

## PENSION SCHEMES ACT 1993, PART X

### DETERMINATION BY THE DEPUTY PENSIONS OMBUDSMAN

<b>Applicant</b>	Mr Peter Bains
<b>Scheme</b>	Hewlett Packard Ltd Retirement Benefits Plan
<b>Respondent</b>	1. Hewlett-Packard Limited ( <b>HP UK</b> ) 2. Trustees of the Hewlett Packard Ltd Retirement Benefits Plan ( <b>the Trustees</b> )

#### Subject

- HP UK has a discretionary power to provide increases to Mr Bains' pension from the Plan (in respect of pensionable service prior to 6 April 1997). Mr Bains has complained that he has not received the increases to his pension from the Plan to which he feels he is entitled.
- Mr Bains says that before the merger of his previous scheme and the Plan the provision of discretionary increases in excess of 0% was an established custom. Mr Bains complains that this established custom was lost when the trustees of the previous scheme entered into a deed to merge that scheme with the Plan on 1 October 2006 (**the Merger Deed**). In entering into the Merger Deed, Mr Bains says, the Trustees therefore failed to act in accordance with their fiduciary duties and in the best interests of the beneficiaries and, as a consequence, he has suffered "substantial financial loss".

#### The Deputy Pensions Ombudsman's determination and short reasons

The complaint about HP UK is not upheld because I am satisfied that HP UK has exercised their discretion properly in respect of pension increases in accordance with the requirements set out in the Plan's governing documentation.

The complaint about the Trustees is not upheld because the provision of discretionary increases in excess of 0% was never an established custom. Accordingly, the Trustees were under no obligation to protect it in the Merger Deed.

## DETAILED DETERMINATION

### Material Facts

1. Mr Bains' former employer, Digital Equipment Company Limited (**Digital**), had a staff pension plan (**the Digital Plan**). Mr Bains became a member of the Digital Plan on joining Digital in 1984.
2. Digital was acquired by Compaq in 1997. (Compaq was then acquired by Hewlett-Packard in 2002.) Mr Bains left pensionable service under the Digital Plan on 18 December 1998.
3. Mr Bains' pension also came into payment on 18 December 1998.
4. The Digital Plan was merged with the Plan in 2006. A section of the Plan was created following a bulk transfer of the assets and liabilities of the Digital Plan to the Plan in 2006 (the Digital Section). The Digital Section was created with effect from 1 October 2006 on the execution of the Merger Deed.
5. Increases to pensions in respect of pre-6 April 1997 pensionable service under the Digital Section of the Plan are provided at the discretion of the principal employer of the Plan, (currently) HP UK. Mr Bains has produced a table which shows the increases applied to his pension from 1989 to present. The information provided suggests that discretionary increases of 0% have been applied to Mr Bains' pension since 2006.

### Jurisdiction

#### *Complaint about HP UK*

6. The statutory framework governing my jurisdiction provides that I am only able to "look-back" three years from the applicant's discovery of the issue that he is complaining about. As Mr Bains has been made aware of the level of pension increases he has received each year, I am only able to consider the increases applied in 2011, 2012 and 2013.

#### *Complaint about the Trustees*

7. Mr Bains' complaint that the Trustees failed to act in accordance with their fiduciary duties and in the best interests of the beneficiaries is essentially a complaint about the trustees of the Digital Plan who entered into the Merger Deed in 2006.

However, as explained previously, the Digital Plan no longer exists as a separate scheme as all assets and liabilities of the Digital Plan were transferred to the Digital Section of the Plan with effect from 1 October 2006. Since the merger the Trustees of the Plan are essentially the successors to the trustees of the Digital Plan who entered into the Merger Deed in 2006 and, therefore, the Trustees of the Plan are the respondents to this part of Mr Bains' complaint.

8. Although the Merger Deed was executed in 2006, I am satisfied that the existence of it has only recently come to Mr Bains' attention. Accordingly, it is within my jurisdiction to "look back" to the events surrounding the entering into of the Merger Deed on 1 October 2006.

### **Relevant documentation**

9. The rules and provisions on discretionary increases are contained in the various documents to which Mr Bains' benefit entitlement is (and has previously been) subject. The documents relevant to Mr Bains' complaints are:

- the definitive trust deed and rules for the Digital Plan, described on its face as the '2004 Definitive Trust Deed and Rules' (the 2004 Trust Deed and Rules);
- a legal notice issued in 2006 ahead of the merger of the Digital Pension Plan and the Plan;
- a GN16 actuarial certificate provided in 2006 in relation to the merger of the Digital Pension Plan and the Plan;
- the Merger Deed; and
- the rules of the Plan from 2008 (the 2008 Rules).

Relevant extracts of these documents are set out in the Appendix to this Determination.

### **Summary of Mr Bains' position**

#### *Complaint about HP UK*

10. HP UK has not provided the increases to his pension from the Plan to which he feels he is entitled.
11. HP UK's failure to provide the correct increases to his pension has resulted in him suffering a financial loss.

*Complaint about the Trustees*

12. The trustees of the Digital Plan were in breach of their fiduciary duties and their duty to act in the best interests of beneficiaries in agreeing to the merger of the Digital Plan and the Plan in 2006 on the terms set out in the Merger Deed.
13. Prior to the merger discretionary pension increases in excess of 0% had become an established custom and practice and, as such, the statement in the Merger Deed - that said that discretionary pension increases were not established practices - was incorrect. Discretionary pension increases in excess of 0% should therefore be (and have previously been) provided on a yearly basis.
14. The Trustees' failure to protect discretionary increases has resulted in him suffering a financial loss.

**Summary of HP UK's position**

15. Mr Bains has no entitlement to pension increases in respect of pensionable service prior to 6 April 1997. HP UK has a discretionary power to award increases to pensions payable in respect of pensionable service prior to 6 April 1997.
16. HP UK made its decision on discretionary increases in 2011, 2012 and 2013 appropriately. Specifically, HP UK made its decision on the basis of the requirements of the Plan's governing documentation and have not breached their implied duty of good faith to Mr Bains.

**Summary of the Trustees' position**

17. The granting of discretionary pension increases for members of the Digital Section of the Plan is "not at the gift of the Trustees". It has not been under the Plan or the Digital Plan. The rules clearly state that it is HP UK's discretion and the Trustees do not have (and, incidentally, never have had) power to unilaterally increase pensions in payment.
18. There was not an established custom of providing discretionary pension increases at the time of the merger in 2006. (This is exemplified by the fact that there were several years of nil increases in the years prior to the merger).

19. The regular exercise of the discretion to award increases in the 1990s did not make it a right. The regular exercise of a discretion does not automatically turn that discretion into a right. In the absence of a guarantee from HP UK, the discretion did not become a right.
20. The Trustees did not act inappropriately in entering into the Merger Deed in 2006. This is because the merger did not change the discretionary nature of the benefit or the balance of power. As such, all the merger meant was that discretionary increases would be considered under the Plan rather than the Digital Plan going forward. HP UK had the power to grant discretionary increases before the merger and it retained that power after the merger and, as a consequence, the merger had no impact on the provision of discretionary pension increases. Further, the Trustees and the trustees of the Digital Plan did not act inappropriately in 2006 because they took and considered legal and actuarial advice throughout the course of the merger discussions.
21. Mr Bains has not suffered any loss as he has been provided with what he is entitled to under the Scheme Rules. Accordingly, Mr Bains should not be awarded any compensation.

### **Conclusions – Complaint about HP UK**

#### *HP UK's discretion*

22. The Plan's governing documentation demonstrates that HP UK has a discretion as to whether to grant increases to pre-6 April 1997 pension benefits under the rules of the Plan. Both the 2004 Trust Deed and Rules and the 2008 Rules give HP UK an absolute discretion to apply increases. There is no requirement to apply a minimum or maximum level of increase and there is no requirement that the trustee of the Plan consents to the increase proposed. The only restriction is that HP UK must act having first taken actuarial advice. There is no express requirement that the advice has to come from Aon Hewitt, the actuary to the Plan, or that the advice received from any actuary consulted must be strictly adhered to.

*The decision-making process*

23. HP UK has provided this office with evidence of the decision-making process adopted in respect of applying discretionary increases in 2011, 2012 and 2013 in their formal response dated 10 June 2014 (the HP UK Response). I consider each year below.

**2011**

In 2011 a discretionary increase of 0% was applied to pensions in payment relating to service prior to 6 April 1997.

The information provided by HP UK shows that advice was not taken directly from the Plan Actuary in 2011. However, HP UK have said in the HP UK Response that “the Pensions Manager was aware from his attendance at quarterly trustee meetings” and “the general trend shown from previous actuarial advice” that the cost of providing a 1% increase was “approximately £1.2 million”.

The HP UK Response shows that the individuals within HP UK who discussed discretionary increases were the Pensions Manager, the Finance Director, the HR Director and the Rewards Manager. The HP UK Response says that the group considered actuarial information (presumably relating to the cost of increases) as well as “the history of increases as against inflationary rises over the same period and levels of salary increases for employees of the company [i.e. HP UK]”.

**2012**

In 2012 a discretionary increase of 0% was applied to pensions in payment relating to service prior to 6 April 1997.

The HP UK Response provides that a formal report was produced by the Plan Actuary in respect of discretionary increases in 2012. The report, dated 23 January 2012, provides detailed information as to the cost of providing discretionary increases to pre-6 April 1997 pensions and provides the results of a survey of other comparable schemes (as to the question of whether they have applied discretionary increases). The report said that, although the figures were provisional, it was likely that if discretionary increases were awarded the trustees of the Plan “would be likely to insist on additional funding to the Plan [i.e. from HP UK]”. The survey

showed that most schemes participating in the survey did not provide discretionary increases and around a third had ceased to provide them in recent years.

The HP UK Response shows that the individuals within HP UK who discussed the application of discretionary increases for 2012 were the Pensions Manager, the HR Director and the Rewards Manager. The group considered the report from the Plan Actuary. The HP UK Response provides that other factors were also taken into consideration by the group, including the number of persons that had pre-6 April 1997 benefits (as a proportion of total membership of the Plan), the application of discretionary increases in other Hewlett-Packard schemes and cost of living increases.

### **2013**

In 2013 a discretionary increase of 0% was applied to pensions in payment relating to service prior to 6 April 1997.

The HP UK Response provides that a formal report was produced by the Plan Actuary in respect of discretionary increases in 2013. This report, dated 23 January 2013, provides details as to the cost of providing discretionary increases with effect from 1 April 2013. The report says that “we [i.e. the Plan Actuary] believe it would be reasonable from an actuarial point of view to fund the cost of any discretionary pension increase in accordance with the Funding Agreement”.

The HP UK Response shows that the individuals within HP UK who discussed discretionary increases for 2013 were the Pensions Manager, the HR Director and the Rewards Manager. They considered the report from the Plan Actuary. The HP UK Response provides that other factors were also taken into consideration by them, including market practice (“noting that most UK plans with discretionary increase provisions had not provided increases in recent years”), “the costs and accounting implications of granting a discretionary increase” and “the pensioners affected”.

*Requirement to take actuarial advice*

24. As I have said previously, the governing documentation of the Plan provides that HP UK must take actuarial advice before making any decision as to whether to grant discretionary increases to pre-6 April 1997 benefits.
25. In 2011 no actuarial report was produced by the Plan Actuary for HP UK's consideration. Instead, the cost of providing the discretionary increases was ascertained by the Pensions Manager on his attendance at trustee meetings (which, presumably, involved some input from an actuary) and on the basis of previous actuarial advice received. Even had the Plan Actuary given his advice it seems unlikely, on the balance of probabilities, that an increase would have been given when they had only been given once in the previous six years (in 2008 an annual increase of 1% was provided in respect of pre-6 April 1997 pensionable service).
26. In 2012 an actuarial report was produced and considered by HP UK. The report did not make any specific recommendations as to funding discretionary increases, but said that if discretionary increases were awarded the trustees of the Plan "would be likely to insist on additional funding to the Plan [i.e. from HP UK]".
27. In 2013 an actuarial report was produced and considered by HP UK. The report suggested that funding discretionary increases was "reasonable from an actuarial point of view" in accordance with the funding agreement in place at that time. Despite this advice, HP UK decided against providing discretionary increases in 2013. However, HP UK is entitled to do this. HP UK is required by the rules of the Plan to take actuarial advice but clearly has discretion as to whether to act strictly in accordance with it. In other words, in making its decision HP UK is entitled to consider factors other than the report produced by the Plan Actuary.
28. Accordingly, having considered the evidence provided, I am satisfied that HP UK made its decisions in respect of discretionary increases in 2011, 2012 and 2013 in accordance with the provisions of the rules of the Plan at the time, which said that HP UK must make their decision in respect of discretionary increases "acting on actuarial advice".

*Implied duty of good faith*

29. An employer's implied obligation of good faith in pensions law comes from the decision in *Imperial Group Pension Trusts Ltd v Imperial Tobacco Limited* [1991] 2 All ER 597. In that case, Browne-Wilkinson VC said that an employer must not, without reasonable and proper cause, act in a way "calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee". The issue of the relationship of trust and confidence was considered at length by the High Court in the case of *Prudential Staff Pensions Ltd v The Prudential Assurance Company Ltd and others* [2011] EWHC 960 (Ch). In that case the High Court found that employers cutting back their discretionary pension benefits will not be in breach of their implied duty of good faith to members unless their conduct is irrational or perverse in a serious manner. Whether an employer had acted "irrationally or perversely" was, according to Justice Newey, whether they had acted in a manner in which no reasonable employer would have acted. Further, the test as to whether the irrational or perverse conduct was "serious" was that established in the *Imperial Tobacco* case, which provided that a breach was "serious" if it was "such as to destroy or seriously damage" the relationship between an employer and a member.
30. I am satisfied that HP UK did not take their decision to apply discretionary increases in 2011, 2012 and 2013 in an irrational or perverse manner and, therefore, have not breached their duty of good faith to members in that period. HP UK clearly took their obligation to review discretionary increases to pensions in payment in 2011, 2012 and 2013 seriously and, even if they did not consider precisely the same factors each year, based each decision they made on a number of relevant factors that they had considered in adequate detail.

*Established custom*

31. The GNI6 actuarial certificate from 2006 says that where it is an established custom to reward "discretionary benefits or increases.....under the transferring scheme" then such discretionary benefits or increases should be treated under the receiving scheme (i.e. here, the Plan) in a manner that is "broadly no less favourable". Further, the legal notice of the merger of the Digital Plan and the Plan in 2006 says that

“Established discretionary practices under the Digital Plan will continue under the HP Plan”.

32. However, section 11 of the schedule to the Merger Deed says that increases to pensions in payment are “not exercised as an established custom”.
33. Accordingly, I do not accept that Mr Bains is entitled to discretionary increases that are broadly no less favourable than those he received prior to his benefits becoming paid by the Plan in 2006. This is because increases to pensions in payment were not identified as an established custom in the Merger Deed and, accordingly, HP UK is free to deal with increases to pensions in payment for ex-Digital Plan members in respect of pre-6 April 1997 benefits in the manner which is provided in the rules of the Plan. As discussed before, these simply say that HP UK has absolute discretion (acting on actuarial advice) as to whether to apply increases. Mr Bains has produced a number of documents which show the consideration of discretionary increases (specifically in the years 1992 to 1997). Although they show that discretionary increases were awarded in those years, each document also makes it clear that the provision of increases is purely discretionary. If a discretion is exercised at one point in time - or even consistently for a number of years - this does not mean that the party exercising that discretion, in the absence of a contractual statement to the contrary (for example, a guarantee), has an obligation to provide similar increases in the future.

#### *Estoppel*

34. No evidence has been produced to suggest that there has been an unequivocal promise or representation made by HP UK in 2011, 2012 or 2013 to apply a certain level of increase to pension benefits in respect of pre-6 April 1997 pensionable service.
35. Accordingly, Mr Bains cannot successfully raise an estoppel argument.

*Summary of conclusions*

36. I am satisfied that in each of 2011, 2012 and 2013 HP UK complied with their duties under the governing documentation of the Plan in considering the exercise of their discretion to provide pension increases. Further, HP UK did not, in exercising their discretion, act in manner that breached their implied obligation of good faith to Mr Bains.
37. It follows that I do not uphold Mr Bains' complaint about HP UK.

**Conclusions – Complaint about the Trustees**

38. As I have set out at paragraphs 31 to 33 above, increases to pensions in payment were not identified as an “established custom” in the Merger Deed and, accordingly, HP UK is free to deal with increases to pensions in payment for ex-Digital Plan members in respect of pre-6 April 1997 pensionable service in the manner which is provided in the rules of the Plan.
39. However, Mr Bains says that the payment of discretionary increases in excess of 0% in respect of pre-6 April 1997 pensionable service was an established custom prior to 1 October 2006 and, therefore, the Trustees' failure to protect the established custom in the Merger Deed was a breach of their fiduciary duties and their duty to act in the best interests of beneficiaries.
40. Contrary to Mr Bains' view, I do not consider that the granting of discretionary increases was an established custom prior to the entering into of the Merger Deed. I therefore do not concur with Mr Bains' view that the Trustees should have protected the established custom in the Merger Deed. I give my reasons below.
41. The simple fact that discretionary increases had been given by the principal employer of the relevant scheme at the relevant time (i.e. Digital, then Compaq and, finally, HP UK) does not mean that the provision of increases in excess of 0% becomes an established custom or, in addition, that affected members have become entitled to the provision of increases in excess of 0% as of right.
42. For an argument that the provision of increases in excess of 0% was an established custom to succeed it must be shown that the existence of an established custom was recognised in the governing documentation of the Plan.

43. None of the documentation governing the Plan that my office has been shown suggests in any way that the provision of pension increases in excess of 0% was an established custom - either before the merger or afterwards. Neither the 2004 Trust Deed and Rules or the Trust Deed 2008 say that the provision of discretionary increases by HP UK in excess of 0% is an established custom. As explained above, the GNI6 certificate says established discretionary practices should be protected post-merger. However, there is no documentary evidence that the provision of pension increases in excess of 0% was an established discretionary practice (i.e. an established custom) before the merger. Accordingly, the Plan's documentation did not require that the Trustees should have protected it as an established custom in the Merger Deed.
44. It follows that I concur with the view expressed by the Trustees that the Merger Deed did not change the discretion to award pension increases in any way. HP UK had absolute discretion to provide increases prior to the merger and they had the same power after it. There was no established custom that provided that HP UK must provide a yearly pension increase in excess of 0% prior to the merger and therefore HP UK had no obligations in this regard after the merger. All that the merger changed in respect of the provision of increases for Mr Bains was that increases to his pension would be considered by HP UK under the Plan rather than the Digital Plan.
45. If HP UK had provided a formal guarantee prior to the merger that increases in excess of 0% would be provided each year then the outcome in this complaint may be different (as the Trustees could have been obliged to protect that guarantee in the Merger Deed). However, in the absence of such a guarantee, the fact that pensions had regularly been increased at varying rates on a yearly basis in the period prior to the merger did not mean that the regular exercise of the discretion to provide such rates automatically turned that discretion into a right. The Trustees, therefore, had no obligation to ensure that yearly pension increases in excess of 0% were provided in the Merger Deed.

46. It follows that I do not uphold Mr Bains' complaint about the Trustees.

**Jane Irvine**

Deputy Pensions Ombudsman

10 September 2014

## Appendix - Extracts from relevant documentation

- *2004 Trust Deed and Rules*

Rule 7 of Schedule G of the 2004 Trust Deed and Rules concerns increasing pensions in payment. Rule 7(1) provides that:

“The Founder [i.e. defined as HP UK] will, as and when it thinks fit, but not less than annually, review all pensions in payment and may, in its absolute discretion and acting on the advice of the Actuary, instruct the Trustees to increase pensions and allowances in payment.”

- *Legal notice of pension plans merger*

A notice to affected persons was issued in 2006 ahead of the merger of the Digital Plan and the Plan in 2006. Page 2 of the notice, under the title “No change to your benefits”, provides that:

“Established discretionary practices under the Digital Plan will continue under the HP Plan [i.e. the Plan]”

- *GN16 certificate*

The certificate, signed off by the Plan’s actuary on 31 August 2006, says:

“Where it is the established custom for discretionary benefits or increases to be awarded under the transferring scheme, there is good cause to believe that the award of discretionary benefits or increases in benefits under the receiving scheme will (making allowance for any amount by which transfer credits under the receiving scheme will (making allowance for any amount by which transfer credits under the receiving scheme are more favourable than the rights to be transferred) be, broadly no less favourable.”

- *Merger Deed*

Clause 14 of the Merger Deed, entitled “Discretionary Benefits”, says:

“Where it is the established custom for discretionary benefits or increases in benefits to be awarded under the Transferring Scheme, the award of the same discretionary benefits or increases in benefits will (subject to the remainder of this clause) be continued under the Receiving Scheme....The discretionary benefits or increases which the Transferring Scheme Trustees believe to be awarded under an established custom are set out in the Schedule to this deed.”

Clause 11 of the schedule to the Merger Deed, entitled “Discretionary pension increases”, falls within the section of the deed entitled “Other discretions”. Clause 11 says:

“Although not exercised as an established custom for the purposes of clause 14 of this deed, the Transferring Scheme Trustees also wish to record the following discretion

11.1 Rule 7(1) of Schedule G of the Transferring Scheme Rules provides that pensions in payment may be increased if the Founder thinks fit and acting on the advice of the Actuary.”

- *Trust Deed 2008*

Rule 12.2 of the Digital Section of the 2008 Rules concerns pension increases. Rule 12.2.4 says that:

“Pensions will be reviewed by the Principal Employer [i.e. HP UK] at least annually and may be further increased by such amount and at such times as the Principal Employer decides, acting on actuarial advice.”