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Barnardo's indexation case: Supreme Court adds another piece to the jigsaw

The Supreme Court has given judgment on the next instalment in the case law determining when pension schemes can switch indices for the purposes of revaluation and indexation. In the Barnardo's case, the court determined that it was not open to the trustees of the Barnardo's Staff Pension Scheme (the **Scheme**), (the **Trustees**), to switch from the Retail Prices Index (**RPI**) to another index whilst RPI remained a published index. The Stephenson Harwood Pensions Law Team acted for the Trustees.

Background

Legislation requires that in defined benefit occupational pension schemes, deferred pensions are revalued and pensions in payment are increased (known as indexation). The purpose of this is to protect pensions from the effects of inflation. Primary legislation does not, however, specify the inflation index that must be used for these purposes. Instead, the Secretary of State makes an annual order to specify the index and the rate to be used. Historically, these orders have specified RPI as the relevant index against which to calculate revaluation and indexation. This, however, changed in January 2011. Since then, the relevant index that has been applied in the annual orders has been the Consumer Prices Index (**CPI**).

Generally, the use of CPI rather than RPI as the relevant index would produce lower rates of revaluation and indexation, and therefore be cheaper for the relevant scheme to provide. For this reason, many schemes are keen to understand if they are able to switch to CPI (or any other alternative index).

The legal lottery

Given this background, pension scheme rules often refer explicitly to "RPI" as the index to be used to calculate the correct level of revaluation and indexation. As CPI was introduced through orders issued by the Secretary State rather than as a legislative override, a legal lottery emerged which meant that whether a scheme could move away from RPI depended upon the specific wording of their scheme rules:

Rule	Able to move away from RPI?
Rule hard-wires that index to be used is RPI	Not without a rule change (and only for future service)
Rule provides that index to be used is that set out in the order issued by the Secretary of State	CPI will automatically apply as specified in annual orders
Rule provides that index to be used can be changed in certain circumstances	Use of alternative index depends upon the interpretation of that rule. The Barnardo's case fell into this category

The Scheme

The Scheme provided that indexation was to be carried out by reference to the "Retail Prices Index". This, in turn, was defined as:

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

The Barnardo's case essentially centres around the meaning of the underlined wording. The two alternative interpretations were:

1. it allowed the Trustees to adopt an index other than RPI (for example CPI) as a replacement for RPI; or
2. the Trustees could only adopt a different index to RPI if RPI itself was replaced as an index first.

In both the High Court and the Court of Appeal, the judges held that the correct interpretation was the latter one. The Trustees did not have the ability to choose an alternative index, such as CPI, whilst RPI remained an officially published index. In the Court of Appeal, Lord Justice Vos, however, dissented from the majority and favoured the first interpretation.

The Supreme Court followed the same line as the majority in the courts below. It was held that another index (such as CPI) was not available to the Scheme unless and until RPI was replaced. Lord Hodge gave eight reasons for this conclusion, summarised briefly as follows:

01 The word "replacement" in the definition of RPI does not naturally suggest the selection of an alternative to an option that is still available

05 No assistance could be derived from Inland Revenue guidance as this does not seem to have been used by the draftsmen when drafting the definition of RPI

02 The word order in the definition of "RPI" suggests that RPI must first be replaced and subsequently an alternative be adopted by the Trustees

06 No assistance could be derived from previous superseded versions of the rules of the Scheme

03 The requirement in the definition that any replacement should not "prejudice Approval" does not undermine the court's preferred interpretation

07 The interpretation favoured by the court would not lack a rational purpose as indices have been changed by the government throughout history. Hindsight could not be used to determine whether the provision makes good commercial sense

04 The use of the word "replacement" in other parts of the Scheme rules suggest that it was envisaged that it was an official body, and not the Trustees, who could "replace" the use of RPI. This term should be interpreted consistently throughout the document

08 Whilst the court accepted its preferred view added to the deficit in the Scheme, it noted the court should not construe the scheme with preconceptions as to whether the sponsoring employer or the members should be favoured

Other court decisions

There has been a wealth of case law in this area. Most of the decisions focus on schemes which, like the Scheme, have rules which permit the index to be changed in certain circumstances. Some key examples include:

Case	Rule	Ability to move away from RPI?
Danks and others v Qinetiq Holdings Ltd	"Index of Retail Prices...or another suitable cost of living index selected by the trustees..."	✓
Arcadia Group Limited v Arcadia Group Pension Trust Ltd	"...the Government's Index of Retail Prices or any similar index satisfactory for the purposes of HMRC"	✓
Thales UK Ltd v Thales Pension Trustees	If RPI is not published or if "...its compilation is materially changed...the nearest alternative index..." shall be applied	X
British Telecom v BT Pension Scheme Trustees	An alternative index shall be used if RPI "...ceases to be published or becomes inappropriate..."	X (awaiting appeal)

What now?

In the absence of a legislative override for private sector defined benefit pension schemes, the availability to schemes of an alternative index to RPI for use in revaluation and indexation will turn on the precise wording of the scheme rules. Whilst the case law offers useful guidance, each case is very much limited to the precise wording in play. As a result, the legal lottery, and litigation in this area, will continue.

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