

## Ombudsman's Determination

Applicant	Mr Y
Scheme	Smiths Industries Pension Scheme ( <b>the Scheme</b> )
Respondent	Smiths Group plc ( <b>Smiths</b> )

### Complaint Summary

Mr Y has complained that Smiths has failed to inflation link pensions in accordance with its previous undertakings.

### Summary of the Ombudsman's Determination and reasons

The complaint is not upheld because there was no absolute commitment to pay the higher rate of increase and Smiths has acted in accordance with the Rules.

## Detailed Determination

### Material facts

1. Mr Y's complaint is against Smiths. However, for completeness I have also referred to correspondence with the Trustee of the Scheme (**the Trustee**) where it is relevant to do so. I have also given the Trustee the opportunity to comment on my Preliminary Decision and have considered those comments in drafting this Determination.
2. At the time of the matters Mr Y has complained about the Scheme was governed by 'the 1999 Rules' (**the Rules**). The relevant wording is contained in Rule 7.1, 'Payment of benefits - Increase of pensions' (see Appendix 1).
3. In 1998, all members of the Scheme received a newsletter entitled 'Pensioner Newsletter August 1998 Special Edition' (the **Newsletter**) from the Trustee advising them of an improvement in the inflation protection of pensions in payment (see Appendix 2).
4. The Newsletter and an edition of "Simply Pensions" (for employees) announced various benefit improvements, including "the aim of providing annual increases in line with the Retail Prices Index (**RPI**) up to a maximum of 10% a year, subject to the finances of the Scheme" (the **Stated Aim**). There was no other condition applied.
5. These benefit improvements were incorporated into the Rules by a Deed of Variation dated 22 September 1998 and were then reconfirmed in the current Rules by a Deed of Variation dated 29 March 1999.
6. RPI is used as the "Index" for the purpose of pension increases. Rule 7.1, applicable to members of the main section of the Scheme, provides for pensions in payment in excess of the Guaranteed Minimum Pension (**GMP**) to be increased on each 1 May by the lower of 5% and the percentage increase in the RPI published for the previous calendar year ending 31 December.
7. Rule 7.1 also states that if in a year the percentage increase in the Index is greater than 5% the Trustee may, at the request of Smiths, calculate the rate of increase for that year as if the 5% maximum percentage figure was 10% and that, in applying this rule, both Smiths and the Trustee will have regard to the Stated Aim.
8. In May 2022, the RPI rate at the preceding 31 December was calculated as 7.5%. However, an increase of 5% only was applied to pensions in payment.
9. A similar scenario applied in May 2023, when the relevant RPI rate was above 10% but increases were again limited to 5%.
10. On 28 September 2022, Mr Y wrote to the Trustee to complain under the Scheme's Internal Dispute Resolution Procedure (**IDRP**). He followed this up with a further letter dated 7 October 2022. He complained that the annual increase applied to his Scheme pension in excess of the GMP from 1 May 2022 should have been 7.5% instead of the 5% increase that was actually awarded. He said this was in

contradiction to the commitment made to members in August 1998. He asked for the higher increase to be paid together with accumulated arrears.

11. In summary, Mr Y asserted:-

- There was no intention in 1998 to provide Smiths with a 'veto', that 'the finances of the Scheme' was intended to be deliberately vague and that discretionary increases should be provided when the Scheme is in surplus on an ongoing basis but not where there is material deficit.
- While the Stated Aim did not provide a guarantee, eligible beneficiaries had legitimate expectations of increases provided in accordance with it given the communications they had received in 1998 and subsequently. He considered Smiths had ignored these communications.
- He considered that Smiths was not acting in good faith in its decisions connected with the Stated Aim.
- He asked:
  - what actions the Trustee had taken to oblige Smiths to meet the Stated Aim; and
  - why the wording about the Stated Aim had been changed in the 2022 Scheme report and accounts.
- He requested a copy of the Rules reflecting the Stated Aim together with various other papers and legal advice.

12. The Trustee responded to Mr Y's IDRP complaint on 9 December 2022. It said among other things:-

- 12.1. The Stated Aim was not a contractual promise, guarantee or commitment that the additional increase would definitely be paid in any given year. It was communicated in the special Pensioner Newsletter of August 1998, and is now known as the "Stated Aim" of providing annual increases in line with RPI up to a maximum of 10% a year, subject to the finances of the Scheme.
- 12.2. The award of the Stated Aim pension increases is discretionary and the Trustee may only pay this if there has been a request to do so from the Principal Company. No such request was received from Smiths as the Principal Company in relation to the 1 May 2022 increase.
- 12.3. By mid-March 2022 the Trustee decided that in principle it was prepared to agree to the additional Stated Aim increase being awarded, should Smiths as the Principal Company request this. Smiths, however, decided not to request payment of the Stated Aim increase in relation to that year.

- 12.4. The Trustee does not have any unilateral power to award Stated Aim increases (or any other higher increases) without the Principal Company's agreement.
- 12.5. The percentage increase in the RPI in the year to 31 December 2021 was 7.5% and the Trustee was disappointed that Smiths did not request the increase to pensions on 1 May 2022 to reflect this. The Trustee was unable to uphold Mr Y's complaint, however, because ultimately it had acted in accordance with the Rules which state that pensions in payment in excess of the GMP will increase each year in line with the smaller of the percentage increase in the Index and 5%, unless Smiths as the Principal Company requests the higher Stated Aim amount. The Principal Company did not make this request, and the Trustee therefore awarded increases capped at 5% on 1 May 2022.
- 12.6. The Trustee had considered the wording of Rule 7.1 and its interpretation. The Trustee noted that Mr Y was involved in the introduction of the Stated Aim into the Rules in 1998, in his role as the senior company executive responsible for pensions, and that his view was there was no intention at the time to provide Smiths as the Principal Company with a veto as to whether the Stated Aim increases are provided. It acknowledged that Mr Y believed that the wording of the 1998 Trust Deed amendment should have given beneficiaries reasonable assurance of the Stated Aim increases other than in adverse funding conditions (that is a deficit on the ongoing basis). It understood Mr Y's view was that the phrase "subject to the finances of the scheme" was deliberately vague but its meaning was constrained by the historical practice before 1998 where discretionary benefits were provided when the Scheme was in surplus and not when there was a reasonable deficit.
- 12.7. The "aim" was translated into the Rules in 1998 (and then into the consolidation in 1999). When the Stated Aim was first put into the Rules, Smiths as the Principal Company required that this be included as a joint discretion in similar terms to the general augmentation power (rather than including, for example, a unilateral discretion for the Trustee to make the decision on its own). So a Principal Company "veto" does exist (because the Principal Company required it), subject to the Principal Company complying with its legal duties.
- 12.8. The Trustee considered the previous award of discretionary increases in the years before 1998 did not create any binding precedent now, which required Smiths or the Trustee to award the increases or consider the 'finances of the Scheme' in a limited way.
- 12.9. It said it was not obliged to disclose its meeting papers or legal advice and would not provide this to any members. It considered it had explained its position in detail.

- 12.10. It did not have access to any of Smiths' legal advice (which is subject to its own legal privilege).
- 12.11. The Trustee observed that Mr Y had noted that the Stated Aim does not provide a guarantee but that eligible beneficiaries have legitimate expectations of Stated Aim increases given the communications mentioning the Stated Aim that they will have received in 1998 and subsequently over the years. Mr Y's view is that Smiths has ignored these communications.
- 12.12. The Trustee agreed that the Stated Aim does not provide a guarantee of the increases being paid. The Trustee also agreed the eligible members have an expectation that there is an aim to award the increases, having been told about this over the years. However, the communications had always referred to this being an 'aim' and not a guarantee and it would not be reasonable for members to have considered it as a guarantee.
- 12.13. The Trustee noted that Mr Y considered that Smiths as Principal Company had not acted in good faith in its decisions connected with the Stated Aim. Mr Y's view is that Smiths as the Principal Company has not considered the bargain struck on behalf of the beneficiaries in 1998. Mr Y has said that Smiths as the Principal Company has not considered the quantum of the "loss" to those subject to the Stated Aim and the quantum of "gain" to those not subject to it, which is created by not awarding the increases. Mr Y's view is that the Principal Company has attributed too much weight to the fact that there is benefit to all beneficiaries (including those who are not in scope to receive Stated Aim increases) or not awarding the Stated Aim increases as it allows full insurance "buy-out" increases. Mr Y believes that the Principal Company wants to defund the Stated Aim.
- 12.14. In relation to the good faith issue the Trustee recognised that members are disappointed by the outcome of the Principal Company decision making process. The Trustee is also disappointed that members have not been awarded the increases. Nevertheless, so long as the Principal Company has considered the exercise of the discretion properly and in line with the Rules, the decision on whether to request the increases in any given year is one for the Principal Company to make. A Court will not substitute its own decision (or the Trustee's or members' decision) for the Principal Company's decision and would only ask whether the Principal Company has complied with its legal duties. The question is therefore – what are the Principal Company's duties when considering the discretion?
- 12.15. The Trustee noted that the Principal Company is required when making its decisions connected with the Scheme, not to undermine or damage the relationship of trust and confidence it has with Scheme members. The duty is known as the "Imperial duty" (as it was first established in *Imperial Group Pensions Trust Limited v Imperial Tobacco [1991] 1 WLR 589*) and the

principle has been reconsidered and developed in subsequent cases including a recent case from 2017 involving the IBM pension arrangements<sup>1</sup>.

12.16. The legal test as to whether Smiths has acted properly has two limbs. The first limb is that it must take into account relevant factors and discard irrelevant factors when making its decision, and it is then free to attribute what weight it thinks appropriate to those relevant factors. The second limb of the test asks the question whether any reasonable employer could reach the decision Smiths had reached – this is essentially an objective test of rationality. Therefore, an employer's decision can only be successfully challenged if the decision it has reached is irrational – which is a high bar (that is no other decision maker could reasonably have reached the same conclusion). It is not enough to say that a different decision-maker would have reached a different decision. The Trustee noted that Smiths had not raised “de-funding” of the Stated Aim with the Trustee.

12.17. It recognised that members were disappointed by the outcome of Smiths decision making process. Nevertheless, Smiths had discretion as to whether to request that increases are awarded.

12.18. Provided Smiths had considered the exercise of its discretion properly and in line with the Rules, the decision on whether it wished to request the increases in any given year was for it to make.

12.19. The Scheme's report and accounts had been amended in 2022 to clarify that while there was an aim to provide the additional increases this was subject to Smiths' consent. This clarification reflected the existing Rules.

13. On 15 December 2022, Mr Y wrote to Smiths. He said he disputed its decision not to request an increase consistent with the Stated Aim. He said that he considered that Smiths was in breach of its duty of good faith, and that the May 2022 pension increase should have been paid in accordance with the Stated Aim.

14. In summary he said:-

- He believed that Smiths had an obligation which was set out in the Newsletter which said:

“The Company will also improve the future inflation protection of qualifying pensions by adopting the aim of providing annual increases in line with RPI up to a maximum of 10% a year, subject to the finances of the Scheme.”

Similar wording was included in pension handbooks.

- This improvement was Smiths' side of a bargain from which it obtained considerable monetary benefit. Aside from any legal obligation derived from the Rules, the Newsletter and the bargain that was behind it could not be lightly

---

<sup>1</sup> *IBM United Kingdom Holdings Ltd & Anor v Dalgleish & Ors* [2017] EWCA Civ 1212

ignored by Smiths. This was particularly so as the Scheme had been funded since 1998 on the basis of meeting the higher liability.

- *Imperial* defined good faith as requiring Smiths to avoid “conducting themselves in a manner likely to destroy or seriously damage the relationship of confidence and trust between employer and employee”. He considered Smiths’ stance of failing to comply with the Stated Aim seriously damaged that relationship.
- Smiths’ explanation sought to give the impression that this was simply a matter of it exercising its discretion, as it would be if the communication with members and the Rules had remained as was in place prior to 1998, when these matters were simply discretionary. But this was not the situation. Smiths had agreed to the Scheme being run and funded so as to meet the Stated Aim.
- The Stated Aim provisions require Smiths to act in a manner that is likely to enable the aim to be fulfilled, and in doing so it has a responsibility to consider all relevant matters, to not consider irrelevant matters, and to avoid acting perversely. He believed Smiths had failed in its responsibilities.
- He believed Smiths had acted perversely as demonstrated by the following:-
  - Until 1998, when there was no Stated Aim, Smiths’ practice was to authorise discretionary increases from time to time when the Scheme funding was in surplus.
  - In 1998, Smiths agreed to improve the prospect of future inflation protection by incorporating the Stated Aim and funding for such increases with those increases being subject to the finances of the Scheme.
  - Thus the potential for annual increases in the range from 5% to 10% was no longer purely discretionary but became a Stated Aim and the Scheme’s Technical Provisions now included an allowance for such potential increases.
  - This agreement was quid pro quo for Trustee agreement to matters benefitting the Principal Company, yet on the first occasion when the Stated Aim came into play Smiths had declined to agree the pension increase.
  - He believed that Smiths had erred in its decision making process, particularly in its obligation to not consider irrelevant matters.
- The marginally reduced funding level in relation to other beneficiaries did not influence their realistic expectations of future payments, as this group was almost entirely fixed GMP pensions, which in the unlikely event of scheme failure would be fully compensated by the PPF. He considered Smiths’ explanation of its rationale to be disingenuous and incomplete, and that the reason why it had declined to request the Trustee for the Stated Aim to be applied might be because it had been determined that the Scheme surplus was recoverable by the Group. By not requesting the Trustee to apply an annual increase utilising the Stated Aim provisions Smiths stood to ultimately recover a greater surplus from the Scheme.

- By establishing a history of not requesting the Trustee to apply an annual increase utilising the Stated Aim provisions, Smiths may hope that at some future date it may be able to secure a buyout of the Scheme with an annual increase provision capped at 5% rather than the Stated Aim of 10%. However, Mr Y considered that it would be incompatible with Smiths' implied duty of good faith for it to state that an increase over 5% would never be paid in the future and that it therefore followed that the Trustee would never be able to agree to a buy-out of the Scheme liabilities that did not include the prospect of annual pension increases in accordance with the Stated Aim.

15. Smiths responded to Mr Y's letter on 11 January 2023. In summary it said:-

- It did not accept Mr Y's claims. In exercising its discretion in respect of the Stated Aim it had acted in accordance with its duties and obligations under the Rules and all applicable legislation.
- It had fulfilled its duty as set out in *Imperial*. It had considered the matter carefully and in depth, with a decision being taken by its Board of directors. In reaching its decision, Smiths followed due process, obtained professional advice and had taken into account all relevant (and no irrelevant) factors.
- It had not acted in a manner calculated (or likely) to destroy or seriously damage the relationship of confidence and trust with Scheme members.
- Mr Y's comments about a 'bargain' struck in 1998 were not accepted. The documented legal position was clear - the power to pay increases over RPI capped at 5% is entirely at Smiths' discretion. Rule 7.1(3) states that higher increases are only payable "at the request of the Principal Company" and that in making its decision the Principal Company must "have regard" to the Stated Aim.
- This provision in the Rules would have been carefully considered by Smiths and the Trustee (and their advisers) before the wording was agreed and, if the intention had been to place a binding obligation on Smiths (or the Trustee), this would have been incorporated in the relevant wording agreed by both parties at the time.
- The Stated Aim of paying increases of RPI up to 10% is "subject to the finances of the Scheme". The Scheme was fully funded on all the relevant financial measures that applied around the time the Stated Aim was established. The reality is that, despite Smiths having made substantial contributions in the intervening years, the Scheme is not currently fully funded on the gilts-flat measure (which can impact contributions payable to the Scheme) or the solvency measure (full solvency funding is the long-term funding target for the Scheme). These are key metrics that the finances of the Scheme are now monitored and measured against.
- There had been no breach of any regulatory or other legal requirements in respect of how the Principal Company has made its decision. The process followed by



Smiths in reaching its decision is consistent with current case law, other legislation and the Scheme's governing documentation.

- The Rules are clear that, on a wind-up of the Scheme, the Trustee has the sole power to increase member benefits before any surplus is returned to the Principal Company or another employer. The surplus disclosed in respect of the Scheme in the Group's 2022 annual report is disclosed, per page 128, "assuming gradual settlement of the liabilities over the lifetime of the scheme", i.e. assuming all benefits due from the Scheme have been paid and there are no remaining beneficiaries. Whilst the surplus is disclosed in accordance with accounting standards, the long-term funding target for the Scheme is to achieve full solvency funding, and against this measure the Trustee's latest funding update reported a deficit of £138 million (as at 31 March 2022).
- One of the factors considered by Smiths in reaching its decision was RPI as a measure of inflation and, as part of this, it considered RPI in the context of other indices such as the Consumer Prices Index ("**CPI**"). Mr Y thought that this was an irrelevant factor, which Smiths should not have taken into account. Smiths disagreed. Since the Stated Aim was introduced, RPI has lost its status as a National Statistic and the Office for National Statistics has confirmed that evidence suggests RPI overstates actual inflation. It is widely accepted that CPI is more accurate. The merits of RPI as a measure of inflation, and the impact that increases by reference to RPI have on the value of member benefits over time, are clearly relevant to a decision on discretionary increases.
- Mr Y had also complained that Smiths should disregard beneficiaries who would not benefit from a discretionary increase under the Stated Aim provision as these individuals "in the exceptionally unlikely event of scheme failure would be fully compensated by the PPF". Smiths did not accept this assertion. It said that case law confirmed that the existence of the PPF was not a relevant factor for a decision on whether to increase the benefits of members.

### **Summary of Mr Y's position**

16. Mr Y's submission concentrates on – and examines in detail - whether Smiths has exercised good faith in honouring the 'bargain' he says was reached with employees in 1998.

#### *Background to the "bargain"*

17. Mr Y states, from his own personal knowledge as representative of the Principal Company who was directly involved in the negotiation of the "bargain", that the background to the bargain and the adoption of the Stated Aim was as follows:-
- In early 1998 Smiths saw financial and operational advantages would accrue from merging three smaller schemes into the Scheme (which was its principal scheme). In addition to the administrative savings, the merger of the schemes facilitated the movement of personnel. Previously inter-scheme transfers could require large

company contributions from Smiths. The financial and operational gains to Smiths were large.

- There was however a significant impediment to such scheme mergers, being the difference in funding levels of the potentially merging schemes. Smiths' enhancing the funding of the less well funded schemes was considered unaffordable. However, no merger could take place unless it was in the interests of all members of the merging schemes – or at least it was not to their detriment
- For members of the incoming schemes the benefit of the proposed mergers would be the enhanced funding level protection that would apply once they became members of the larger and better funded merged Scheme. For existing Scheme members professional advice was sought from actuarial and legal advisers for potential benefit improvements so that the professional advisers could advise the Trustee that the proposed merger was also in the members' best interest, with the loss of security stemming from the reduction in the Scheme funding level outweighed – or at least balanced – by the value of the proposed benefit improvements for members.
- Consequently, Smiths with its professional advisers devised a benefit increase for existing Scheme members that they considered met these objectives. Critical was the requirement that the proposed benefit increase had substance and assurance, such that the Trustee's advisers could opine in writing to the Trustee that the reduction in the existing Scheme funding level resulting from the proposed incoming scheme mergers would be reasonably balanced with the proposed improvements to members' benefits.

*Trustee approval of proposal – Mr Y's personal recollection*

18. Mr Y's personal recollection of the background to the proposal (of which he says he has direct knowledge) is as follows:-

- Smiths' senior representative (Mr Y) explained that the proposal was an "integrated package" – mergers involving some degree of security reduction for existing Scheme members, counterbalanced by a benefit improvement for those same members.
- The scale of the benefit improvement necessary to balance the loss of security was assessed by the Trustee's advisers, this resulted in the creation of the Stated Aim to match RPI inflation up to 10% p.a. The capital cost of giving effect to the Stated Aim was assessed at £5.4m, with employees also benefitting from the future service aspect. Smiths agreed that this amount would be immediately added to Scheme's technical provisions, that is the additional liability arising from the benefit improvement would be fully recognised immediately. The total cost of the proposed benefit improvements for the current members at the time was estimated by the Scheme actuary at £22 million including the capital cost of £5.4 million for the Stated Aim.

- The creation of the “Stated Aim” to match RPI inflation up to 10% p.a. enhanced Scheme members benefits in two ways: it gave greater assurance by turning something that previously was entirely discretionary into something that became a stated aim, and it was a further enhancement due to the increased funding paid by the Principal Company into the Scheme specifically to meet the cost of potential future pension increases in the 5% to 10% range in accordance with the introduction of the Stated Aim.
- Mr Y considers that the Stated Aim represented a substantial enhancement to members’ benefits and that it could not be summarily/arbitrarily set aside or dismissed by Smiths using discretionary powers.

*Mr Y’s arguments*

19. Mr Y asserts that Smiths has not complied with its obligations arising from the Stated Aim. In particular he says:-

- Prior to 1998 the obligation to increase pensions to match inflation was limited to 5%. However, the practice had been to match inflation fully when the finances of the Scheme allowed it. By Smiths stating that in the future it would aim to bring about such increases, subject to the finances of the fund, it enshrined the past practice, rather than it being purely discretionary. Increases beyond 10% remained discretionary.
- He recalls explaining to the Trustee that the choice of wording in the letter sent to all employees and that proposed in the Trust Deed – the Stated Aim – had much more effect than simply codifying the existing practice of paying increases above 5% if they could be afforded. It required Smiths to “aim to” make such increases, which in turn required Smiths to take actions that would make the payment of such increases likely. This included but was not limited to higher contributions. Although the Stated Aim enhanced the prospect of increases matching inflation above 5%, such increases could not be guaranteed as volatile markets could mean that from time to time there would be inadequate funds, hence the wording “subject to the finances of the scheme”.
- He also recalls a figure of circa £20 million as the approximate total cost to Smiths of the proposed benefit improvements for current members, including the capital cost of £5.4million for the Stated Aim, and he recalls citing to the Trustee a similar figure for the capitalised value of the benefit to beneficiaries.
- The Trustee had considered the financial quantum of the gain to Smiths and the gain to beneficiaries. The professional advisers considered that the sums were appropriately aligned, thus the Trustee could agree to the proposals as the benefit improvement balanced other issues.
- The legal adviser had assured the Trustee that the proposed wording sensibly enabled Smiths to withhold consent to increase above 5% if the scheme was in

deficit, but that this provision should not be thought of as giving Smiths a wide ranging “get-out”.

20. Mr Y says that in or around 2012, Smiths had asked the Trustee to remove the funding for prospective increases above 5% from the actuarial valuation and from company contributions. The Trustee took advice from the same legal adviser as in 1998. Mr Y claims that the legal adviser opined to the Trustee that:-
- Smiths could not simply categorise such increases as discretionary and interpret this as giving it the power to veto such prospective increases.
  - Smiths had agreed the Stated Aim, and it had an obligation to act in a manner consistent with it.
  - For Smiths to do otherwise – for example eliminating the funding for such increases – would not be consistent with its good faith obligation.
21. Mr Y says no change to the valuation methodology or contributions was made or has been made since. The Scheme’s assets substantially exceed the value of the liabilities. At the dates of the vetoed pension increases the surplus was about 9%. Furthermore, Smiths itself is in a strong financial position, having recently returned £742 million surplus capital to shareholders.
22. Smiths argues that because the relevant clause appears in the part of the Rules dealing with Principal Company discretion, it has the wide-ranging discretion that applies to other matters. It also argues that all the wording requires it to do is to “have regard” to the Stated Aim, which could mean merely ‘take a look at’, that the Stated Aim is not a commitment, it is just an aim.
23. In 1998, Smiths’ three pension schemes were merged into one. A package of measures was put to the Trustee – the mergers with a potential detrimental and maybe continuing effect on Scheme funding, packaged with a tangible benefit improvement. That improvement was that matching RPI to 10% would be the subject of a non-withdrawable aim, enshrined in the Trust Deed, with Smiths obliged to do whatever was necessary to make achievement of the aim likely.
24. Mr Y argues that the changes to the pension arrangements were significant, and it was recognised that if a subsequent dispute arose the legal interpretation of the wording in the Rules would not be made in isolation from the bigger picture of the events taking place.
25. It was said at the time that the word “aim” obligated Smiths to take actions that would make fulfilment of the aim likely. It required the funding to be increased such that the “finances of the scheme” condition was unlikely to be an obstacle.

*Mr Y’s supplementary argument on the finances of the Scheme*

26. The commitment to match RPI inflation to 10% is “subject to the finances of the Scheme”.

27. Mr Y contends that this clause requires interpretation consistent with the clear intent of the parties in 1998 when the commitment was made. At the time matching RPI above 5% was a discretionary benefit. Past practice had been to make such increases when the Scheme actuary reported the scheme to be in surplus, measured on what is now known as the technical provisions basis. The clear intention of the parties was for the Stated Aim to give greater assurance that, in future, when the scheme was in surplus on the technical provisions basis, pension increases would be given that matched annual inflation up to 10% p.a.
28. Smiths has agreed that: "The Scheme was fully funded on all relevant measures that applied around the time the Stated Aim was established".
29. At March 2022, the Scheme was in surplus by over 8% relative to its technical provisions, and was highly hedged so as to give strong funding level security. The Scheme has remained in surplus since.
30. Mr Y contends that in judging the "finances of the Scheme", it is not open to Smiths to now consider the finances insufficient based on shortfalls against buyout funding or against any funding measure related to the transition to buyout. Such possible interpretations of the wording would have, from the outset, frustrated the objectives of the Stated Aim that Smiths had negotiated with the Trustee in good faith. This would be incompatible with the agreement reached at the time.

*Mr Y's supplementary argument on 'reasonable expectation'*

31. In relation to the issue of reasonable expectation, Mr Y considers that the fundamental issue is whether or not Smiths has unfettered discretion. Mr Y maintains that Smiths does not, in which case the consideration of whether or not the disputed matter is an issue of "reasonable expectation" becomes irrelevant.
32. In any event, a review of the extensive analysis provided by the judgement in *IBM*, points to there being no relevance to the Smiths case.
33. In *IBM* the judge referred to numerous prior cases, some relating to pension matters, others relating to other aspects of employment. The purpose of the judge's discussion was to give clarity as to what "reasonable expectation" means. In all cases the expectations arose from the company having previously made a general statement, falling substantially short of a commitment, giving rise to expectations as to future conduct. In the pension examples – as in *IBM* – the company had previously made a statement to the effect that "we have no current intention of making changes to the pension scheme in the next 3 years".
34. In this case, what took place in 1998 was quite different to a statement of intent. Mr Y argues that the Newsletter was a change to his terms of employment, and had certainty. It was much more than something that gave rise to reasonable expectations.

### **Summary of Smiths' position**

35. The aim to pay discretionary increases over 5% has always been a discretionary benefit. It is not a contractual promise, nor a commitment to be paid.
36. Smiths does not accept that a 'bargain' was 'struck' with employees in 1998 as the documented legal position is clear – the power to pay increases over RPI capped at 5% is entirely at its discretion. Rule 7.1 states that higher increases are only payable "at the request of the Principal Company" and that in making its decision the Company must "have regard" to the Stated Aim.
37. Smiths does not agree that the Stated Aim required it to aim to make increases above 5%, which in turn required it to take actions that would make the payment of such increases likely. The Rules are unambiguous on the payment of pension increases and payment of an increase over 5% is not a legal entitlement of members; it is a discretionary benefit which is only payable at the request of Smiths (with the consent of the Trustee).
38. Mr Y's comments on the reasons for the benefit improvements agreed in 1998, the negotiations that took place at the time and the Principal Company's actions since then are not accepted.
39. Rule 7.1 requires Smiths to consider the finances of the Scheme when deciding whether to award higher pension increases. When the aim of increasing pensions was communicated to members in 1998, the Scheme was fully funded on all of the relevant financial measures that applied at the time, though Smiths was still careful to reiterate that higher pension increases could only ever be provided "subject to the finances of the Scheme". This condition was made clear from the outset.
40. The current long-term funding target for the Scheme, which has been agreed between Smiths and the Trustee, is to achieve full buy-out funding (to be able to afford to insure all of the Scheme's pension liabilities with an external insurance company). Smiths and the Trustee have set this as the Scheme's target because it is generally accepted that a pension payable from an insurance company provides greater security for members.
41. At the most recent formal triennial actuarial valuation of the Scheme, the Trustee and Scheme actuary reported that there was a significant buy-out funding shortfall. Although Smiths and Trustee have worked together diligently to improve the funding since then, there remains a significant funding shortfall of £96 million as at 31 March 2023 on the buy-out funding basis.
42. Mr Y has complained that Smiths failed to act in good faith when it decided not to exercise its discretion to award higher pension increases. Smiths does not agree for the reasons set out in its letter to Mr Y dated 11 January 2023 (see paragraph 15 above).

43. Smiths had regard to the reasonable expectations of members when making its decision and, in particular, considered the statements made in the August 1998 Newsletter and the Stated Aim set out in Rule 7.1 of the Rules. Case law has confirmed that members' reasonable expectations are one of the (potentially many) 'relevant factors' that must be considered, with appropriate weight, for a discretionary decision to be properly made.
44. In accordance with the "Imperial Duty" (and the implied duty of trust and confidence that applies to employers), Smiths considered all relevant factors (and no irrelevant factors) and reached a decision that is within the parameters of that which could have been reached by a reasonable decision-maker, in light of the particular circumstances.
45. After careful, in-depth consideration, and having taken professional advice, Smiths decided not to propose such discretionary increases for relevant members, due to the finances of the Scheme and other relevant factors. These included the desire to strengthen further the financial security of the Scheme for all of its members over the long term (recognising that approximately 40% of the membership would not benefit from the discretionary increase), enhancing the resilience of the Scheme against the macro-economic environment at the time, and the fact that past increases had been based on RPI.
46. At all times members' benefits have been paid in accordance with the prescribed Rules of the Scheme and they will continue to be paid in future in line with their legal entitlement.

## **Conclusions**

47. Mr Y has put forward a detailed argument based on his personal involvement in the discussions/negotiations which took place in 1998 that the failure to give effect to the Stated Aim in years when inflation exceeded 5% was not consistent with the bargain reached in 1998 and Smiths' duty of good faith. Only the main points have been set out above, but I have considered all the issues raised in Mr Y's submission.
48. I acknowledge that Mr Y was involved in the discussions in 1998, but much of his argument is simply his view of what was intended by Smiths and the Trustee when negotiating the rule change. Mr Y says there was no intention in 1998 to provide Smiths with a veto enabling it to categorise prospective increases as discretionary and that the phrase 'the finances of the Scheme' was deliberately intended to be vague. Moreover, Mr Y argues this interpretation was supported by legal advice.
50. I cannot, however, base my decision on what he believes the understanding and motives of the various parties were at the time, and his understanding of the respective legal advice received by the parties in 1998 and 2012 might only be relevant to the extent it provides context to what was being negotiated. Neither Smiths nor the Trustee have waived legal privilege in relation to the legal advice received at the time.

*Approach to interpretation of the Rules*

51. I need to consider:

- the proper interpretation of Rule 7 which was adopted following the negotiations between Smiths and the Trustee in 1998 and in particular what powers and discretion Smiths and the Trustee have under Rule 7 to grant increases in excess of 5% in periods of high inflation; and
- whether Smiths acted in accordance with its legal obligations and in particular its implied duty of good faith or fettered its discretion when deciding not to request the Trustee to grant increases in excess of 5% when RPI exceeded that figure in May 2022 and May 2023.

52. Any determination of the Ombudsman is only binding on the parties. There is nothing to prevent the other members bringing similar claims if I were to uphold the complaint.

53. Mr Y's complaint is essentially the same as that brought by Mr S (Case ref CAS-110689-M5K1) although the arguments advanced by Mr Y are more developed, and aimed at Smiths rather than the Trustee.

54. Rule 7.1 (3) states:

"If in a year [RPI] is greater than [5%] the Trustee may, at the request of the Principal Company, calculate the Rate for that year as if the figure in (a) was 10% (instead of 5%). In relation to this provision both the Principal Company and the Trustee will have regard to the aim (stated in the "Simply Pensions" Newsletter of August 1998) of "providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme". Any price inflation increases above 10% may be provided under rule 6.5, but not under this rule..."

55. The relevant wording in the Newsletter states:

"The Scheme will also improve the future inflation protection of qualifying pensions by adopting the aim of providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme."

*Law relating to construction of occupational pension scheme trust deeds and rules*

56. In very general terms, construction of a document involves ascertaining the meaning which a document conveys to a reasonable person having all the background knowledge as would reasonably have been available to the parties in the situation in which they were at the time of the contract (*Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] WLR 1587, 161- per Warner J). Recent Supreme Court decisions have however moved away from contextualisation and purposive interpretation, towards greater emphasis on the language of the document (*Arnold v Britton* [2015] UKSC 35 [2015] AC 1619; *Wood v Capita Insurance Services Ltd* [2017] UKSC 24 [2017] AC 1173).



57. It has been said that there are no special rules governing construction of the trusts of occupational pension schemes. However, the general rules have to be adapted to the particular characteristics of pension schemes in a manner which effectively amounts to separate principles. The principles of construction applicable to pension documents can be taken from a number of lead pension cases.
58. The lead case on interpretation of pension scheme documents is *Barnado's v Buckinghamshire* [2018] UKSC 55 in which the Supreme Court gave some general guidance on the construction of pension scheme documents following the restatement of the general construction principles referred to above. Lord Hodge began by identifying the following distinctive characteristics of a pension scheme which are relevant to determining how a court (or the Ombudsman) should approach the construction of its provisions.
- Firstly, it is a formal legal document which has been prepared by skilled and specialist legal draftsmen.
  - Secondly, unlike many commercial contracts, it is not the product of commercial negotiation between parties who may have conflicting interests and who may conclude their agreement under considerable pressure of time, leaving loose ends to be sorted out in future (although it is clear that there was negotiation of the provisions of the Rules in this case).
  - Thirdly, it is an instrument which is designed to operate in the long term, defining people's rights long after the economic and other circumstances, which existed at the time when it was signed, may have ceased to exist.
  - Fourthly, the scheme confers important rights on parties, the members of the pension scheme, who were not parties to the instrument and who may have joined the scheme many years after it was initiated.
  - Fifthly, members of a pension scheme may not have easy access to expert legal advice or be able readily to ascertain the circumstances which existed when the scheme was established.
59. Lord Hodge went on to say at paragraph 15:
- “Judges have recognised that these characteristics make it appropriate for the court to give weight to textual analysis, by concentrating on the words which the draftsman has chosen to use and by attaching less weight to the background factual matrix than might be appropriate in certain commercial contracts: *Spooner v British Telecommunications plc* [2000] Pens LR 65, Jonathan Parker J at paras 75–76; *BES Trustees v Stuart* [2001] Pens LR 283, Neuberger J at para 33; *Safeway Ltd v Newton* [2018] Pens LR 2, Lord Briggs, giving the judgment of the Court of Appeal, at paras 21–23. In *Safeway*, Lord Briggs stated (para 22):

“the Deed exists primarily for the benefit of non-parties, that is the employees upon whom pension rights are conferred whether as members or potential members of the Scheme, and upon members of their families (for example in the event of their death). **It is therefore a context which is inherently antipathetic to the recognition, by way of departure from plain language, of some common understanding between the principal employer and the trustee** [Ombudsman’s emphasis in bold], or common dictionary which they may have employed, or even some widespread practice within the pension industry which might illuminate, or give some strained meaning to, the words used.”

60. However, Lord Hodge then went on to recognise that:

“The emphasis on textual analysis as an interpretative tool does not derogate from the need both to avoid undue technicality and to have regard to the practical consequences of any construction. Such an analysis does not involve literalism but includes a purposive construction when that is appropriate. As Millett J stated in *Re Courage Group’s Pension Schemes* [1987] 1 WLR 495, 505 there are no special rules of construction applicable to a pension scheme but “its provisions should wherever possible be construed to give reasonable and practical effect to the scheme”. Instead, the focus on textual analysis operates as a constraint on the contribution which background factual circumstances, which existed at the time when the scheme was entered into but which would not readily be accessible to its members as time passed, can make to the construction of the scheme.”

61. The relevant case law on construction of pension and other documents was also revisited in the more recent *Britvic v Britvic Pensions* (CA) decision at paragraphs 16 – 24 which took a slightly less literal approach than *Barnado’s*. However, *Barnado’s* is still the lead authority and *Britvic* references the fact that Lord Hodge in *Barnado’s* said at [15] that:

“[j]udges [had] recognised that these characteristics make it appropriate for the court to give weight to textual analysis, by concentrating on the words which the draftsman has chosen to use and by attaching less weight to the background factual matrix than might be appropriate in certain commercial contracts.”

62. My view, on the basis of current authorities, is that in interpreting the increase rule I should give significant weight to textual analysis, by concentrating on the plain meaning of the words which the draftsman has chosen to use and attaching less weight to the background factual matrix than might be appropriate in certain commercial contracts. The circumstances in which the amendments to the increase rule were entered into do, however, provide some helpful context to why the rule was adopted. Also, the rule cannot be interpreted without sight of the 1998 Announcement which effectively is incorporated by reference to the increase rules and in effect sets out the purpose of the rule which was to provide some enhanced inflation protection for members benefits when RPI exceeds 5% subject to the finances of the scheme.

63. The key issue I have to decide is what the final wording incorporated into the increase rule means.

*What does the rule say?*

64. Under Rule 7.1(3) as adopted the Trustee, at the request of Smiths as Principal Company, can provide increases of up to 10% in years where the rate of [RPI] exceeds 10%. Accordingly, the Trustee cannot, as noted by the Trustee at IDR, award an increase in excess of 5% if Smiths does not request any such increase. Rule 7.1(3) has not been drafted, as it could have been, to give the Trustee a unilateral discretion to grant increases in excess of 5% in years where the rate of inflation exceeds 10%. I agree therefore that Smiths effectively does control when the increases are granted subject to the wording of Rule 7.1(3)
65. In deciding whether to request the Trustee to grant an increase in excess of 5% in Years where [RPI] exceeds 5% the Principal Company is required under Rule 7.1(3) to have regard to the aim (stated in the "Simply Pensions" Newsletter of August 1998) of "providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme". Smiths therefore does not have a completely unfettered discretion to decide not to request increases in excess of 5%, as the rule says the Principal Company "will" have regard to the Stated Aim of providing increases of up to 10% "subject to the finances of the Scheme". I would describe the rule as a "constrained" discretion.
66. Similarly, in deciding whether to agree to any requested increase in excess of 5% in years where inflation exceeds [RPI] the Trustee is also required to have regard to the aim (stated in the "Simply Pensions" Newsletter of August 1998) of "providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme". However, if no such increase is requested, even if the Trustee wants to grant one as it did in the current case, there is nothing the Trustee can do about it.
67. I would also note that the expression "subject to the finances of the scheme" is widely drafted and does not specify an actuarial basis (ongoing technical funding basis or buy-out basis) by reference to which the finances of the scheme are to be determined, or specify that the manner in which the finances of the scheme are assessed cannot change. And I do not consider the fact that, before 1998, Smiths historically may have had a practice of granting increases in excess of 5% where RPI exceeded 5% constrains its ability to take a different approach in the future. Smiths must however genuinely consider whether to make a request to the Trustee to grant increases in excess of 5% each time inflation exceeds 5%.

*Exercise of power*

68. To recap, I consider that the power conferred on Smiths in deciding whether to make a request to the Trustee is discretionary. However, the remaining wording of the rule does not confer an entirely discretionary power on Smiths, rather it is "constrained" by the requirement under the Rule that it "will" have regard to the Stated Aim (of

providing increases of up to 10%), which is itself stated to be subject to the finances of the Scheme.

69. So, in my view this requires Smiths to consider both the Stated Aim and also the finances of the Scheme in deciding whether to request the Trustee to grant an increase. There is no further elucidation of what “finances of the scheme” means in this context. It could simply mean, in the broadest sense that the increase is “affordable” by the Scheme. Mr Y has not advanced the argument that Smiths ought to fund any increase, rather that the funding position of the Scheme is sufficient that the increase can be funded from its ongoing surplus. Mr Y noted that following the adoption of the revised increase rule the technical funding provisions did assume that increases of RPI capped at 10% would be provided until at least 2012 and the Scheme was funded on an ongoing basis that RPI increases capped at 10% would be provided. Smiths has advanced the argument that although the Scheme is in surplus on an ongoing valuation basis, it is significantly underfunded on a full buyout basis. Accordingly, even though the Scheme is funded on a technical funding basis it was not appropriate to grant increases in excess of 5% in 2022 and 2023.
70. Although the phrase “finances of the scheme” derives from the 1998 Newsletter, a communication to lay members, and so one which may not have been intended to be subject to extended legal analysis, the drafter of the 1999 amendment chose to include the same phrase in the Rules. Neither interpretation of the phrase is unreasonable, but given the extremely broad range of reasonable meanings of the phrase, there is no scope for me to find that one reasonable interpretation is correct over another.
71. Even if I considered that the phrase meant that an increase only had to be “affordable” by the Scheme in the broadest sense, the clause still does not require Smiths to request the Trustee to increase by 10% if the increase is affordable, only that it must have *regard* to the Stated Aim in the context of the finances of the Scheme. I consider that for Smiths to fulfil the requirement to have regard to the Stated Aim, it must consider it as a factor (and attach some weight to it), but it may also consider or ascribe weight to other factors.
72. Smiths has set out its reasoning for not requesting the higher increase in 2022 and 2023, namely that there was a significant funding shortfall on a full buy-out funding basis and that it wished to strengthen the financial security of the Scheme for all members. In deciding this, it has also had regard to the members who would not benefit from an increase in pensions in payment. Furthermore, it took professional advice before deciding not to request the Trustee to increase pensions in payment above 5%.
73. I find that Smiths did have regard to the finances of the Scheme and to the Stated Aim (albeit that it gave greater weight to the finances of the Scheme than giving effect to the Stated Aim) when making its decision not to request the Trustee to increase pensions in payment above 5%.

74. In cases involving the exercise of discretion, it is not for me to make my own decision based on the evidence provided as long as the discretion was exercised in accordance with the wording of the applicable rule. I do not have to agree with the decision and I will not intervene just because I consider the decision-maker could have reached a different decision or I disagree with the weight attached to the different factors that were considered when reaching the decision not to request the Trustee to grant increases in excess of 5%.
75. I accept that once Smiths had considered the finances of the Scheme and the Stated Aim, it retained a discretionary power to request the Trustee to increase pensions in payment. Mr Y has submitted that its decision not to exercise its discretionary power to make such requests in May 2022 and May 2023 was a breach of its Imperial Duty. In its most commonly applied formulation by Lord Steyn in *Malik v BCCI* [1997] 3 All ER, the duty is set out in an implied term in an employment contract that requires that an employer:
- “shall not without reasonable and proper cause conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence between employer and employee.”
76. In *Imperial*, the context was the employer's discretionary power to consent, or to withhold its consent, to an amendment to the scheme proposed by the trustees to increase pensions in payment. It was held that the employer was not exercising a fiduciary power, but nonetheless one which had to be exercised within the limits of the implied obligation of good faith. The obligation to act with good faith requires that a discretionary power should not be exercised capriciously or in a manner that fetters future decision making. A power should be exercised with a view to the efficient running of the scheme and not for a collateral purpose.
77. However, the obligation to act with good faith does not require an employer to act to an objective standard of reasonableness or to reach a decision which is “fair” between the parties. It preserves the entitlement of an employer to take into account its own interests, financially and otherwise, in the future operations of the scheme, even where those interests conflict with those of active and pensioner members: *National Grid Co Plc v Laws* [1997] OPLR 207.
78. In *Prudential Staff Pensions Ltd v The Prudential Assurance Company Ltd & Ors* [2011] EWHC 960 (Ch) it was held that acting capriciously means, by analogy to cases which considered the implied duty of mutual trust and confidence in an employment context, acting perversely or irrationally. It was held that a discretionary power to increase a pension requires a “genuine and rational, as opposed to an empty or irrational, exercise of discretion.”
79. Members’ interest and expectations may be of relevance when considering whether an employer has acted irrationally or perversely. Where a power is fiduciary, it is incumbent on the decision-maker to show that it has given proper consideration to relevant matters and excluded consideration of irrelevant matters. It was held in

*Prudential* that where a power is not fiduciary, the court will consider overall whether the decision reached was irrational or perverse not whether regard has been had to particular matters. Members' interests and expectations may be of relevance when considering whether an employer has acted irrationally or perversely.

80. In *IBM*, the Court of Appeal held that the correct test where an employer is exercising a non-fiduciary discretionary power under an occupational pension scheme is:
- was the discretionary decision exercised for a proper purpose;
  - was the decision reached in a rational manner taking into account all relevant factors (and no irrelevant factors); and
  - was it a decision that could have been reached by a reasonable decision maker in the position the employer was in when it made it.
81. In making its decision whether to request the Trustee to increase pensions in payment above 5%, Smiths was not exercising a fiduciary power. So, I consider the correct test to apply is that set out in paragraph 80, taking into account the comments made about relevant and irrelevant factors in *Prudential*. If the answer to any of these questions is “no”, Smiths will have breached its Imperial Duty. However, if the answer to each is “yes”, there is no scope to set its decision aside.
82. Under the first limb, Smiths has stated that it decided not to propose to the Trustee to increase pensions in payment above 10% in May 2022 and May 2023 due to the finances of the Scheme and other relevant factors. I consider that this is sufficient to meet the first limb. The power was exercised in response to a request by the Trustee to propose an increase, and the purpose of exercising the power was to reach a decision about whether to request the increase.
83. Under the second limb, Smiths has stated that, having taken professional advice, it did not propose increases based on the following factors:
- the finances of the scheme;
  - the aim of strengthening the financial security of the Scheme for all of its members over the long term (recognising that approximately 40% of the membership would not benefit from the discretionary increases);
  - enhancing the resilience of the Scheme against the macro-economic environment at the time; and
  - past increases to pensions in payment had been based on RPI.
84. Expanding on the finances of the Scheme, Smiths has stated that by not paying increases over 5% in 2023, it was estimated that this has shortened the time to achieve the long-term funding target of full buyout funding by more than two years. A delay in reaching this could result in adverse effects caused by external factors to this

aim. It has also taken into account its other stakeholders and business needs in reaching its decision. I consider that these are relevant factors to take into account.

85. Expanding on the point about RPI increases, Smiths has stated that in practice, RPI frequently overstates the actual rate of inflation and members have received higher increases historically than they would have had increase been calculated by reference to CPI.
86. Under the Rules, members are entitled to receive increases based on RPI. The fact that RPI may or may not be an accurate measure of inflation, or that CPI is lower, is not, I consider, relevant in itself to the question about whether Smiths should exercise the power. However, to consider the protection members receiving pensions in payment have had historically against inflation, and to weigh this against the long term future financial security of the Scheme and the interests of all members, is a relevant factor and I do not consider that this in any material sense renders the decision flawed, taking into account *Prudential* and the fact that Smiths is not exercising a fiduciary power.
87. I acknowledge that Mr Y has formed an expectation of annual increases up to 10% based on the wording of the 1998 newsletter. Although it was decided at first instance in *IBM* that the exercise of a power in a manner contrary to a member's "Reasonable Expectations" or in a manner that failed to take these into account could result in the Imperial Duty being breached, this was overturned by the Court of Appeal. The Court of Appeal held that "Reasonable Expectations" had no special status and are simply a relevant factor to take into account. In any event, in this case, I consider that Smiths did have regard to any expectations engendered by the wording of the 1998 newsletter, and indeed was required to, due to Rule 7 incorporating the requirement for it to have regard to the Stated Aim in its decision making.
88. Under the third limb, Smiths has reached a decision based on evidence, relevant factors, and having taken advice. I can see no indication that it was irrational or perverse to reach the decision it did, or that it is a decision that no reasonable decision maker could have reached. I find that, in reaching its decision not to request the Trustee to increase pensions in payment by 10%, Smiths has not breached its Imperial Duty.
89. I therefore do not uphold Mr Y's complaint against Smiths.
90. I will however for completeness mention that I agree with Mr Y that it is not open to Smiths to decide that they will never request the Trustees to grant any future increases in years when inflation exceeds 5%. To do so would amount to fettering of Smiths discretion under the Rules. Smiths must genuinely consider the issue afresh in any future year when inflation exceeds 5%, and the fact that increases were not granted in 2022 and 2023 and accordingly the value of members pensions has been eroded by inflation may well be a factor that they should have regard to in reaching any future decision on whether to request the Trustee to grant increases up to 10% where inflation exceeds 5%.

CAS-99766-L5X6

**Dominic Harris**

Pensions Ombudsman

30 April 2025



## Appendix 1

Extract from the Rules

### 7.1 **INCREASE OF PENSIONS**

- (1) This rule relates to all pensions payable under the Scheme except -
  - (a) any Guaranteed Minimum (as defined in the Previous Rules), GMP or EPB;
  - (b) any pension provided on Special Terms which did not provide for it to be increased in the same manner as standard pensions under the Scheme;
  - (c) any other pension to which the Trustee and the Principal Company agree this rule should not apply.
- (2) This rule governs only increases taking effect on or after 1 May 1999. The Previous Rules govern the time and rate of increases to pensions (including prospective and contingent pensions) under the Scheme before that date.
- (3) In this rule -

"Index" means the Government index of retail prices for all items, or such other published index which the Trustee may decide is the nearest readily available equivalent index if it stops being published or its constituents are, in the Trustee's opinion, substantially altered.

"Pension" means the current yearly amount of a pension. If the pension has been re-arranged under rule 4.10 (or a corresponding provision of the Previous Rules) it means that amount of the pension after re-arrangement.

"Rate" means, in relation to any 1 May and a Member's pension or pension payable following his death, the smaller of (a) and (b) below, divided by 12 and then multiplied by the smaller of 12 and the number of complete Months since the Member left Service.

- (a) 5%; and
- (b) the percentage increase in the Index published for the previous calendar year ending 31 December. The percentage will be taken as zero if it would otherwise be negative. If the Index is not published in respect of the relevant period, the Trustee may substitute such percentage as it considers to be a reasonably likely figure on the basis of Information available to it.

If in a year (b) is greater than (a) the Trustee may, at the request of the Principal Company, calculate the Rate for that year as if the figure in (a) was 10% (instead of 5%). In relation to this provision both the Principal Company and the Trustee will have regard to the aim (stated in the "Simply Pensions" Newsletter of August 1998)

of "providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme". Any price inflation increases above 10% may be provided under rule 6.5, but not under this rule.

(3) *Pensions in payment*

Each Pension, whilst the pension is in payment before State Pension Age, will increase on 1 May each year by the Rate.

The excess over the GMP of each Pension, whilst the pension is in payment on or after State Pension Age, will increase on 1 May each year by the Rate.

The GMP will increase as provided under the Previous Rules.

(4) *Pensions in deferment*

The excess over the Guaranteed Minimum (as defined in the Previous Rules) of the prospective Pension of a Deferred Pensioner will increase on 1 May each year by the Rate.

The Guaranteed Minimum of the Deferred Pensioner will increase as provided under the Previous Rules.

(5) *Statutory increases*

The increases under (3) and (4) above will be treated as satisfying (to the maximum extent consistent with the Pension Schemes Act 1993 and the Pensions Act 1995) the requirement to revalue accrued rights to GMPs under the Previous Rules and the following provisions of those Acts -

- (a) the "anti-franking" requirement;
- (b) the requirement to revalue deferred pensions;
- (c) the requirement to provide increases on that part of any GMP attributable to earnings in the Tax Years from (and including) 1988/89; and
- (d) the {limited price} indexation requirement under section 51 of the Pensions Act 1995.

## Appendix 2

Extract from the Newsletter

---

# A message from the Chairman

*"It gives me great  
pleasure to be  
able to bring  
you news of  
these benefit  
improvements"*

I am delighted to write to you with news of significant benefit improvements in the Smiths Industries Pension Scheme.

As you will be aware, the Scheme provides that qualifying pensions receive annual increases, which match the increase in the Retail Prices Index (RPI), up to a maximum of 5% each year. In practice greater increases than this have been awarded in times of high inflation.

I have, however, been concerned for some time that the pensions of our older pensioners have lost some ground against inflation. Three special increases, in 1987, 1989 and 1990 were made to try to make-up some of this ground. More recently inflation rates have been more subdued and the pensions of members who retired from 1990 onwards have fully matched increases in inflation.

I am very pleased to announce that another special increase will be made as at 1st October 1998, which will ensure that all Smiths Industries pensioners, whose pensions qualify for normal annual increases from the Scheme, will have their pensions increased, where necessary, to fully restore them against increases in inflation.

The Scheme will also improve the future inflation protection of qualifying pensions by adopting the aim of providing annual increases in line with the RPI up to a maximum of 10% a year, subject to the finances of the Scheme.

It gives me great pleasure to be able to bring you news of these benefit improvements. At the same time the Company is re-organising its pension schemes by merging them all into one – the combined scheme will then have assets of nearly £750 million and will provide strong security for the benefits promised to members.

As many of you will know, I will be retiring from Smiths Industries in November and I extend my best wishes to you all.



Sir Roger Hurn  
Chairman