

# United Kingdom: Arcadia - a recent case involving the sharing of surplus between schemes

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DB Surplus

Pension Scheme Merger

Winding-Up

## In brief

The High Court has handed down a judgment approving the merger of two pension schemes in the process of winding up and which resulted in the dilution of the surplus for members of the receiving scheme to address a shortfall in the transferring scheme. The case will be of interest to employers and trustees of occupational pension schemes, many of whom are currently considering issues related to surplus, although its application may be limited in practice given the unusual circumstances in this case.

## Background

The case involved two pension schemes, the Arcadia Group Pension Scheme ("**Staff Scheme**") and the Arcadia Group Senior Executives Pension Scheme ("**Executive Scheme**") (together the "**Schemes**").

The Schemes had been administered as "sister" schemes. They had a common Principal Employer, Arcadia Group Limited, there was material overlap in the Schemes' trustee boards and they shared the same administrators and professional advisers. A significant proportion (approximately 50%) of members of the Executive Scheme had been transferred from the Staff Scheme. Decisions in relation to the Scheme were generally made at joint meetings and key changes to the schemes (such as closure to new members and closure to accrual) had been implemented at the same time. They had a joint investment and funding committee, and, in recent years, they had been generally managed in a way which had been designed to achieve parity between their funding levels.

Sir Philip Green's Arcadia Group collapsed in 2019. Sir Philip Green had previously been subject to investigation by the Pensions Regulator in relation to a separate business, BHS, which had also collapsed. As part of CVA proposals for the restructuring of the Arcadia Group, various agreements were entered into in relation to the pension schemes. These included the payment by Philip Green's wife, Lady Green, of GBP 100 million into the Schemes, the payment of deficit repair contributions and the implementation of a security package in respect of the Section 75 debts owed to the Schemes. All these arrangements were put in place on the basis of ultimately achieving funding parity between the schemes and, owing

to the fact that the Staff Scheme was understood to be in a worse funding position than the Executive Scheme at the time, the various agreements resulted in more money being paid into the Staff Scheme than the Executive Scheme (in fact, all of the GBP 100 million from Lady Green ended up being paid into the Staff Scheme).

A combination of developments in the insurance market and the economy led to a reversal in the relative funding positions of the Schemes compared to what had been expected. This included the unexpected market volatility caused by the mini-Budget of September 2022, scheme "experience" (e.g., mortality of the beneficiaries) and differences in insurer pricing between the two schemes (the "shape" of benefits in the Executive Scheme was less attractive to insurers than benefits in the Staff Scheme). The funding disparity between the two schemes was also anticipated to be further widened by the fact that future section 75 recoveries arising from the liquidation of Arcadia would be based on a much higher section 75 debt being owed to the Staff Scheme than the Executive Scheme. The Schemes' actuaries estimated that, based on information as of 30 September 2024, the Staff Scheme was expected to have a surplus of GBP 35 million and the Executive Scheme a deficit of GBP 11 million once the liquidation of Arcadia had been completed.

A proposal was put together under which the Executive Scheme would merge into Staff Scheme. This would mean that members of both schemes would be entitled to the basic level of benefits to which they had been entitled under the respective schemes and the surplus would become available to members of both schemes should the trustees exercise their discretion to augment benefits. For members of the Staff Scheme, the receiving Scheme under the merger and whose provisions were being amended, this meant that their contingent interest in the surplus would become diluted. It was relevant that Staff Scheme members were not entitled to that surplus (augmentation depended on the exercise of trustee discretion).

In order to implement the merger, it was necessary to amend the provisions of the Staff Scheme's Trust Deed and Rules, amongst other things because the Scheme's Trust Deed and Rules expressly prohibited a transfer-in. The power of amendment was drafted widely. Where the Principal Company was in liquidation, as was the case here, the power to amend was vested solely in the trustee. The power to amend was expressed to continue until the point of winding up.

The Trustee of the Staff Scheme applied to the Court for confirmation that making the necessary amendments in order to allow the merger would be within the scope and purpose of the amendment power. If it was, they asked the Court to "bless" the exercise of the amendment power to make the amendment and then to exercise the new power to accept a transfer in.

The Court agreed on all counts, allowing the amendment and merger to proceed.

## Key takeaways

The case does not require any action on the part of trustees or employers but does contain some interesting points for employers and trustees to be aware of:

- **Scope of the power of amendment during wind up: no fetter implied.** Once winding up is triggered, questions can arise around the continued use of powers of amendment unless the provisions of the trust expressly allow them to continue.

As noted above, in this case, the Trust Deed and Rules expressly provided for the power of amendment to continue after winding up had been triggered and so the lack of an express power was not an issue in this case. However, the Court considered whether it would be appropriate to **imply** a restriction given that the amendment power was being used to allow a merger and the existing transfer-in provision in the Staff Scheme expressly prohibited mergers-in. The Court said that no such fetter should be implied, saying "It may be unusual for an amendment to be

made in the course of winding up a scheme with the company in liquidation so as to permit a merger but that is not the point.... The power was intended to be both wide and flexible. There is no reason to consider that it was intended to have a more limited scope when exercised solely by the Trustee."

The scope of a scheme's power of amendment will depend to large extent on the particular wording of the Trust Deed and Rules and the context in which it is being used. This judgment indicates, however, that the Court will not imply fetters on wide amendment powers lightly, even when a scheme is winding up.

- **Proper exercise of powers: amendments resulting in dilution of surplus can be a proper exercise of the power of amendment in certain circumstances.**

Perhaps the most interesting aspect of the judgment is what the Court had to say on the question of whether the trustees would be acting properly in exercising the power of amendment (and then the new transfer-in power) in order to bring about the merger.

It is well established that trust powers must generally be exercised for the benefit of the beneficiaries and that this applies to beneficiaries of the scheme to which the power relates. The result in this case, which was counter to the (contingent) interests of the beneficiaries in the Staff Scheme does, therefore, appear surprising at first glance.

It was relevant in this case that the overall purpose of the Staff Scheme referred specifically to the provision of Scale Benefits, which were essentially members' basic entitlement and expressly excluded any benefits which had been granted to members via augmentation. The Court also appeared to place reliance on the fact that here the object of the Staff Scheme included the provision of benefits for persons "who are at any time Members" (i.e., the object contemplated a changing group of members with new members being admitted). The Court, citing the Privy Council decision of *Grand View Private Trust Co Ltd v Wong*, agreed that "It is generally the case that fiduciary powers conferred on a trustee of trust with identified beneficiaries must further the interests of beneficiaries" but noted that "there is no overriding principle that all powers must be exercised in the interests of some or all of the beneficiaries (unless express provision to the contrary is made)" and so "the interests of the current members of the Staff Scheme do not have to be considered exclusively".

The Court appears to have felt that this reasoning, together with another Privy Council decision, *Bank of New Zealand v Board of Management of the Bank of New Zealand Officers' Provident Association* meant that it was appropriate for the trustees to take into account wider factors such as the close relationship between the two Schemes, with the Court noting that "In using the surplus in the Staff Scheme to benefit members of the Executive Scheme the claimant would be providing pension benefits the principal employer intended those members to receive, albeit the intention was that they receive those benefits through the Executive Scheme." The Court also felt it was relevant to take into account the historical funding objective of the trustees in relation in both schemes (which was reflected in the commercial agreements which had been reached by the Schemes in relation to recoveries from the Arcadia liquidation), as well as the fact that the surplus in the Staff Scheme and the deficit in the Executive Scheme were an unintended consequence of forces outside the control of the trustees.

It will be interesting to see the extent to which this judgment is applied in subsequent cases involving the use of surplus from one scheme in relation to another scheme; given its specific facts, it may be distinguished in other cases involving similar considerations, including in ongoing schemes. It is not unusual to encounter "sister" schemes within corporate groups for both executive and non-executive members (or other differentiated groups of employees) which have been run in parallel and where funding levels are different, but the specific facts of and background to this case may be less commonly found in other situations.

- **The Court's willingness to bless "monumental" decisions**

Applying to the Court for its "blessing" to a particular course of action can be a valuable way to protect trustees against their decisions being challenged in future. In particular, where the decision is "momentous", as was considered to be the case here, where an amendment power was being exercised during winding up to effect a merger resulting in the dilution of surplus.

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