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## Pensions and extrinsic contracts

An article by [Nigel Burroughs](#) of 4 New Square considering how the legal principles of extrinsic contracts and estoppel apply in the context of pension schemes.

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### Introduction

Due to ever-increasing funding pressures on occupational pension schemes, employers and trustees are particularly astute to ensure the benefits which they are paying are those which are provided for by the scheme's governing documents. Frequently, they discover that changes which they thought had been made to the scheme were not properly documented. If the scheme has not been validly amended according to its terms, they seek to find other means by which the changes can be given effect. Two of the most frequently considered alternative routes are extrinsic contracts and estoppel.

In this article, I am going to concentrate on extrinsic contracts, although I will also consider how contractual arguments may overlap with estoppel issues; often both will be argued together. I will deal with the leading cases in the pensions context, and in particular the decisions of Neuberger J in *South West Trains v Wightman* [1998] PLR 113 and Arnold J in *IMG Pension Plan HR Trustees Ltd v German and another IMG (UK) Ltd* [2009] EWHC 2785.

### When is an extrinsic contract used?

In relation to pensions, an extrinsic contract would generally be a contract between the employer and the employee or member which affects the pension benefits to which the employee is entitled. This agreement will usually be the employment contract or a variation of that contract. Whilst it can deal with any of the provisions of the pension scheme, it is more likely to confine itself to issues such as normal retirement date, pensionable salary, and breaking the link to final salary.

One of the principal difficulties arising from the use of extrinsic contracts is how it is to be enforced by the trustees of the scheme who were not parties to the contract. This issue is dealt with in *South West Trains v Wightman*.

The other significant problem is the court's reluctance to step outside the formal governing documents of a pension scheme when considering its provisions. This is because pension schemes are generally long-lived, and it is potentially unfair on the members who will not have easy access to expert legal advice to depart from the terms of the trust deed and rules. The courts have, therefore taken a strict

approach to the formalities for amending pension scheme trusts and construing any associated documents, including any extrinsic contracts.

## The development of the case law

### South West Trains v Wightman

*South West Trains v Wightman* arose out of the privatisation of British Rail. Pursuant to the Railways Act 1993, a new pension scheme was established for the employees of British Rail who were transferred to the private sector. One of the private sector employers was South West Trains (SWT), originally a subsidiary of the British Railways Board, but a subsidiary of Stagecoach Holdings Plc at the time in question. As part of the restructuring process, SWT set about renegotiating the employees' contracts of employment.

The case was concerned with an agreement reached between SWT and ASLEF, the trade union representing drivers and other employees, and approved by the union's membership in a ballot. The material parts of the agreement were that, instead of paying drivers approximately £11,950 a year plus allowances of £11,000 (which is what they received before privatisation), they would be paid a salary of £25,000 with no significant allowances. So far as contributions to the pension scheme were concerned, they would be based on a notional salary of £18,000, whereas before the restructuring it was based on the actual salary of £11,950.

Neuberger J decided that:

- The agreement did not fall foul of Article 6(1) of the Railway Pensions (Protection and Designation of Schemes) Order 1994 (*SI 1994/1432*) by substituting a notional salary for the actual salary.
- Section 67 of the Pensions Act 1995 (PA 1995) did not invalidate the agreement since it was reached before section 67 came into force.
- The agreement reached between SWT and the union, and endorsed by a ballot of the union's members, was contractually binding as between SWT and each of the drivers.
- SWT could prevent the drivers from claiming pensions calculated on the basis of their newly increased actual salary as opposed to their notional salary.
- The trustee could, and probably should, execute a deed of amendment giving effect to the agreement between SWT and the drivers.

After concluding that SWT would be able to injunct the drivers from claiming pensions based on their actual salary, the judge continued by considering whether the trustee could refuse to pay the drivers' pensions based on the higher rate. Without deciding the issue, he thought that it was well arguable on three possible bases:

- The trustee could argue that any claim brought against them by a driver should be dismissed as an abuse of process.



- Any claim brought by a driver would be as a beneficiary under a trust. For there to be a valid trust, there must be a beneficiary in whose favour performance of the trust can be decreed. As there was a valid and enforceable contract between SWT and the driver, the trustee might be able to say that there was no basis upon which the driver could demand a pension on any more favourable basis.
- A driver's pension is calculated by reference to his final average pay. To determine the driver's final average pay, the trustee would have to have regard to the driver's contract of employment. If that contract provides that, for the purposes of calculating his pension, his pay is to be treated as being £18,000 a year rather than his actual pay of £25,000 a year, that is the pay for the purposes of the trust deed.

While the suggested outcome has much to recommend it, Neuberger J himself recognised that none of the arguments in favour were clear cut. He also declined to make a decision on the trustees' position because he did not need to do so - he had already concluded that SWT could prevent the drivers from claiming a pension calculated on a salary of £25,000. The question, then, is still at large, and while *South West Trains v Wightman* will form the basis of any argument by the trustees of a pension scheme to enforce an extrinsic contract between a member and the principal employer, it is not authority for the proposition that they can enforce the agreement.

### **Hodgson v Toray Textiles Europe**

*Hodgson and others v Toray Textiles Europe Ltd and others* [2006] EWHC 2612

(Ch) ([www.practicallaw.com/5-378-8433](http://www.practicallaw.com/5-378-8433)), in which I appeared as counsel for the third defendant, is one of the many cases concerned with the failure to properly document the terms on which employees were admitted to the pension scheme of a new employer that had acquired their former employer. One of the issues decided by the court was whether the terms of the offer made to Mr Skinner to transfer into the Toray Scheme, which he accepted, amounted to a legally binding contract which incorporated the benefits described in the Toray explanatory booklet. Those benefits included a right to retire at any age between 60 and 65.

Relying on *Gibson v Manchester City Council* [1979] 1 WLR 294, Lewison J decided that the letter from Toray inviting Mr Skinner to complete and return an application form if he wanted to join the scheme was no more than an invitation to treat. It was not an offer capable of acceptance, and did not bring a binding contract into existence.

The judge also found that the letter had been sent by the company, not the trustees, and the only communication sent to the trustees (who were said to be parties to the agreement) was the application form. That document did not mention the scheme booklet, but was simply an application to join "the Scheme". Furthermore, the explanatory booklet which was said to form the basis of the contract expressly provided that if there were a conflict between the terms of the scheme and the terms of the booklet, the scheme prevailed.

The judge, therefore, rejected the claim based on an extrinsic contract. It is worth noting, however, that the case advanced by Mr Skinner was that there was an agreement between him and the trustees which entitled him to a flexible retirement date. He did not seek to rely on a contract with Toray, and did not rely on *South West Trains v Wightman* to assert that the contract between him and his employer could be enforced by the trustees.



(For more information, see Legal update, Pension scheme rules: announcement not effective to close Barber window ([www.practicallaw.com/4-205-6154](http://www.practicallaw.com/4-205-6154).)

## HR Trustees v German

The underlying issue in *HR Trustees v German* ([www.practicallaw.com/8-500-7182](http://www.practicallaw.com/8-500-7182)) was the closure by the principal employer of its final salary scheme, and the transfer of the members into a new money purchase section. The judgment deals with a number of matters, but the discussion of the extrinsic contract and estoppel are at paragraphs 151 to 190.

Unlike in *Hodgson v Toray Textiles*, the argument in relation to the extrinsic contract was expressly framed by reference to *South West Trains v Wightman*. Arnold J set out the court's conclusions in respect of the five issues set out above, and recorded that counsel for the existing members did not take issue with Neuberger J's contractual analysis.

The first contentious issue was whether there was an intention to create legal relations when the members returned the completed applications to join the scheme. The judge decided that there was no such intention. The foundation of the employers' contract case was a memorandum issued in November 1991. That was described by Arnold J as an announcement by the employers to their employees of what the employers had unilaterally decided to do, and presented to them as a *fait accompli*. There was nothing in the memorandum which suggested that it was dependent on the employees' agreement.

Furthermore, the document stated that full details would be provided in a new explanatory booklet. Turning to the booklet, it provided that the scheme "has been... amended". It also stated that it was not comprehensive and that the scheme was governed by its trust deed and rules. The judge was particularly influenced by this statement and could not see how the parties could have intended to enter into contractual relations governed by the extrinsic documents as opposed to the legal relations governed by the trust documents.

While consideration is a necessary ingredient of any extrinsic contract, Arnold J was happy to accept that the promise to pay a transfer value into the members' money purchase accounts and additional special contributions was good consideration.

He was not, however, persuaded that the extrinsic contract could be enforced by the employers or the trustee where it would override a provision in the trust deed. Clause 7(i) provided that the trustee could only amend the trust deed and rules by deed or a signed declaration. The extrinsic contract was not a deed of amendment made by the trustee, or a signed declaration. If it was effective, it would override the requirements of clause 7(i). The judge distinguished *South West Trains v Wightman* where Neuberger J accepted that the extrinsic contract in that case only affected the salary on which pension would be calculated; which salary the trustee would have to look for outside the terms of the scheme in any event. The only situation where an extrinsic contract could override the provisions of the trust deed was where it also amounted to an informed consent by the members that the strict terms of the deed should not be adhered to.



The effect of Arnold J's decision is to severely limit the situations in which an extrinsic contract will be enforced. Essentially, it will only be available to amend the terms of the scheme where it relates to matters outside the terms of the scheme such as salary, or where it amounts to an informed consent to ignore the restrictions on the trustee's (or employer's) amendment powers.

(For more information, see [Legal update, Scheme conversion from final salary to money purchase falls foul of restrictive amendment power \(www.practicallaw.com/9-500-7105\).](#))

Although *HR Trustees v German* is not expressly mentioned in his judgment, Henderson J in *Capita ATL Pension Trustees v Gellately* [2011] EWHC 485 (Ch) ([www.practicallaw.com/0-505-2442](#)) adopts a similar approach to Arnold J when considering the question of an extrinsic contract and estoppel and frames the discussion by reference to *South West Trains v Wightman* and *Jones v Associated Tunnelling Co* (referred to below). For more information, see [Legal update, High Court considers extrinsic contract and estoppel arguments in Sea Containers case \(www.practicallaw.com/0-505 2442\).](#)

## Khatri v Cooperatieve Centrale Raiffeisen-Boerenleenbank

*Khatri v Cooperatieve Centrale Raiffeisen-Boerenleenbank* [2010] EWCA Civ 397 ([www.practicallaw.com/2-502-1303](#)) is not a pensions case, but reiterates that the approach of the Employment Appeal Tribunal in *Jones v Associated Tunnelling Co* [1981] IRLR 477 is still the starting point for any consideration of whether silence is to be treated as acceptance of a contractual offer.

Mr Khatri was a derivatives trader with Rabobank International (the trading name of the respondent). On 18 March 2008, he signed a variation of his employment contract which provided him with a guaranteed bonus of 12% of revenue generated by him in excess of EUR551,000. In mid-July 2008 he was told by the bank that he might be made redundant. By letter dated 23 July 2008 he was informed that his job was safe, but that he would be redeployed. The amended terms and conditions of his employment were contained in a letter dated 24 July 2008. Crucially, that letter provided for a purely discretionary bonus. Mr Khatri did not sign the letter of 24 July 2008 as requested, nor was he ever pressed to do so. Although he was supposed to be redeployed, his job, in fact, did not change at all. On 28 October 2008, he was made redundant. A dispute arose over whether he was entitled to the guaranteed bonus provided for by the contract signed on 18 March 2008, or only a discretionary bonus as set out in the letter dated 24 July 2008.

The Court of Appeal, following *Jones v Associated Tunnelling Co*, decided that he was entitled to the guaranteed bonus. It accepted that where an employee continued to work after his employer had proposed a variation of his contract of employment, he would only be taken to have impliedly agreed to the variation in so far as it has immediate practical implication. The classic example of this is a change in pay. However, where the variation has no immediate practical impact, he is not taken to have agreed to it. The paradigm example of this sort of variation is a change in pension arrangements.

The effect of these decisions is that an employer (or trustee) will have to show that the member has expressly agreed a variation to his pension entitlements. Merely continuing to work will not be sufficient to show an acceptance of a change which will only have any practical impact on the member when he retires.



(For more information, see Legal update, Performance-related bonus awarded by summary judgment ([www.practicallaw.com/4-502-1279](http://www.practicallaw.com/4-502-1279).)

## Overlap with estoppel

A detailed discussion of estoppel in the pension schemes context is beyond the scope of this article. However, an estoppel argument often runs hand in hand with an extrinsic contract argument, and it is worthwhile pointing out some of the areas of overlap between the two types of claim:

- The courts will scrutinise with care the documents which are relied upon as containing the representation or contract. There must be a clear and unequivocal representation for an estoppel by representation, and there must be "agreement" to form a contract (as opposed to the announcement of a decision already taken by the employer, for example).
- If a scheme booklet is relied upon, it will not found an estoppel or establish an extrinsic contract if it provides that it is a summary of the scheme's provisions and that the trust deed and rules prevail.
- An extrinsic contract must be supported by consideration. Detrimental reliance must be shown with an estoppel by representation.
- Mere passive acceptance of a common assumption will not be sufficient to support an estoppel by convention. The receipt of benefits, or the payment of contributions, will not be sufficient. This approach is similar to the court's approach to acceptance by silence in the contractual situation.

Perhaps the most significant difference between an extrinsic contract claim and one based on estoppel is that an extrinsic contract claim will fail if it contradicts or overrides a provision in the scheme deed and rules. An estoppel claim will not, and is used to get round the amendment formalities.

## Section 91 of the Pensions Act 1995

Section 91 of the PA 1995 renders unenforceable any agreement by which a member assigns, commutes or surrenders his rights under an occupational pension scheme. In *HR Trustees v German*, Arnold J had to consider the effects of this section on agreements entered into with individual members to waive any claim arising out of the reorganisation of the pension scheme in return for improved terms of employment.

The specific question for the judge was whether a compromise agreement constituted a surrender of rights under the section. He thought that there were two competing objectives which he had to bear in mind:

- It was apparent from the *Goode Report (1993)* that section 91 was intended to make "inalienability a rule of general application", subject to certain exceptions, and that the statutory purpose behind the section was not merely to protect members of pension schemes, but also to protect the public purse.
- There is a public policy in favour of enforcing compromises of disputes.



The judge decided that the word "surrender" in section 91(1)(a) encompassed a compromise by which a member waived rights to which he would otherwise be entitled.

He also held that such a compromise included an agreement where there was a genuine dispute as to the existence of the rights, so this would amount to an unenforceable surrender under section 91.

Arnold J's decision was subject to an appeal to the Court of Appeal, which decided as a preliminary point that section 91 did not prevent the parties from entering into a compromise of the appeal (in *International Management Group (UK) Ltd v German and another* [2010] EWCA Civ 1349 ([www.practicallaw.com/2-504-1075](http://www.practicallaw.com/2-504-1075))). The Court of Appeal was not persuaded that the competing objectives referred to by Arnold J led to a conclusion that the word "surrender" included an agreement where there was a genuine dispute as to the existence of the rights. Rather than just focussing on the word "surrender", Mummery LJ concentrated on the inalienability of surrender of an "entitlement" or "right". He distinguished between an "entitlement" or "right" to a pension the existence of which was accepted or established, which **was** covered by section 91, and a putative entitlement or right that was claimed but whose existence was in dispute or doubt, which was not. Mummery LJ held (with the agreement of the judicial panel) that:

"In my judgment, the policy reasons of protection of pension scheme members and the public do not apply to a *bona fide* compromise under which a putative entitlement or right is waived in order to avoid the need for legal proceedings and for a judicial determination." (Paragraph 37.)

(For more information, see [Legal update, Court of Appeal clarifies pension compromises post-IMG v German](http://www.practicallaw.com/0-504-1000) ([www.practicallaw.com/0-504-1000](http://www.practicallaw.com/0-504-1000)).

## Key points for practitioners

Going forward, the prudent advice will be that a variation of an employment contract (or some other extrinsic contract) is only likely to be effective to alter the provisions of a pension scheme in so far as it relates to a facet of the benefit structure to which reference must be made outside of the scheme documents. An example of this is ascertaining a member's salary when calculating the benefit to which he is entitled. Another example might be years of pensionable service under a final salary scheme. Again, the trustee would, in any event, have to look outside the terms of the scheme to obtain this figure.

If advising on the enforceability of extrinsic contracts where there has been a failure to properly amend the terms of the scheme, the first question will be whether the agreement contradicts an express term of the trust deed and rules. As resort will only be had to an extrinsic contract if the scheme has not been amended in accordance with its power of amendment, there will always be such a contradiction unless it relates to matters outside the terms of the scheme documents.

If that hurdle can be overcome, it will be necessary to consider the following points:

- What are the terms of the agreement? Has the employer actually made an offer, or merely announced what he and the trustees are going to do?



- If the agreement is to be made by reference to some other document, such as a scheme booklet, what does that document say? Does it expressly state that the deed and rules govern the scheme? If so, it will be conclusive.
- Has the member agreed to the offer made by the employer? Passive acceptance, without express approval, is unlikely to amount to the acceptance of an offer that has the effect of amending pension benefits which are payable at some point in the future.
- Does the agreement fall foul of section 67 of the PA 1995? Does it affect subsisting rights, or is there an underpin so as to preserve those rights?

Even if an agreement between the employer and the member can be established, there is still the question of whether that agreement is enforceable by the trustees of the scheme. Although *South West Trains v Wightman* suggests that the trustees can enforce such an agreement, and counsel for the members in *HR Trustees v German* did not take issue with Neuberger J's contractual analysis, there is no binding authority to that effect, and the issue is still at large.