpose" argument, in relation to which I have reached a different conclusion.
85. The proviso under attack is the amendment to rule 15 which provides:
- "the Management Trustees may at their discretion, and shall in any event at least once in any one year period, review the annual rate of pension payable or prospectively payable under Rules 8, 9, 10, 11, 12, 13 and 34 and shall have the power, following such a review, by resolution to apply discretionary increases in addition to those set out in this Rule, subject to taking such professional advice as appropriate."
86. As Lord Sumption pointed out in *Eclairs* at [15]:
- "The important point for present purposes is that the proper purpose rule is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication. It is concerned with abuse of power, by doing acts which are within its scope but done for an improper reason."
87. There have undoubtedly been cases in which the court has upheld the exercise of a power of amendment by pension fund trustees either to augment benefits or to increase contributions payable by sponsoring employers. But I think that it is necessary to examine those cases more closely.
88. In *The PNPF Trust Co Ltd v Taylor* [2010] Pens LR 261 the trustees of the pilots' pension fund exercised a unilateral power of amendment in order to seek additional contributions from participating employers. The purpose of the increased contributions was to repair a deficit funding gap. As I understand that case the increase in contributions was required in order to enable the fund to pay the benefits that had already been promised to members; not to alter the extent of the promise. In

the course of his judgment Warren J reviewed a number of authorities, some of which I will come back to in due course.

89. *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustee Ltd* [2010] Pens LR 411 was another such case where a power of amendment was used to widen the class of employers required to contribute towards a deficit in the fund. Again, it was not a question of increasing the promised benefits. In a subsequent round of litigation about that scheme (*Merchant Navy Ratings Pension Fund Trustee Ltd v Stena Line Ltd* [2015] EWHC 448 (Ch), [2015] Pens LR 239) Asplin J said at [233] that a power of amendment could be exercised “as long as the primary purpose of securing the benefits due under the Rules is furthered”. The feature of the deficit cases is that the trustees are doing no more than taking steps to secure for members the benefits that they have been promised under the rules.
90. *Edge v Pensions Ombudsman* [2000] Ch 602 was a case in which there was an actuarial surplus. This, then, was a case in which the trustees of the scheme already had the assets in question under their management and control, and the question was whether in those circumstances they were entitled to introduce a contributions holiday. As Chadwick LJ explained at 623:

“First, the purpose of the scheme is to provide the retirement and other benefits to which the members, pensioners and dependants are entitled under the rules. The scheme is a “defined benefits” scheme: the benefits are fixed by the rules.”
91. He added on the same page:

“... it is no part of the trustees' function, in a fund of this nature, to set levels for contributions which will generate surpluses beyond those properly required as a reserve against contingencies.”
92. Other cases, including the previous round of litigation about this very scheme, have also been concerned with dealing with a surplus. One such case was the decision of my Lord Patten J in *The Law Debenture Trust plc v Lonrho Africa Trade and Finance Ltd* [2003] Pens LR 13, where the rules already contained an express power of augmentation on the part of the trustees. The feature of all the surplus cases is that the trustees are doing no more than managing assets that have already been entrusted to them.
93. Clause 11 of the deed in our case deals with what is to happen in the event of a deficit. The trustees must make a scheme for making good the deficiency; and that scheme must provide for the employer to make additional contributions. There is provision for employer’s consent and for any dispute to be referred to an actuary. The scheme will come into force subject to any amendments directed by the actuary. If the trustees are right, they could, by exercising the power of amendment, delete the dispute resolution procedure.
94. Again, clause 11 of the deed deals with what is to happen in the event of a surplus. In essence, the employer gets a contribution holiday for up to 30 years. If the trustees are

right, they could, by exercising the power of amendment, deprive the employer of that contribution holiday, and augment benefits instead.

95. In the present case, however, the proviso to rule 15 introduced by the amendment gives the trustees unlimited power, in effect, to design the scheme. The difficult question is whether that goes beyond the proper purpose of the power of amendment.

96. In *PNPF* Warren J referred to the decision of the House of Lords in *Hole v Garnsey* [1930] AC 472. That was a case in which the rules of an industrial and provident society were altered by amendment so as to compel members to subscribe for additional shares. The amendment was held to be invalid. Lord Dunedin said at 487:

“First it was decided that a rule of this kind if it took its place among the original rules, or was assented to as a new rule, was not bad in itself as being struck at by the provisions for limitation of liability, and secondly it was decided that such a rule was not bad because it prescribed an expanding liability to take extra shares, inasmuch as it gave a method by which that expanding liability could be accurately calculated. But when we come to the question of admitting a rule of that kind for the first time only by virtue of a general power of amendment, all seems to me to be altered. You are then supposed to be under a contract to be bound by any extension of your liability which a three-fourths majority may enforce without any power of prescience as to what form that liability may take. Take the present case. If, instead of the 5l. nominal value the rule had said 100l., it would be all the same. I therefore come most determinately to the conclusion that a contract to take extra shares and incur extra liability, which is not set forth but only introduced through a general power of the amendment of the rules, is too vague to be enforced and is bad at common law.”

97. Lord Tomlin said at 500:

“In construing such a power as this, it must, I think, be confined to such amendments as can reasonably be considered to have been within the contemplation of the parties when the contract was made, having regard to the nature and circumstances of the contract. I do not base this conclusion upon any narrow construction of the word "amend" in Rule 64, but upon a broad general principle applicable to all such powers.”

98. Warren J also referred to the decision of the House of Lords in *Society of Lloyd's v Robinson* [1999] 1 WLR 756, where Lloyd's exercised a power of amendment so as to require names to provide additional security. In explaining why that amendment was valid, Lord Steyn said at 767:

“The 1995 amendments do not impose any new liability on Names. They do not require Names to pay more than they were

already obliged to pay. They simply provide for additional security for pre-existing obligations.”

99. It is, of course, necessary to try to delimit the proper purpose for which the power has been conferred. I agree with Patten LJ that the objects clause in clause 2 of the trust deed is not enough on its own to invalidate the exercise of the power of amendment. But in my judgment that is not the end of the inquiry.

100. As Patten LJ has pointed out, by reference to *Bank of New Zealand*, the objects clause is the first port of call, but it is not decisive. As Lord Sumption said in *Eclairs* at [30]:

“Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context.”

101. In my judgment particular importance should be placed upon the constitutional functions given to the trustees under the Trust Deed. Clause 4 (a) describes their functions:

“The Management Trustees shall manage and administer the Scheme and shall have power to perform all acts incidental or conducive to such management and administration...”

102. I would draw from this that the function of the trustees is to manage and administer the scheme; not to design it. The general power that is given to them is limited to a power to do all acts which are either incidental or conducive to that management and administration. That is my understanding of the “business context”. This is consistent not only with Chadwick LJ's description of the purpose of a pension scheme, but also with the observations of Park J in *Smithson v Hamilton* [2007] EWHC 2900 (Ch), [2008] 1 WLR 1453 at [87]:

“A decision to have a pension scheme and the consequential decisions about the structure and design of the scheme are matters for the employer, or at least matters primarily for the employer. If the scheme is to have a pension trust fund there will be trustees, but the design of the scheme is still a matter for the employer, not for the trustees. This is not to say that the trustees are compelled to accept the employer's design. If the trustees object to it they cannot be compelled to join in executing the deed and rules. However, I persist that it is the employer which takes the lead in formulating the design of the scheme. If in the event the trustees do not object and are content to execute the documents in the terms prepared by the employer or the employer's advisers, then the scheme is the employer's scheme, not the trustees' scheme. Once the scheme is established the trustees will have important functions to carry out and duties of a fiduciary nature to perform in connection with the scheme, but the trustees do not have a major role in determining what the rules of the scheme are to be.”

103. These are, to paraphrase Lord Sumption in *Eclairs* at [37], “the respective domains” of the trustees and the employer. I do not consider that the design of the benefit structure falls within the purpose of the general power given to the Trustees under clause 4 (a). The design of the benefit structure is neither the management nor the administration of the scheme. In addition, even where a power is apparently unlimited, its use to alter the constitutional balance of an entity can amount to a breach of the proper purpose principle.

104. *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 concerned the exercise by directors of a power to allot or otherwise dispose of shares to such persons on such terms and conditions and either at a premium or otherwise and at such time as the directors might think fit. Although the company was in need of fresh capital, the directors issued shares primarily to fend off a takeover bid. Giving the advice of the Privy Council, Lord Wilberforce said at 835:

“In their Lordships' opinion it is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not.”

105. In holding that the exercise of the power was invalid, Lord Wilberforce said at 837:

“The constitution of a limited company normally provides for directors, with powers of management, and shareholders, with defined voting powers having power to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. Just as it is established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office ... so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers.”

106. Lord Sumption made much the same point in *Eclairs* at [16]:

“A company director differs from an express trustee in having no title to the company's assets. But he is unquestionably a fiduciary and has always been treated as a trustee for the company of his powers. Their exercise is limited to the purpose for which they were conferred. One of the commonest applications of the principle in company law is to prevent the

use of the directors' powers for the purpose of influencing the outcome of a general meeting. This is not only an abuse of a power for a collateral purpose. It also offends the constitutional distribution of powers between the different organs of the company, because it involves the use of the board's powers to control or influence a decision which the company's constitution assigns to the general body of shareholders.”

107. At [29] he approved Briggs LJ’s observation:

“Furthermore, I consider it important that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, all the more so where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders.”

108. It is to be noted that:

- i) The impugned proviso imposes an obligation on the trustees to review the annual rate of pension; and
- ii) The power to apply increases is not limited to increases in the cost of living.

109. It is true that the trustees are required to take actuarial advice. But there is no restriction on the nature of the advice. The actuary may, for example, advise the trustees that if they wish to augment benefits they must require additional contributions from the employer. The rules would then require the employer to pay them.

110. I would readily accept that managing and administering the scheme entitles the trustees to deal (if necessary by amendment) with assets which already form part of the scheme (i.e. where there is a surplus); or to require (if necessary by amendment) additional contributions to be made in order to secure the benefits promised under the rules. As I have said, clause 11 in fact makes provision for these eventualities. But I do not agree that, in effect, the trustees can do whatever they like so long as their ultimate purpose is to provide pensions. It is true, as Patten LJ points out, that exercise of the power conferred by the proviso requires the trustees to balance the interest of the employer against other considerations. But I do not regard that as detracting from the fundamental point that the trustees are arrogating to themselves the responsibility for *designing* as opposed to managing and administering the scheme, in circumstances in which (a) the fund is in deficit and (b) the employer would be required to make additional contributions not for the purpose of funding benefits already promised but for funding additional benefits decided upon by the trustees. That is not the trustees’ constitutional function under the trust deed. In my judgment the amendment goes beyond the purpose of the power of amendment contained in clause 18 of the trust deed.

111. I would allow the appeal.

Lord Justice Peter Jackson:

112. I have had the real advantage of seeing the above judgments in draft and I also gratefully adopt the comprehensive account of the facts given by Patten LJ.
113. Like the other members of the court, I do not accept BA’s argument that the exercise of the amended Rule 15 power fell foul of clause 2 of the Trust Deed as being benevolent or compassionate. I agree with Patten LJ that the provision is likely to have been designed to differentiate the scheme from benevolent schemes of the kind that were common before the advent of occupational pensions and that the payment in this case would have been a pension payment and not a benevolent or compassionate one. Although the result is the same, I prefer this route to the reason given by the judge at [478], which relies on the fact that the payment was made to all pensioners regardless of personal circumstances. It is possible to envisage a payment made to all pensioners that would nonetheless be benevolent and it is, I think, the nature of the payment and not the cohort of recipients that matters in this context.
114. The further question is whether the addition in 2011 and subsequent exercise in 2013 of the proviso to Rule 15, allowing the trustees to apply discretionary pension increases in addition to the automatic increases already provided for by that rule, was a valid exercise of the power of amendment contained in Clause 18. This calls for consideration of the purpose of that clause, which itself (by its first proviso) requires identification of the purpose of the scheme as a whole, so that it can be determined whether a proposed amendment would bring about an impermissible change.
115. Like all such documents, the Trust Deed seeks to identify the areas of responsibility and competence of the parties in a way that reflects the intentions of the settlor. For our purposes, the essential contours of the scheme within which Clause 18 sits are seen in these clauses:
- Cl. 2 Objects clause
 - Cl. 3 Employer covenant
 - Cl. 4 Trustees’ duty to manage and administer
 - Cl.11 Employer’s duty to remedy certified deficiency
 - Cl.13 Trustees’ power to determine entitlement and resolve disputes
 - Cl.24 Employer’s power to increase benefits
- Rule 15 Automatic PIRO [Pensions (Increase) Review Order] increase
116. The question therefore is: what is the purpose of the power of amendment in the context of the purpose of the scheme as a whole? It seems to me that the answer to this will be affected by the manner in which the inquiry is undertaken. In the first place there must be an understanding of what is meant by ‘the purpose of the scheme’. Is this restricted to the result that the scheme exists to produce, or is it a wider concept encompassing both the result and the essential means by which it is to be produced? In my view, the latter is correct. As the authorities show, the inquiry begins with but is not limited by the objects clause (‘to provide pension benefits’). The scheme’s purpose is wider than that, in particular in the way that it ordains the balance of powers as between employer and trustees so as to ensure a durable scheme that

balances all interests. The purpose of the scheme is therefore not simply to provide pensions, but also to provide the machinery whereby pensions are provided. I therefore respectfully part company from Patten LJ when he characterises core elements of the scheme, listed above, as matters of detail. This effectively limits the inquiry to what appears in the objects clause and overlooks the essential character of the scheme that was designed to achieve those objects.

117. Consideration must then be given to the level of detail to which it is appropriate to descend when scrutinising the scheme. I accept that one must take a broad view ('a fairly high level of generality'), but this does not require the view to be so broad as to be essentially uninformative. Patten LJ notes that the trustees did not confer on the members a benefit that was different in kind from what they had always enjoyed. That is so, but it does not take one further forward in the inquiry into the purpose of the scheme and of clause 18.
118. Approaching the matter in this way, there are in my view a number of matters that shed light on the question.
119. The design of the scheme as contained in the Trust Deed specifically mandates circumstances in which the employer is or may be required to pay more: for example, as a result of rule 15 (automatic increases), clause 11 (remedying deficiencies), or clause 13 (if adding beneficiaries). At the same time, the deed allocates a discretionary power to increase benefits *to the employer* (clause 24).
120. In contrast, there is self-evidently no provision for unilateral discretionary increases *by the trustees*, that omission being the entire reason for the contested amendment. Mr Rowley argues that this absence from the face of the deed is of no significance, and that it is implicit that the trustees' wide power under Clause 18 can validly be deployed to remedy this (see transcript 2.5.18 p.127: "...the core of our submission is that the power of amendment can be used to change a scheme's benefit structure.") This submission was accepted by the judge, who concluded at [635(8)] that the trustees had the unilateral power "to define the benefits of the scheme".
121. The description at clause 4 of the trustees' role as being to manage and administer the scheme is unsurprising and is in my view of clear significance. This does not preclude them from making decisions that have financial repercussions for the employer, indeed almost all management and administration decisions will have some effect, however small, on the employer's liabilities. But there is nothing to suggest that the power of amendment was intended to give the trustees the right to remodel the balance of powers between themselves and the employer. In my view, the amendment to Rule 15 resulted in a scheme with a different overall purpose, in which the trustees effectively added the role of paymaster to their existing responsibilities as managers and administrators. The observations of Sir Andrew Park in *Smithson*, cited by Lewison LJ, are in my view persuasive.
122. It is no answer to this to say that the power of amendment is framed in general terms and contains safeguards in requiring proper trustee-like behaviour, the taking of advice and the achievement of a supermajority. These are brakes on the power of amendment, but the question here is not whether the brakes are working but whether the journey itself is permitted.

123. It is also true that a fundamental change in the scheme's balance of power was effected by the removal of the ministerial veto, but the remaining provisions of the scheme were unaffected by that. The removal of the veto and the unusual historical context does not imply a more expansive power of amendment of the kind argued for by the trustees.
124. Further, it is said that this deployment of the proper purposes rule would be novel, even unprecedented. In my view, it is the actions of these trustees that are novel, not the application of the rule. It may be no coincidence that all the authorities arise from cases involving surpluses, and I would consider the trustees' actions in taking steps to dispose of a surplus to be conceptually different from actions that would increase the employer's liability for a scheme already in very substantial deficit.
125. I would not, however, accept Mr Tennet's submission that the fundamental purpose of any occupational pension scheme is to deliver the benefits that the employer is willing to fund. The purpose of a scheme is to be ascertained from the contents of the instrument, an analysis of their effect and an understanding of the business context: *Eclairs* at [30].
126. Taking all these matters into account, I conclude that the true purpose of clause 18 is to give the trustees a wide power to (as was described in *Courage*) make those changes which may be required by the exigencies of commercial life. The amending power granted to these trustees was never intended to permit them to impose discretionary increases upon BA and the amendment of Rule 15 in 2011 and the exercise of the purported power in 2013 were 'for purposes contrary to those of the instrument': *Equitable Life* at 460F. I would firmly reject as mere polemic the submission that this conclusion emasculates clause 18 and reduces the trustees to little more than a cypher.
127. For these reasons, and in full agreement with the reasoning much better expressed by Lewison LJ, I would allow this appeal.