



## Court of Appeal decision in *IBM UK Holdings Limited and another v Dalgleish and others*

How “reasonable” are pension scheme members’ expectations that benefits will not be changed?

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### Pensions briefing

October 2017

### Summary

In *IBM UK Holdings Limited and another v Dalgleish and others* [2014], the High Court held that IBM’s actions in respect of pension benefit changes amounted to a breach of its duties. It was not the nature of the scheme changes themselves that constituted the breach, but the fact that the changes were at variance with the members’ reasonable expectations resulting from the employer’s past conduct. This decision could have led to significant claims by members against IBM for damages.

The Court of Appeal’s August 2017 judgment has dismissed this decision on the basis that the members’ reasonable expectations were just one of the relevant factors that IBM should have taken into consideration when deciding to make the changes. The Court of Appeal has, however, left open the possibility of members seeking damages in respect of IBM’s failure to comply with its consultation obligations.

### Background

The employer, IBM, decided in 2009 to make a number of changes to its two defined benefit schemes in the UK. This package of changes, which was known as Project Waltz, included

- The closure of the schemes to future benefit accrual from April 2011.
- A new cost neutral early retirement policy from April 2010.
- Entering into agreements with members that salary increases from 2009 would not be pensionable.

There had been two previous benefit change exercises: Project Ocean in 2004 which involved changes to employee contribution rates; and Project Soto in 2006, which gave members an option either to agree to part of their future salary increases not being pensionable, or to transfer to a new scheme with enhanced defined contribution benefits for future service, while retaining full final salary linkage for past accrual.

In light of the requirement for trustee consent to implement Project Waltz and opposition to the changes from members, IBM sought a court order that the proposed changes could be made.

### High Court decision

The High Court decided that the members had reasonable expectations in relation to the pension benefits to be provided under the schemes. In particular, they had reasonable expectations that accrual would continue, the existing early retirement policy would remain in place and that the previously agreed part of future salary increases would remain pensionable. These reasonable expectations arose from IBM's previous conduct, including communications to members at the time of the previous benefit change exercises.

By implementing Project Waltz, IBM was acting contrary to members' reasonable expectations. The High Court decided that this was a breach of

- IBM's implied duty of mutual trust and confidence between the employer and employee in relation to their contractual relationship.
- The separate duty in the pensions context known as the Imperial duty, after the 1991 case in which it was first recognised (namely, the implied duty of good faith that is owed by an employer to the members of a pension scheme when exercising its functions in relation to such a scheme).

In addition, the High Court decided that IBM had not carried out the necessary statutory consultation correctly prior to the implementation of Project Waltz, as IBM had neither provided members with full background to the proposed changes nor consulted with an open mind.

### The *Imperial* duty and the duty of trust and confidence

The Court of Appeal disagreed that the implementation of Project Waltz was in breach of either IBM's *Imperial* duty or its duty of trust of confidence towards members. The High Court had been incorrect to give members' reasonable expectations an overriding significance in determining whether these duties had been breached.

The correct test was that of rationality set out in the 1948 case of *Wednesbury*. Under this two-limb test, a court must determine

- Firstly, whether only relevant (and no irrelevant) matters have been taken into account by the decision-maker.
- Secondly, whether the result is one that no reasonable decision-maker could have reached.

This approach does not prevent members' reasonable expectations from being taken into account by a court in deciding whether these duties have been breached. However, they do not constitute more than a relevant factor. It is, therefore, up to the decision-maker to determine what weight to give to members' reasonable expectations in making its decision. In IBM's case, it was possible for it to take account of the group's financial position and wider economic circumstances, as well as members' reasonable expectations.

## Consultation

IBM did not appeal the High Court’s decisions in relation to its failure to comply with its consultation obligations. Consequently, the Court of Appeal considered what remedies would be available to the members in respect of this breach. It was noted that the consultation legislation sets out the remedies that may be applied in respect of such a breach, which include a penalty of up to £50,000 that can be imposed by the Pensions Regulator. The Court of Appeal decided, however, that this did not affect the availability to members of remedies for breach of contract resulting from a failure to consult correctly.

The Court of Appeal decided it would be inappropriate to require IBM to unravel the implementation of Project Waltz to put members in the position they would have been in had the consultation been carried out correctly. This was principally because of the difficulties arising from the length of time since implementation, although this course of action was not dismissed as a possibility in other circumstances (for example, if a court is requested to do this closer to the implementation date).

The Court of Appeal decided members were entitled to claim damages from IBM in respect of its consultation failures. If members were to bring such a claim against IBM, they would face the challenge of showing how Project Waltz would have been altered had the consultation been carried out correctly.

## Comment

It is difficult to imagine a more favourable outcome for IBM. The Court of Appeal’s judgment is the end of the litigation road in this case, as the members have decided there is “little merit” in seeking an appeal to the Supreme Court.

Despite IBM’s success, the lengthy and costly litigation is a clear warning that employers must still take their Imperial duty to act in good faith seriously. Communicating with members in an honest and open way when scheme changes are proposed offers a less troublesome route in effecting benefit changes. It is clearly preferable to ensure that any such exercises are conducted so that members cannot argue that the contractual duty of trust and confidence between the employer and its employees is adversely affected.

The manner in which IBM carried out the consultation, and the heavy-handed way members were notified of future pay rises being non-pensionable, was a breach of the statutory duty. However, the time lapse between the implementation of Project Waltz and the Court of Appeal’s judgment and the change in economic circumstances over that period worked in IBM’s favour. This resulted in the Court of Appeal’s refusal to require the whole process to be revisited in order to punish IBM for the past breach.

While the Court of Appeal’s decision will be welcomed by scheme sponsors considering benefit changes as a means of addressing funding deficits, it remains the case that employers must consider consultations on pension scheme changes carefully. It is also essential that they allow themselves sufficient time to provide to members accurate and thorough advance communications of any intended changes so as not to fall foul of the statutory consultation requirements.

It will be a relief to employers that past member communications are not automatically legally binding and that members cannot rely on their “reasonable expectations” to unwind scheme changes. Employers should, however, be aware of the possibility that affected members may seek some form of remedy if any necessary consultation is not carried out correctly.

## Contacts

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