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Barnardo's case – Supreme Court denies RPI to CPI indexation swap

Briefing

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Introduction

After three years of hearings, in a judgment handed down on *November 7, 2018*, the Supreme Court has unanimously denied Barnardo's permission to switch from the Retail Prices Index to the generally lower Consumer Prices Index as its measure for calculating benefit increases.

The case centred on the precise definition of RPI in the scheme rules. Many final salary schemes have sought to adopt CPI in order to reduce funding deficits and Barnardo's was no exception. The ruling maintains the status quo such that each scheme will need to seek advice to confirm it can substitute CPI for RPI.

The Barnardo's rules

The Barnardo's rules provided for indexation at the lesser of 5 per cent or RPI, which was not, in itself, unusual.

However, the heart of the dispute lay in the definition of RPI which was:

" ... the General Index of Retail Prices published by the Department of Employment or any replacement adopted by the Trustees without prejudicing Approval.

Where an amount is to be increased 'in line with the Retail Prices Index' over a period, the increase as a percentage of the original amount will be equal to the percentage increase between the figures in the Retail Prices Index published immediately prior to dates when the period began and ended, with an appropriate restatement of the later figure if the Retail Prices Index has been replaced or re-based during the period."

What the Supreme Court said

The Supreme Court considered the critical words "or any replacement adopted by the Trustees without prejudicing Approval."

The central question was did that mean

i. The RPI or any index that replaces the RPI and is adopted by the trustees.

ii. The RPI or any index that is adopted by the trustees as a replacement for the RPI?

The Court of Appeal had previously ruled that the official "replacement" of the RPI had to precede the adoption of that measure for indexation by the trustees. RPI can only be "re-based" by the authority responsible for publishing it and, without its official replacement, there was no other "replacement" the trustees could adopt instead.

The Supreme Court agreed unanimously for the following reasons

- "Replacement" does not naturally mean the selection of an alternative, although it depends on the context.
- The wording of the rule suggested a sequence of events rather than a single event of an index being adopted by the trustees. Their discretion and the requirement not to prejudice [Revenue] approval did not counter this view.
- The provision should be considered in the context of the whole document. Consistency with the with the Barnardo's rules as a whole (noting the definition of "re-basing") suggested that it was the official body and not the trustees who could replace the index.
- In the event of inconsistency between [Revenue] terms and scheme rules, the scheme rules must prevail.
- It was inappropriate to use hindsight to assess whether a provision made good commercial sense.
- The scheme provisions had to be viewed without any preconceptions as to whether a certain construction would favour the employer or the members.
- Having essentially agreed with the reasons given by the Court of Appeal, Barnardo's appeal in the Supreme Court failed.

In relation to the questions arising under section 67 of the Pensions Act 1995, the Court of Appeal had approved the approach in the *Qinetiq* case. A switch from RPI to CPI was not viewed as a detrimental modification for section 67 purposes, as indexation gave rise to no accrued rights until the calculation had been done. As Barnardo's appeal to switch indices had been dismissed, the cross-appeal on the subsisting rights provisions of section 67 was not addressed further by the Supreme Court.

What this means for other schemes

It should be emphasised that Barnardo's RPI definition was unusual. In what is a disappointing judgment for the charity, the scheme deficit (which stands at about £130 million) cannot be reduced by adopting CPI.

The starting point for other schemes in deciding whether to move to a new index is their own rules, and the powers and discretions available to the trustee or employer. If the construction of the rules permits a switch from RPI to CPI, this change will not infringe section 67, as there is no accrued right to payment until the index has been selected.

Cases such as *Barnardo's* highlight the constraints that may arise from specific historic drafting. Employers' attempts to adopt CPI may encounter problems which need to be examined on a case-by-case basis where the scheme has retained an RPI link.

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