Neutral Citation Number: [2010] EWCA Civ 179

Case No: A3/2008/1520

IN THE HIGH COURT OF JUSTICE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
Miss Sarah Asplin QC (Sitting as a Deputy High Court Judge)
HC06C03676

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 04/03/2010

Before :

LORD JUSTICE MUMMERY
LORD JUSTICE WILSON
and
LORD JUSTICE RIMER

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Between :

(1) MARK HOULDSWORTH (2) JOHN HUNTER	**Appellants**
- and -	
(1) BRIDGE TRUSTEES LIMITED (2) JOHN YATES	**Respondent**
and	
SECRETARY OF STATE FOR WORK AND PENSIONS	**Intervener**

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MR ANDREW SIMMONDS QC and MR NICOLAS STALLWORTHY (instructed by **Lee & Priestley LLP**) for the **Appellants**
MR KEITH ROWLEY QC (instructed by **Eversheds LLP**) for the **First Respondent**
MR PAUL NEWMAN QC and MISS EMILY CAMPBELL (instructed by **Pinsent Masons LLP**) for the Second Respondent
MR CHRISTOPHER NUGEE QC and MR JONATHAN HILLIARD (instructed by Department for Work and Pensions Legal Group) for the Intervener

Hearing dates : 9th, 10th & 11th June 2009

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Judgment Approved by the court for handing down (subject to editorial corrections)

LORD JUSTICE MUMMERY :

This is the judgment of the Court to which all members of the Court have contributed.

A. Overview

1. This case is about the winding up of a substantial occupational pension scheme. The dispute is about the order in which members' benefits should be paid.

2. An occupational pension scheme called "The Imperial Home Décor Pension Scheme" (the Scheme) was established with effect from 1 January 1972. Over the following 30 years it underwent major structural changes. The legislation changed. The Scheme rules were amended. The principal employer then became insolvent. The Scheme began to be wound up in October 2003. The estimated value of the Scheme assets is significantly less than the cost of securing the members' benefits. The deficit is in the region of £40m. Not all the members will receive their pension benefits in full.

3. A sole independent trustee of the scheme, Bridge Trustees Limited (the Trustee), was appointed. It applied to the court. The purpose of the application was to get authoritative answers to questions. There were doubts about the interpretation of the winding up provisions in the pensions legislation and their application to the Scheme. The answers to the questions affect the order in which the assets of the Scheme will be used to satisfy the Scheme's pension liabilities to its members. The appeals are about whether the court of first instance gave wrong answers to some of the questions.

4. The Trustee discovered that there were some basic difficulties in the winding up of the Scheme. That occurred soon after the principal sponsoring employer company, Imperial Home Décor Group (UK) Limited, went into administrative receivership on 26 June 2003. Liquidation followed. Unfortunately for the members, the Scheme is not eligible for admission to the Pension Protection Fund. That is a "lifeboat" introduced by the Pensions Act 2004 and funded by levies on eligible occupational pension schemes. The Scheme is not eligible, as the winding up began before 6 April 2005. The members may be eligible to have their benefits topped up under the Financial Assistance Scheme (FAS). That is a publicly funded "lifeboat" also introduced by the Pensions Act 2004. The FAS applies to schemes where the winding up commenced between 1 January 1997 and 5 April 2005. It is applicable where the principal employer has been, as here, subject to "an insolvency event." However, as counsel for the Trustee was careful to explain to the court, the FAS does not necessarily offer a solution for all members. The court is not asked to rule on the application of the FAS.

5. The relevant legislation deals with preferential liabilities in a winding up. It lays down the order in which Scheme assets should be applied towards satisfying liabilities to the members for pensions and other benefits. Section 73 of the Pensions Act 1995 (the 1995 Act) sets out, in order of priority, the different kinds of pension benefits affected. The Occupational Pension

Schemes (Winding up) Regulations 1996 (the 1996 Regulations), in particular regulation 13, modified the application of s73 in important ways. It did so by excluding certain kinds of benefits from it, though with exceptions. The way in which that was done is the cause of considerable uncertainty and controversy in this case.

6. Section 73 does not apply to the winding up of every kind of pension scheme. It applies only to the winding up of a "salary related occupational pension scheme" and to the benefits specified in that section, as modified. The fundamental problem is whether the order of payment in s73 applies at all to some of the main benefits under the Scheme. The benefit structure of the Scheme is complex. The Scheme began life in a simple "salary related" form. Pension benefits provided to members were related to their final salary. The Scheme was later amended. The changes introduced additional and new pension benefits. They are not calculated in the same way as salary related benefits. Are those benefits covered by s73?

7. Scheme assets are held on trusts. The court has jurisdiction to determine issues arising "in the execution of trusts": CPR Part 64. The Trustee's application to the court and the judgment of the court below have generated 7 issues on these appeals. All of them relate to the order of application of the Scheme's assets in the trusts. The answers to the questions as to whether s73 applies to various benefits turn mainly on the interpretation and application of the definitions of key terms in the 1995 Act. The definitions are not easy to understand or to apply.

8. The main point is whether particular pension benefits under the Scheme are "money purchase benefits" (MP benefits). The expression is defined in the legislation (s 181 of the Pension Schemes Act 1993 (the 1993 Act), as imported into the 1995 Act by s124(5)):

> "...benefits the rate or amount of which is calculated by reference to a payment or payments made by the member or by any other person in respect of the member and which are not average salary benefits."

9. The definition focuses on how the amount of the members' benefits is calculated: the calculation must be "by reference to" payments made into the Scheme by or in respect of the member. MP benefits are not calculated by reference to some other form of payments, for instance salary payments *to* the member. Must MP benefits be calculated *only* by reference to contribution payments? The definition is of crucial importance: if the benefits in question are MP benefits, they are, in general, excluded from s73. That is the effect of the modification of s73 made by regulation 13(1) of the 1996 Regulations.

10. If the benefits are MP benefits, the other main point is whether any of the MP benefits excluded from s73 are "underpin benefits." They are defined in regulation 13(3). Underpin benefits, by way of exception to the general exclusion, fall back into s73. They are defined in regulation 13 (3) as

> "...money purchase benefits which under the provisions of the scheme will only be provided in respect of a member if their value exceeds the value of other benefits in respect of him under the scheme which are not money purchase benefits."

That definition gives rise to problems. How does it work in the case of benefits that have a minimum or guaranteed element?

11. Another definition central to the application of s73 is that of a "salary related occupational pension scheme." That is the only kind of pension scheme to which s73 applies on a winding up. The legislation defines a "salary related" pension scheme in a negative way. It says what a salary related scheme is not: it is an occupational pension scheme "which is *not* [our emphasis] a money purchase scheme": see s125(1) of the 1995 Act. This default definition means that, if an occupational pension scheme is not a money purchase scheme, then it is a salary related scheme, though that does not mean that all the benefits under it are salary related benefits.

12. The term "money purchase scheme" (MP scheme) is defined. It is positively defined as a scheme under which *all* the benefits that may be provided are MP benefits. That takes you back to the definition of MP benefits. What is the overall effect of those definitions? It is, in general, that s73 does not apply to MP schemes, or to MP benefits, unless they qualify as underpin benefits.

13. The application of the definitions to the Scheme and the benefits under it is not a straightforward exercise. The Scheme provides members with both salary related benefits and with MP benefits. It is agreed that the Scheme is not an MP scheme: not *all* the benefits under it are MP benefits. Some benefits dating from the Scheme's early days and simpler structure are clearly salary related. The Scheme itself may be described as "salary related" in the sense that it is *not* an MP scheme. However, as already noted, that does not mean that all the benefits under the Scheme are salary related. It has to be asked of each benefit in question: is it an MP benefit within the statutory definition? It does not necessarily follow that, if a benefit is not an MP benefit, then it must be a salary related benefit. That is not the way the legislation works. A benefit may quite simply fail to qualify as an MP benefit. A benefit may fall outside the definition of an MP benefit without necessarily itself being salary related. We emphasise, at the risk of repetition, the key question. It is not whether the benefits are salary related: it is whether they are calculated "by reference to" payments contributed to the Scheme by or in respect of members. If they are calculated in that way, they are MP benefits and they are outside s73. If they are not calculated in that way, they are inside s73.

14. That is not quite as simple in practice as it might suggest. For example, it is argued in this case that benefits are not calculated "by reference to" the contribution payments if the benefits are in a composite bundle and a guaranteed or minimum salary related factor or component enters into the calculation of the benefit in question. The benefit is not then calculated *only* "by reference to" contribution payments.

15. As in the judgment under appeal and in the legal submissions, a scheme consisting of salary related benefits, of MP benefits and of other benefits is best described as a "hybrid" scheme. It is the mixture of benefits that presents considerable difficulties in the application of s73 to the Scheme. Regulation 13(1) of the 1996 Regulations modified s73 in the case of hybrid schemes. The modification was not made in a straightforward way. That will become apparent when reading the relevant legislation quoted below.

16. In brief, the method adopted in the legislation was to start with an exclusion of MP benefits from s73. There are disputes about the application of that exclusion. Then regulation 13(2) made exceptions to that exclusion. Those exceptions caused certain MP benefits to fall within s73. The exceptions are termed (a) benefits derived from the payment of voluntary contributions and (b) underpin benefits, as defined above. The application of the exceptions is disputed.

17. Sorting all this out is not made easier by the complex restructuring of the members' benefits under the Scheme. That was done under a succession of Trust Deeds and Rules. Initially the benefits provided were of a conventional final salary kind (1/60th of Final Pensionable Salary, as defined). Later, in 1983, the final salary benefits were lowered and additional benefits were introduced. They were considered to be MP benefits, though that is in dispute in this case. Members of the Scheme could elect to pay further specified contributions in order to acquire additional benefits. That was called Voluntary Investment Planning (VIP). Participation in VIP gave rise to the VIP Interest of a member. Members with VIP Interests were also able to continue, in return for payment of pre-revision level contributions, to accrue final salary benefits. That was referred to in the Scheme documentation as "the Core Plan" and it included "the 1983 Guarantee". That guarantee was the means by which members were able to continue to accrue final salary benefits under the Core Plan at the level they had previously enjoyed, if they elected to continue to pay contributions at the pre-revision level.

18. From 6 April 1992, another tier of new benefits was introduced. They were also considered to be MP benefits, though their status is disputed in this case. They were called MoneyMatch benefits. Participation gave rise to a Member's Interest. There was a choice of benefits depending on the number of Membership Points that a member had. Members could convert their accrued final salary benefits into MoneyMatch, or they could retain them in their existing final salary form. Matching contributions by the employer were also introduced. MoneyMatch Contributions by the members were matched by the Employer's MoneyMatch Credits; and MoneyMatch Plus Contributions by the member were matched by the Employer's MoneyMatch Plus Credits. (We will return to the topics of VIP Interest and the MoneyMatch Member's Interest for further detail later).

19. As a result of restructuring the Scheme benefits in 1983 and 1992 there were, at the beginning of the winding up in October 2003, four categories of Scheme members for the Trustee to consider: -

(a) Members who had elected to convert their accrued final salary benefits into MoneyMatch and to accrue future benefits under MoneyMatch;

(b) Members who retained their accrued benefits in the final salary scheme, but accrued future benefits under MoneyMatch;

(c) Members who both retained their accrued benefits in final salary form and continued to accrue future benefits in final salary form and could accrue VIP benefits, but did not participate in MoneyMatch at all; and

(d) New members joining the Scheme after 22 April 1992 who accrued benefits exclusively by reference to MoneyMatch.

20. An additional complication with the Scheme was that, prior to 6 April 1997, it was contracted out of the State Earnings Related Pension Scheme (SERPS). That was done on the basis of a "Guaranteed Minimum Pension" (GMP). GMP was a minimum pension benefit to be provided under the Scheme in place of SERPS under the state scheme and the level of National Insurance contributions payable was reduced. The MoneyMatch Member's Interest is used to pay the GMP. The dispute on this point is about the effect of GMP on whether the relevant benefits are MP benefits excluded from s73 and, if so, whether they fall back into s73 as underpin benefits and, if so, to what extent.

21. This overview indicates how, as the deputy judge observed (paragraph 20 of the judgment below), the deficit in the Scheme could seriously affect members' pension benefits as a result of the application of the order of priorities in s73, as modified by regulation 13.

22. In essence the position is that liabilities and assets in respect of MP benefits are generally excluded from the priority exercise required by s73. The court has to decide, first, what benefits payable under the Scheme are MP benefits; and, second, whether some MP benefits are derived from the payment of voluntary contributions or are underpin benefits. If they are, they are not "relevant" MP benefits and the general exclusion does not apply. They fall back into the order of priorities in the s73 regime.

B. Order appealed

23. The appeals are from the order of 1 May 2008 (the Order) made by Miss Sarah Asplin QC, who was sitting as a Deputy High Court Judge. The terms of the Order reflect her reserved judgment [2008] EWHC 964 (Ch). She granted permission to appeal against the parts of the Order to do with MP benefits and underpin benefits and on the voluntary contributions issue. She rightly said that they involve arguable points of "industry-wide importance", that large sums of money are involved and that many people are affected. The assets of the Scheme are valued at £65.7m. Annuities purchased for about £70m are also presently an asset of the Scheme. There are 1,287 pensioners and 2,433 deferred members.

24. After the Order was made and the notice of appeal was served fresh developments altered the course and shape of the appeal. The Secretary of State for Work and Pensions (the Department) was advised that parts of the judgment could have serious policy ramifications. The Department was not a party to the case. It applied for and was granted permission to intervene in the appeal. That enabled it to appeal parts of the Order relating to MP benefits and underpin benefits. The appeal became more complicated than the case at first instance. The Department volunteered to foot the costs bill for all parties on the indemnity basis.

25. At the hearing of the appeal the Department's Leading Counsel (Mr Christopher Nugee QC) made a major contribution to the legal argument. The parties and the court agreed that the Department's appeal, though later in time, should go first. Mr Nugee QC argued the MP benefit and underpin issues in a broader perspective. He concentrated on the consequences of the deputy judge's rulings on priorities in the winding up of pension schemes generally. His points were illustrated by reference to the members' benefits under the Scheme. The result was that on most of the 7 issues on this appeal this court had the advantage, not shared by the deputy judge, of more extensive argument from the new party as well as from the existing parties.

26. The proceedings and the parties to them will now be described in more detail.

C. The parties

27. The original appellants, Mr Houldsworth and Mr Hunter, are deferred members of the Scheme and will be referred to as "the deferred members." Their entitlement to payment of pension has not yet arisen. As 2nd and 3rd defendants to the claim they have been appointed to act as representative beneficiaries. Mr Houldsworth contributed to MoneyMatch and has a Member's Interest. Mr Hunter contributed to VIP and has a VIP Interest. Mr Andrew Simmonds QC is their Leading Counsel. Procedurally this was their appeal. It was initially confined to just one issue - the "Voluntary Contributions issue" (to be explained in due course). It is in the interests of the deferred members to argue that the Trustee was right in the opinion formed by it that benefits derived from the employer's matching contributions to the Scheme were benefits *derived from the payment by any member* of the scheme of voluntary contributions within the meaning of s73(3)(a).

28. So far as those represented by Mr Houldsworth are concerned, it is also in their interests to argue that (a) MoneyMatch benefits are MP benefits which fall to be dealt with outside s73; and (b) pensions derived from a Member's Interest are not underpin benefits that fall back into s73. They do not want s73 to apply. So far as those represented by Mr Hunter are concerned, it is in their interests to argue that that the benefits derived from VIP Interests are also MP benefits outside s73.

29. The 1st respondent is the Trustee of the Scheme. As the claimant in proceedings under CPR Part 64 it adopts a neutral position on the issues. This has not inhibited its Leading Counsel, Mr Keith Rowley QC, from assisting the court with valuable written and oral submissions. His sweeping-up role, as

he called it, helped to ensure that the court had all the proper arguments and relevant legal materials before it.

30. The 2nd respondent, Mr Yates, is a pensioner and will be referred to as "the pensioner." As 1st defendant to the claim, he has been appointed to represent all pensioners in receipt of pensions in payment. He obtained permission to serve a respondent's notice appealing parts of the Order. Mr Paul Newman QC appears for him.

31. It is in the interests of those whom the pensioner represents to argue that (a) all the members' benefits in question arising from MoneyMatch and VIP are not MP benefits and so fall within s73; and (b) even if they are wrong on that and the benefits are MP benefits, they are underpin benefits within regulation 13, or they are "protected rights" expressly specified in s73(3)(c)(i), and so still fall within s73; and (c) the Trustee wrongly decided to treat benefits derived from the employer's matching contributions in the form of MoneyMatch Plus Credits and VIP Match as credits *derived from the payment by a member* of the scheme of voluntary contributions within s73(3)(a). (They take first place in the order of priority ranking ahead of pensions in payment).

32. The ground of the Department's intervention is that the judgment below on the MP benefit issues has public interest and public policy consequences. They spread well beyond the limits of this case. It is said, for example, that, if allowed to stand in its entirety, the judgment and the Order may place the United Kingdom in breach of its obligations under EC Law, in not having fully or properly implemented Directives EC/80/987 (the Insolvency Directive) and EC/2003/41 (the Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORP)). The Directives related to the protection of members of pensions schemes. They are relied on by the Department, which invokes the *Marleasing* principle (*Marleasing SA v. La Comercial Internacional de Alimentation SA* Case C-106/89; [1990] ECR 1-4135), which is discussed later, for the interpretation of the domestic legislation in order to prevent, if possible, relevant benefits from being left unprotected. If it is possible to do so, the court must interpret the legislation so as to be compatible with EC law.

33. The Department's practical concern is that, if certain aspects of the deputy judge's decision are correct on the MP benefits issues (in particular, points relating to the crediting of notional investment returns to a guaranteed interest fund and the use of internal annuities to convert, on the basis of actuarial assumptions, the value of a capital sum into a retirement annuity) there may be pension funds with deficiencies that

(a) will not have a priority order imposed by s73 despite having insufficient assets to meet their liabilities, and

(b) will not have the statutory protection of a number of regimes designed to deal with under-funding of pension benefits, namely s75 of the 1995 Act (liability on employer), ss56-61 of the 1995 Act

(minimum funding requirements) which is now replaced by Part 3 of the Pensions Act 2004 (the scheme specific funding regime), and the two statutory pensions lifeboats, FAS and the Pension Protection Fund, because none of these regimes apply to MP schemes.

34. The overall thrust of the Department's appeal is that MP schemes (providing only MP benefits) have been assumed to be schemes that, by their very nature, are fully funded. They are pension schemes with no possibility of mismatch or a deficit. That is because the benefits under them are limited to what can be provided out of the assets available in them. It usually follows that there is no need for an overriding statutory priority order as in s73. As Mr Nugee QC neatly puts it: an MP scheme cannot generate a deficit; and a scheme which generates a deficit is not providing MP benefits. He submits that MP benefits exist only where particular assets determine the benefits that the members get. That means that there are always enough assets in the scheme to pay the benefits in full and the order of priority in s73 is simply not needed.

35. Mr Nugee QC highlights the fact that the rulings by the court below suggest the possibility of MP benefits where the cost of the benefits exceeds the assets available to meet them. There is a consequent risk of under-funding. Practical guidance for the Secretary of State and for the occupational pensions industry is sought on the operation of s73. General guidance is required specially on the criteria for determining whether the benefits in question are MP benefits and, if they are, when they are underpin benefits.

36. The four Leading Counsel instructed on the appeal are well known practitioners in the field of pensions law. Together with their teams of junior counsel and solicitors they have brought to this case specialised knowledge and experience in this developing area of the law. This court is able to rely with confidence on their contributions. This is re-assuring, as they acknowledge that this is one of the most challenging pensions cases to date. In the words of Mr Rowley QC the case is "brimful of technical difficulty."

37. The deputy judge deserves a generous tribute. The impressive qualities of her judgment have been recognised by counsel in this court, even by those arguing that some of her conclusions are wrong. Our different conclusions on some points do not diminish our collective respect for her clear and careful explanation of the issues, the legal materials and the competing arguments.

38. The court's aim has been to produce, as far as possible, a judgment that Scheme members can themselves understand, if not the dense detail, at least the crucial conclusions and the reasons for them. This is particularly important in a case where the benefits of the members are significantly scaled back. Many employees belong to an occupational pension scheme and the workings of a scheme should be capable of brief explanation in simple, non-technical language. Being short or simple in this area is a real challenge: pensions law grapples with the problems of planning complicated things over a long time span; the schemes are inevitably complex legal arrangements which are further complicated by periodic revision; professional people, who have the

advantages of knowledge and experience which members and others do not normally have, are responsible for drafting, for administering and for giving advice to one another, but do not always appreciate the difficulties in communication to non-specialists; and the schemes themselves and the spate of legislation in recent years use unfamiliar notions, special language and imprecise legal concepts.

39. Attempts to translate the legislation and the Scheme precisely into ordinary English for the benefit of a wider audience of non-experts are probably doomed to failure. The complexity of the subject must be respected. Over-simplification that does not do so could make matters even worse by causing confusion and misunderstanding through error and inaccuracy.

D.The legislation

I. General

40. When, as here, there are not enough assets in the scheme to go round and pay the members' pension benefits in full, there is a competition for payment. The members' benefits are paid in the order in which the law ranks them for payment. The order of precedence or preference produces what are called priorities questions. They are decided in accordance with the legislation or, if that does not apply, the rules of the scheme. Which pension benefits are first in the queue? In what order do the rest of the benefits go? Which benefits are not entitled to be in the queue at all?

41. In the case of salary related pension schemes and in respect of specified benefits the order of priority is expressly governed by s73 of the 1995 Act, as modified by regulation 13. This judgment is based on the legislation and regulations that were in force at the date when the Scheme went into winding up (15 October 2003: since then the relevant law changed in certain respects, most recently as a result of the Pensions Act 2004 and subordinate legislation made under it). The legislation is mandatory in the cases to which it is applicable. It overrides the Scheme rules. Section 73 and regulation 13 have to be interpreted by the court, as do the rules of the Scheme. As an aid to the interpretation of the provisions in the legislation it may even be necessary to have regard to relevant EC law and, if it is possible to do so, to interpret domestic legislation in accordance with the *Marleasing* principle, in order to make it compatible with EC law that the United Kingdom is under an obligation to implement.

42. The key concepts in the legislation will be examined more closely in due course. The argument is mainly about the scope of the statutory definition of an MP benefit. An MP benefit is not a defined benefit, such as a pension benefit defined by reference to the final or average salary paid *to* the member. The calculation of an MP benefit is related to the contribution payments to the scheme made *by*, or in respect of, the member. The Department and the pensioner contend that this must mean that the value of the assets precisely matches the value of the liabilities and there is no deficit giving rise to priorities questions under s73.

43. An MP benefit falls outside the priorities provisions in s73, save for underpin benefits. They fall within s73, even if they are MP benefits. The definition and operation of underpin benefits are highly technical. What the members get from MP benefits is, in general, calculated by reference not to the amount of the salary paid to them at any particular time, or on average, but to the investment performance of the amount in the pot into which contribution payments have been made. That pot is made up of their payments, payments made by the employer and the investment returns on the amounts invested. That pot is used to provide the pension benefits. That essential difference is the reason why an MP scheme and MP benefits are not subject to the same statutory priority regime as a salary related scheme. Instead of defining pension benefits by reference to the salary (final or average) paid to the member, MP benefits are normally limited to what can be provided from the pensions pot.

44. The normal consequence is that MP benefits are not liable to be under-funded. That distinguishes them from salary related schemes which are liable to under-funding. That is often recognised, for example, by a requirement that the employer tops up the assets of a salary related scheme. That will enable the scheme to meet the full level of salary related, defined benefit for each member. It is what is meant when there is talk of the employer having to bear "the balance of cost" in a pension scheme.

45. In the case of an MP scheme the assets in the pensions pot, together with the investment returns, are, while the scheme is on-going, notionally earmarked for each member of the scheme. As the amount in the pot is what is available to provide benefits, the members bear the risk as to what the pot may be able to provide or purchase for them as pension benefits.

46. That point attracted the interest of the Department in the outcome of the appeals. The judgment leading to the Order under appeal appears to the Department to have adopted a view that it is possible for members' benefits to be MP benefits in cases where the cost of them exceeds the available assets and the benefits under the scheme are not "directly" related to the contribution payments into it. In such a case there would be a risk of a mismatch between the Scheme liabilities and its assets. This possibility of under-funding and a deficit is considered by the Department to have serious ramifications for the pensions legislation, as MP schemes and MP benefits usually fall outside s73, and MP schemes fall outside the scope of s75 of the 1995 Act, the minimum funding requirement and scheme specific funding regimes, and the two statutory pension lifeboats.

47. The actual wording of the relevant legislation needs to be set out in addition to the statutory definitions quoted earlier. Only one previous judicial decision is relevant to the interpretation of the legislation, but there is disagreement about the scope of the legal proposition(s) for which that case is binding authority.

II. The statutory provisions

48. At this stage we quote only those statutory provisions that featured prominently in the judgment under appeal and in the legal submissions. When

we deal with the 7 issues on the appeal separately the detailed language of the provisions will be looked at more closely, sometimes in the light of other parts of the legislation.

49. Section 73, as amended, came into force on 6 April 1997. It deals in a mandatory manner with the order in which liabilities are to be met on winding up the sort of pension scheme to which it is applicable:-

> " (1) This section applies, where a salary related occupational pension scheme to which section 56 applies is being wound up, to determine the order in which the assets of the scheme are to be applied towards satisfying the liabilities in respect of pensions and other benefits (including increases in pensions).
>
> (2) The assets of the scheme must be applied first towards satisfying the amounts of the liabilities mentioned in subsection (3) and, if the assets are insufficient to satisfy those amounts in full, then
>
> (a) the assets must be applied first towards satisfying the amounts of the liabilities mentioned in earlier paragraphs of subsection (3) before the amounts of the liabilities mentioned in the later paragraphs, and
>
> (b) where the amounts of the liabilities mentioned in one of those paragraphs cannot be satisfied in full, those amounts must be satisfied in the same proportions.
>
> (3) The liabilities referred to in subsection (2) are-
>
> (a) any liability for pensions or other benefits which, in the opinion of the trustees, are derived from the payment by any member of the scheme of voluntary contributions,
>
> (aa) [immaterial]
>
> (b) in a case not falling within paragraph (aa), where a person's entitlement to payment of pension or other benefit has arisen, liability for that pension or benefit and for any pension and other benefit which will be payable in respect of that person on his death (but excluding increases to pensions),
>
> (c) any liability-
>
> (i) for equivalent pension benefits (within the meaning of section 57(1) of the National Insurance Act 1965), guaranteed minimum pensions, protected rights, section 9(2B) rights (within the meaning of regulation 1(2) of the Contracting-out (Transfer and Transfer Payment) Regulations

1996), or safeguarded rights (within the meaning of section 68A(1) of the Pension Schemes Act 1993) (but excluding increases to pensions)

or

(ii) [immaterial]

(d) any liability for increases to pensions referred to in paragraphs (aa) and (b),

(e) any liability for increases to pensions referred to in paragraph (c),

(f) so far as not included in paragraph (c) or (e), any liability for-

(i) pensions or other benefits which have accrued to or in respect of any members of the scheme (including increases to pensions), or

(ii) future pensions or other future benefits, attributable (directly or indirectly) to pension credits (including increases to pensions)

and, for the purposes of subsection (2), the amounts of the liabilities mentioned in paragraphs (aa) to (f) are to be taken to be the amounts calculated and verified in the prescribed manner.

...

(7) Regulations may modify subsection (3)"

50. To recap: a "salary related" scheme is one which is not an MP scheme; an MP scheme is one under which *all* the benefits that may be provided are MP benefits; and MP benefits are those the rate or amount of which is calculated by reference to payments by or in respect of members. The application of s73 to benefits under the Scheme depends on whether particular benefits under it are MP benefits. That is the effect of regulation 13(1) of the 1996 Regulations. It modifies s73 in the case of hybrid schemes by excluding from the operation of s73, with some exceptions, the liabilities and assets of a scheme in respect of the relevant MP benefits.

51. Regulation 13 provides that-

"(1) In relation to any scheme-

(a) which is not a money purchase scheme, but

(b) where some of the benefits that may be provided are relevant money purchase benefits,

section 73 applies as if-

(i) the liabilities of the scheme did not include liabilities in respect of those benefits, and

(ii) the assets of the scheme did not include the assets by reference to which the rate or amount of those benefits is calculated.

(2) In paragraph (1) "relevant money purchase benefits" means money purchase benefits other than

(a) benefits derived from the payment by any member of voluntary contributions, or

(b) underpin benefits.

(3) In this regulation, "underpin benefits" means money purchase benefits which under the provisions of the scheme will only be provided in respect of a member if their value exceeds the value of other benefits in respect of him under the scheme which are not money purchase benefits."

52. As the deputy judge observed, the general effect of regulation 13(1) on the Scheme is to exclude assets and liabilities in respect of MP benefits from the priorities exercise required by section 73. The first question is to determine whether any, and, if so, which benefits payable under the Scheme are MP benefits.

53. However, while the general approach is to exclude MP benefits from the operation of section 73, exceptions to that have already been noted. The effect of regulation 13(2) is that two categories of MP benefits are not excluded. That means that they are covered by section 73. The first category is of benefits derived from the payment by any member of voluntary contributions. They are also expressly mentioned in the body of section 73 as the first preferential liability in the winding up of a scheme: see s73(3)(a). The second category is of underpin benefits defined in regulation 13(3). Even if they are MP benefits normally excluded from s73, those benefits fall back into s73 if they will only be provided if they are of a value which exceeds the value of other, non-MP benefits in respect of the member under the Scheme.

E. The *KPMG* case: what did it decide about MP benefits?

54. The only authority cited at any length is an important one. The case is one of an on-going pension scheme with a deficiency. The dispute was about the employer's potential liability to top up the assets of the scheme. The case was not about preferential liabilities in a winding up of a scheme. The court did not have to interpret s73. However, it did have to interpret and apply the statutory

definitions of MP scheme and MP benefit. It contains judicial guidance on the nature of MP benefits.

55. On this appeal most of the argument about whether benefits under the Scheme are MP benefits excluded from the operation of s73 is based on passages cited from the first instance judgment of the Vice-Chancellor and the lead judgment in the Court of Appeal in *Aon Trust Corpn v. KPMG (a firm) & Ors* [2005] 1 WLR 995 (Sir Andrew Morritt V-C); [2006] 1 WLR 97 (Court of Appeal). The lead judgment dismissing the appeal from the Vice-Chancellor was given by Jonathan Parker LJ. The other two members of the court (Mummery and Chadwick LJJ) agreed with it. The lead judgment was comprehensive and clear. It was unnecessary to replicate it or add to it. We shall refer to both the case and to the lead judgment as *KPMG*. The court was also taken to passages in the first instance judgment of Sir Andrew Morritt V-C.

56. The outcome at both levels of decision was that the scheme in *KPMG* was held not to be an MP scheme, the benefits were held not to be MP benefits and the employer was held liable to make up the deficiency in order to meet the defined benefits in that scheme. For the purposes of the present case the questions are: what binding legal propositions did *KPMG* establish? Is *KPMG* distinguishable from this case? If so, why?

57. A cautious cliché about judgments on the construction of statutes: they should not be read, construed or applied as if they were themselves statutes. Obviously a judgment on the construction of a statute cannot constitutionally substitute itself for the statute. However, when a court's reading of a statute clarifies it by explaining its purpose, structure and language and by discussing instances of how it actually works in practice, the temptation in later cases is to cite from the judgment in preference to quoting from the statute. But the function of the courts is always to interpret the statute, not to construe a judgment about it as if it had itself become a part of, or a replacement for, the statute in question.

58. Statement of the obvious is necessary in this case. In some of the written submissions and at some moments during the oral hearing passages from *KPMG* were cited with the sort of literal emphasis on individual words and phrases that usually features in arguments on statutory interpretation. The proper role of precedent in promoting certainty and consistency in the application of the law should not be underestimated or downgraded. However, the form, content and composition of a judgment are all conditioned by the unique set of facts in the case, by the formulation of the issues presented for the decision of the court and by the way in which the case was argued by the parties.

59. Judgments on points of statutory interpretation are never exhaustive expositions of the legislation. They are no more than a set of reasons for deciding a disputed point of interpretation one way rather than another way. The drafting techniques used by the Parliamentary draftsman in devising forms of law to cover future situations are quite different. The real value of a judgment on statutory interpretation is usually in the analysis of the scheme and purpose of the legislation and in indications of the correct approach to

finding the meaning of its language. It is rarely found in the exact words and phrases used in the judgment, or even in a sufficient, but incomplete, statement of reasons given for preferring one construction to another.

60. The lead judgment in *KPMG* is not a complete statement of the legal criteria for deciding what is or what is not an MP benefit. However, it does help with the understanding of the following question posed by Parliament's definition of an MP benefit in s181(1) of the 1993 Act: is the rate or amount of the benefit in question "calculated by reference to a payment or payments made by the member or by any other person in respect of the member"? The answer to that question determines whether particular features of the VIP Interest and the MoneyMatch Member's Interest mean that they are not MP benefits.

61. The question in *KPMG* was whether a particular pension scheme, which had a deficiency but otherwise had little in common with this Scheme, was an MP scheme. Contributions paid into the *KPMG* scheme were based on a percentage of the amount of the employees' salaries. The trustee had power to adjust benefits by reference to the actuarial valuation of the fund. The members' benefits were calculated by multiplying the payments in by an appropriate factor and by reference to contributions and any bonuses or reductions made by the trustee. The multipliers used were the product, in part, of actuarial assessments or estimates. The court had to decide whether the benefits under that scheme in the form of the standard pension and bonuses were MP benefits. The Court of Appeal upheld the decision of the Vice-Chancellor that the benefits in question were not MP benefits and the scheme was not an MP scheme.

62. It is submitted by the Department and the pensioner that *KPMG* is binding on the court in this case for the proposition that a pension benefit cannot be an MP benefit, if

(1) there is a mismatch between the members' benefits and the assets held by the scheme to meet them (derived from the members' and employers' contribution payments); and/or

(2) the members' benefits are not the "direct"/"actual" product of those contribution payments; and/or

(3) actuarial assessments are used in the process of calculating the members' benefits and thereby break the direct relationship between the contribution payments and the benefits requisite for an MP scheme. It is submitted that this feature alone is "fatal" to the contention that the members' benefits were "calculated by reference to" contribution payments by or in respect of members.

63. In *KPMG* those particular features of the scheme in that case were relied on for the conclusion that neither component of the pension benefit was an MP benefit. The scheme was not an MP scheme for the purposes of s56(2)(a) of the 1995 Act. The employer was not therefore relieved of the obligation

imposed on it by that provision to ensure that the scheme's liabilities were funded up to a minimum requirement.

64. The Department (supported by the pensioner) contends that the deputy judge in this case was wrong to hold that the relevant members' benefits were MP benefits and was wrong not to follow or apply *KPMG* to this case. All the parties agree that this court cannot hold that *KPMG* is wrong. It was binding on the deputy judge and it is binding on this court. The question in this court is: what did *KPMG* decide about the criteria for holding that benefits are MP benefits?

65. The deputy judge considered that question in detail. After summarising the rival contentions of the parties she concluded that *KPMG* was relevant to the issue whether the benefits in question were MP benefits. She said (paragraph 118) that she took into account the observations in *KPMG* about the general nature of defined benefits and MP schemes. She cited the following paragraphs from the lead judgment in *KPMG*. The paragraphs were based on the Court's understanding of passages from the Goode Committee Report on Pension Law Reform (1993)-

> "30. ....in a typical defined benefit scheme any mismatch from time to time between assets and liabilities is cured by adjusting the assets to match the liabilities: i.e by increasing or, as the case may be, decreasing the level of funding as appropriate in the light of the most recent actuarial valuation. In such a scheme, the level of benefit dictates the level of contribution.
>
> 31. Alternatively, an employer setting up an occupational pension scheme may decide to define the level of benefits by reference solely to the contributions made in respect of the member concerned, so that the benefit represents no more and no less than the product of the contributions. Such a scheme is commonly called a 'money purchase scheme.' [I will come to the statutory definition of that term later].
>
> 32. Thus in a typical money purchase scheme there can, by definition, be no mismatch between assets and liabilities. Hence there is no need (indeed, no scope) for a 'balance of cost' obligation on the employer, since the level of contribution dictates the level of benefit and no 'balance of cost' can arise."

66. The deputy judge also considered the approach adopted in *KPMG* to determine the relationship between contributions and benefits in the Scheme. It was held in *KPMG* that, in addressing the question whether a benefit is an MP benefit, the key lies-

> "151. ... in the relationship between contributions and benefits, as that relationship emerges from a consideration of the scheme as a whole, properly construed. So, faced with such a plethora of argument and counter-argument, I think it helpful to start at the beginning and remind myself of the salient features of the scheme in that respect."

67. The deputy judge reached the conclusion that the differences between the scheme in *KPMG* and the Scheme here made *KPMG* distinguishable from this case. This makes it necessary to examine both *KPMG* and the first instance judgment of the Vice-Chancellor in more detail before considering the criticisms of the deputy judge's conclusion.

68. *KPMG* analysed the respective parts of that scheme relating to contributions and benefits. As for benefits, it was explained that there were 3 stages in the calculation process of the standard pension, that is the annual pension which came into payment on the normal pension date and continued to be payable during the remainder of the member's life.

69. The first stage was to find the total amount of contributions, including the employer's contribution, made in respect of each contribution period, and to apply to that total the appropriate multiplier as determined by the tables. It was common ground that the multipliers were in part the product of actuarial assessments of factors, such as future investment return, inflation and mortality.

> "...Thus the quantification of the standard pension depends in part upon actuarial assessments of future anticipated trends." (paragraph 156 of *KPMG*)

70. The second stage in the calculation process was to adjust the totals resulting from the first stage by adding any bonuses declared under the power conferred by the scheme rules.

71. The third and final stage in the calculation process, as prescribed by the rules, was to aggregate the totals, adjusted pursuant to the rules. The result of that aggregation represented the amount of the member's standard pension as at the date of the calculation.

> "...So all the pensions for which the scheme provides share the characteristic that the process of calculation includes actuarial factors. This seems to me to be a highly relevant consideration in the context of question 3...[whether the scheme was an MP scheme]" (paragraph 159 of *KPMG*).

72. In arriving at the conclusion that the scheme in that case was not an MP scheme *KPMG* also referred, with apparent approval, to submissions of the counsel contending for the result reached by the court. Reference was made to the submission of counsel that MP schemes "do not provide you with benefits, they provide you with a pot." (paragraph 131 of *KPMG*). Reference was also

made to the submission of another counsel contending that it was not an MP scheme on the ground that

> "148. ....if one is looking for common sense badges of a "money purchase scheme", one such badge is the fact that in such a scheme the measure of the benefit is the value of the fund, and hence there is no need for an actuary. He submits that the fact that the tables to be applied in calculating the amount of a member's basic pension under the scheme incorporate actuarial factors is a very strong indication that the scheme is not a "money purchase scheme". There is, he submits, no equivalent under the scheme to the "pot" which is the badge of a "money purchase scheme"."

73. Counsel in the present case cited passages from the judgment of the Vice-Chancellor in *KPMG,* pointing out that he had been upheld on appeal and that the Court of Appeal had not expressed disapproval of the passages cited. The passages in question are helpful for their generalisations about typical MP schemes.

74. The Vice-Chancellor referred to provisions in s84 of and Schedule 3 to the 1993 Act as envisaging that

> "...a money purchase benefit arises from and is correlative to a fund, actual or notional, and its investment yield constituted by the contributions paid by the member and his employer" (paragraph 42).

75. In referring to the use of the expression MP benefit in the context of contracting out of SERPS, the Vice-Chancellor said that an MP benefit

> "...had no guaranteed or defined benefit for it depended on the investment yield obtained or attributable to the fund derived actually or notionally from the contributions made by the member and his employer" (paragraph 44).

76. The Vice-Chancellor was also prepared to assume, without deciding, that s144 of the 1993 Act indicated a real possibility that an MP scheme may have a deficit, though he added: -

> "...Nevertheless it appears to me to be obvious that Parliament recognised that in a money purchase scheme in all normal circumstances the benefits are matched by equivalent assets. That is to be contrasted with a defined benefit scheme, such as a final salary scheme, when assets and liabilities will not match each other unless the actuarial and other assumptions on which the level of contribution was fixed actually occur." (paragraph 46).

77. He summarised his consideration of the various statutory contexts in which MP schemes and MP benefits are referred to as follows:-

> "52. This excursus into the various contexts in which the definitions or concepts of money purchase benefits or schemes appear does show the characteristics such benefits or schemes are expected to have. First, a money purchase benefit cannot be a defined benefit because the investment yield from the underlying fund whether actual or notional cannot be precisely predicted. Second, a money purchase scheme is fully funded in the sense that liability for the benefits is in all normal circumstances exactly matched by available assets. Such schemes or benefits are to be contrasted with salary-related schemes. They provide a benefit defined by reference to the salary of the member whether average or final. The liability for such benefit is unlikely to be exactly matched by available assets."

78. As for the expression "calculated by reference to" used in the statutory definition of MP benefits the Vice-Chancellor said-

> "54. ….In my judgment the phrase "calculated by reference to" points to the yardstick or measure by which the benefit is to be ascertained or defined in the context of an occupational pension scheme. In a conventional money purchase scheme that will be the payments, actual or notional, into the fund for the ultimate benefit is defined only by what the fund will purchase on retirement. By contrast in a final salary scheme the benefit is ascertained or defined by reference to the final salary whether or not the liability for it has been matched by the contributions.
>
> 55. An average earnings-related scheme is likely to have resort to both earnings and contributions/payments in the ascertainment or definition of the benefit. It is necessary to do so in order to take account of both the level of earnings going to make up the average and the time when they arose. This, in my view, is the explanation for the exclusion of average salary benefits at the conclusion of the definition of "money purchase benefits." It was recognised that in the calculation of such benefits account must be taken of contributions paid in order to weight them according to the period in which they were paid. But as the resulting benefit was ultimately defined by reference to average earnings, not contributions, it was not to be regarded as a money purchase benefit."

79. As for actuarial factors, their role in determining whether members' benefits were MP benefits was considered by the Court of Appeal in *KPMG* in the following passages-

> "167. Looking no further for the moment, therefore, the scheme would appear to lack the basic characteristics of a money purchase scheme (using that expression for the moment in a colloquial as opposed to a statutory sense) as

> identified in Part 3 of this judgment. In the first place, the requisite direct relationship between contributions and benefits is broken by the introduction of actuarial factors ....As Mr Ham succinctly put it at the conclusion of his submissions ....in the case of a money purchase scheme you do not need an actuary. Secondly, by including the powers in clauses 8.4 and 8.5 the scheme not only recognises but positively caters for a continuing mismatch between assets and liabilities.
>
> 168. However, the overall appearance of the scheme (on its true construction) is not necessarily determinative of the question whether it is a "money purchase scheme" in the statutory sense. I therefore turn to the statutory provisions ....
>
> 169. As noted earlier ....an occupational pension scheme is a "money purchase scheme" if "all the benefits that may be provided for are money purchase benefits", i.e. "benefits the rate or amount of which is calculated by reference to [contributions] and which are not average salary benefits": see section 181 (1) of the 1993 Act.
>
> 170. I turn first to the question whether either of the two elements in the pension benefit as prescribed by rule 7.2 , that is to say the standard pension benefit and any bonuses declared in exercise of the clause 8.4 power are, on analysis, "calculated by reference to" contributions within the meaning of that definition.
>
> 171. In my judgment the inclusion in the first stage of the calculation process of the actuarial factors to which I have referred earlier is fatal to such a contention. The expression "calculated by reference to" means, in my judgment, "calculated *only* by reference to", in the sense that the benefit in question must be the direct product of the contributions (that being the basic characteristic of a money purchase scheme, as that expression is commonly understood; see Part 3 above). Neither the standard pension nor bonuses fall within that category."

80. The deputy judge distinguished *KPMG* from this case on the basis that the rules of the Scheme are materially different from the scheme rules in *KPMG*. In that case the "actuarial factors were an integral part of the calculation of the benefits provided under the scheme and could be described as defining the benefits provided..." (paragraph 129 of the judgment below). She rejected the contention that the application of actuarial factors to the available pot in converting the members' interest into pension was fatal to the benefits being MP benefits.

81. The structure of the *KPMG* scheme was, she said, accepted to be "vastly different" from the Scheme here. As mentioned earlier, in *KPMG* the standard

benefits under the scheme were calculated by multiplying total contributions for each period, paid at a specified rate, by a figure set out in a table. The multiplier was the product of actuarial assessment of factors, such as future investment returns, inflation and mortality. In practice bonuses were added as a percentage uplift in the members' benefits.

82. The Scheme here does not include provisions by which the extent of the benefits to be provided, in respect of each year in which contributions were made, could be determined. Instead there is a "pot" (i.e. of the Member's Interest or the VIP interest under the Scheme as explained below), which remains just that until it has to be applied in the provision of such benefits as the member selects. Only at the stage at which pension is selected are actuarial factors used and then purely as a means of conversion from "pot" to pension. The actuarial factors do not *define* the benefit in the way that the tables in *KPMG* did. In this case actuarial factors are only a tool to effect the conversion into pension of the contribution payments in the pot.

83. The deputy judge concluded (paragraph 134) that the application of actuarial factors was not inevitably fatal to the case that the benefits arising from the Member's Interest and/or the VIP Interest are MP benefits. Further, it makes no difference whether the Trustee secures such benefits by means of internal annuitisation or purchases an annuity in the market. (This point will be considered specifically below.)

84. On the appeal the argument that *KPMG* decided that the presence of actuarial factors means that a benefit could not be an MP benefit is strongly advanced by Mr Nugee QC for the Department and by Mr Newman QC for the pensioner. On their case *KPMG* means that the benefits under the Scheme known as the Member's Interest and the VIP Interest cannot be MP benefits, because of the presence of actuarial factors. That criterion in *KPMG* for determining what are MP benefits is said to be determinative of this case. The deputy judge did not, they submit, apply the full force of the law laid down in *KMPG*. The ground of the *KPMG* ruling that the scheme was not an MP scheme and that the benefits were not MP benefits was clear. The requirement in the statutory definition of MP benefits that the benefits are "calculated by reference to" contributions is equated by counsel for the Department and for the pensioner with the general understanding of an MP Scheme i.e. that the benefit represents the "direct" product of the contributions and that by definition there can be no "mismatch" between assets and liabilities. The introduction of actuarial factors into the calculation process is fatal to the benefit being an MP benefit because it breaks the direct relationship between contributions and benefits. It is not enough to qualify as an MP benefit simply to say that, as in the case of both the *KPMG* scheme and this Scheme, the amount of the benefit depends on the amount of the contribution.

85. We are unable to accept the arguments advanced by Mr Nugee QC and Mr Newman QC that *KPMG* determines the outcome of this case on the MP benefits issues. We have reached certain general conclusions about the impact of *KPMG* on the various MP benefit issues this court is called upon to decide.

86. First, *KPMG* generalises about the common features of typical MP schemes and MP benefits. The generalisations must be read in the context of the very different scheme under consideration in that case. The Scheme is not on all fours with the *KPMG* scheme. The scheme in that case, which was held not to be an MP scheme, in substance provided a defined benefit pension. The standard pension benefits were benefits defined by the rules. They were calculated by reference to tables. The rules in *KPMG* expressly provided for a prescribed actuarial multiplier, which was to be applied to the contributions in each year. That converted the contributions into "building blocks" of defined benefit accrual in respect of each year of service.

87. In the Scheme here the rules do not provide, by reference to any express formula or to actuarial factors, for the definition of the benefits to be paid: the rules only define the contribution and the composition of the pot, which is to be converted into benefits. The members' contributions are paid into it and the members' benefits are purchased with it.

88. Secondly, issues have arisen in this case which did not arise and were not dealt with at all in *KPMG*: namely, the effects of the use of internal annuitisation, of the presence of guaranteed notional returns on the MP benefit pots and of GMP and underpin benefits. The court must be cautious in taking general statements from one case, and applying them, in another case and in a different context, to answer questions that never arose for decision in the case cited.

89. Thirdly, in determining the nature of the relationship between contributions and benefits, it is necessary to consider the Scheme as a whole and to construe it, rather than to single out particular features as determinative of that relationship. On that approach we are unable to accept the Department's submission that *KPMG* decided that, on the statutory definition of an MP benefit, there could *never* be a mismatch between MP benefits and scheme assets. That is an unjustified gloss on the statutory definition. That gloss was not placed on it in *KPMG*. The reference to "mismatch" in that judgment was by way a generalisation about the features of a "typical" MP scheme.

90. Fourthly, we are also unable to accept that a benefit is precluded from being an MP benefit simply because an actuarial factor is applied at *any* stage of the calculation, or because the MP benefit pot is increased by reference to a guaranteed or notional return, as with a guaranteed interest fund. There is force in the comment that there would be no MP benefits at all if the introduction of an annuity rate to convert the capital value of the Member's MP pot into a pension income for the member prevented that benefit from qualifying as an MP benefit. In every case an annuity rate has to be applied, either by an insurance company in the case of the external provision of an annuity, or by the Trustee in the case of internal annuitisation. The important point in such cases is that the pension benefit is related to the size of the member's interest or account in the relevant Scheme fund.

91. We have had to deal with *KPMG* at considerable length, because it is central to the Department's and the pensioner's main arguments on the appeal about the characteristics of MP benefits. In our judgment, *KPMG* did not decide that,

as a matter of law, the statutory definition of MP benefits requires that there must *never* be a mismatch between the members' benefits and the payments made by or in respect of the members; or that there must *never* be a deficit; or that the members' benefits must *always* be an actual or direct product of such payments and can *never* be a notional return; or that the presence of actuarial factors in the conversion of members' benefits from pot to pension is *fatal* to them being MP benefits. No hard and fast rules of that legislative kind either appear in the statutory definition itself or have been inserted or read into it by *KPMG.*

92. The approach submitted to the court by Mr Nugee QC and Mr Newman QC is over-analytical and it is too literal in its treatment of *KPMG* as a judgment and it is too strict in its construction of the definition in the 1993 Act. That approach is not justified by the context or the wording of the definition of MP benefits. The language of the definition is capable of a broader reading than the meaning they give to it. The definition should be construed in a fair and reasonable way and it should be applied sensibly to the provisions of the particular scheme, construed in their context, to determine whether the members' benefits in question are MP benefits. The question in each case is to ask whether, having regard to the combination of all the features of the scheme in question, the rate or amount of the benefit in question can be sensibly and reasonably said to be calculated by reference to the payments by or in respect of the members. That could not be said in the case of *KPMG.* As explained below, it can be said here in relation to the calculation of the Member's Interest and the VIP Interest, notwithstanding the particular features on which the Department and the pensioner rely for their objections to the members' benefits being MP benefits.

93. In the context of the definition of MP benefits the Court also received submissions on other aspects of its interpretation. We will mention them, although we have not found them of much assistance.

94. Mr Nugee QC emphasises the need for certainty and the fundamental importance of knowing where to draw the line between benefits that fall within s73 and those that do not. He submits that *KPMG* made the position clear and certain. This court should stick to the tests laid down in it. But, as we have explained, the guidance in *KPMG* did not consist of hard and fast rules. What was said has to be understood in the context of the issue in that case and the particular scheme under consideration.

95. Mr Nugee QC also relies on the *Marleasing* principle in his written submissions, but little was added to it in the hearing. The submission is that the two Directives point to an interpretation of MP benefits which would confine it to pension schemes that cannot be under-funded. In our judgment, *Marleasing* cannot be relied on in the case of the IORP Directive, which is concerned to ensure that there is a sufficiency of assets in pension schemes to cover pension scheme liabilities and to provide redress for deficiency: its implementation date (23 September 2005) post-dated the inception of the winding up (15 October 2003).

96. The Department submits that Article 8 of the Insolvency Directive would be breached if members of an under-funded MP scheme are not protected by s73 in the event of insolvency. The court should apply the *Marleasing* principle so as to bring within the scope of its protection all schemes at risk of under-funding. In our judgment, it is not possible by the application of that principle to alter the defined meaning of MP benefits and its application to this case.

97. As mentioned in paragraph 33 above, the Department refers to other provisions in the legislation which use the concept of MP benefits and warns of the impact that upholding the interpretation of the deputy judge might have on them. This judgment is only concerned with the winding up provisions and the meaning to be given to MP benefits in that context. It would be unwise for this court to speculate about the way in which other parts of the legislation would be interpreted and applied to issues that do not arise in this case.

98. The deferred members place considerable reliance on the legislative background to the definition of MP benefits in s181. That was in the consolidating legislation in the 1993 Act. The particular provisions cited concern the statutory revaluation of deferred benefits in Schedule 3 to the 1993 Act and its reference to the "money purchase method" of revaluation. We do not think that it is necessary or helpful to dwell on that point to support the conclusion that we have reached about the MP benefits point.

F. The Scheme and its benefits

I. General

99. The relevance of *KPMG* to the Scheme and the criticisms of the judgment below must be considered in the light of the Scheme provisions. The judgment under appeal gives a detailed account of the provisions. It contains references to the Trust Deeds and the relevant scheduled Rules. We shall not repeat in this judgment all the detail that can be found in paragraphs 30 to 49 of the judgment [2008] EWHC 964 (Ch).

100. We shall focus principally on the features of the Scheme which, according to the Department and the pensioner, prevent what appear, at first sight, to be MP benefits from being MP benefits. Those features are the notional investment return on a guaranteed interest fund (MoneyMatch alone); the option of internal annuitisation of pension benefits (MoneyMatch and VIP benefits); the salary related aspects of GMP (MoneyMatch alone) and of the 1983 Guarantee (VIP benefits alone); and the existence of balance of cost provisions at rule 2.3 of Schedule 3 and rule 3.1 of Schedule 4 to the 1998 Trust Deed and Rules (which point was considered by the deputy judge in paragraphs 36,48,62,95-96 and 139-140 of her judgment).

101. The Scheme was established by interim deed dated 15 December 1971. It was a conventional final salary scheme. The members paid contributions of 5% of Pensionable Salary. They were to receive a pension at Normal Retirement Date of 1/60th of their Final Pensionable Salary for each complete year of pensionable service. The participating employers paid the balance of the cost of providing those benefits.

102. As a result of re-structuring the Scheme in April 1983, members were able, in addition to Core Plan benefits, to pay further contributions. They would accrue extra benefits under the arrangement called VIP. One of the issues is whether the VIP benefits are MP benefits falling outside s73 because of the 1983 Guarantee, or because they take the form of internal annuities.

103. As a result of further re-structuring in April 1992 another new benefit structure, MoneyMatch, was introduced. Older and long serving members were given the option of accruing benefits under the existing structure of the Core Plan benefits for the period 1983 to 1992, and VIP. Those who were not given that option, or chose to switch thereafter, accrued benefits on the MoneyMatch basis rather than the final salary basis, as did all new joiners. Those who switched could convert their final salary benefits into MoneyMatch benefits. There is an issue as to whether the MoneyMatch benefits are MP benefits falling outside s73 because of the GMP element, or because they take the form of internal annuities, or because of notional investment returns.

104. By the time the Scheme went into winding up on 15 October 2003 it was governed by a Definitive Trust Deed and Rules dated 12 March 1998, as amended from time to time (the 1998 Deed). The structure of benefits had changed radically from the original benefits structure. The Scheme provided members with a mixture of final salary benefits at the rate of 1/80th of their Final Pay and additional "non-final salary benefits" in the form of the VIP Interest and the MoneyMatch Member's Interest. It had become a hybrid scheme. So there were issues whether, in the winding up, the "non-final salary benefits" fall to be classified as MP benefits outside s73.

105. In the case of final salary benefits paid from the Scheme all that was required to determine the amount of pension payable was an arithmetical calculation. In the case of benefits to be provided out of the Member's Interest or a VIP Interest it was necessary to convert the capital value of the interest into an annual pension by a process of either internal annuitisation or, with the member's consent, the purchase of an annuity from an external annuity provider.

II. VIP benefits-April 1983

106. Schedule 4 to the 1998 Deed contained the rules for members remaining on the 1983 benefit structure of the Core Plan and VIP. Members had the option of paying contributions (VIP Contributions) at a level chosen by them. VIP was subject to limits. Payment of contributions attracted a corresponding credit (VIP Match) from the employer under the Scheme. The credit was between 50% and 100% of the relevant VIP Contributions depending on length of service. The member selected the way in which his VIP Contributions and VIP Match were invested. Together with the investment returns on them, those contributions made up the member's VIP Interest. That was identifiable and quantifiable. The 1983 Guarantee was extended to those who elected to pay VIP Contributions at the pre-1983 revision level, not to all members who paid VIP Contributions. So the question arises as to the effect of that guarantee on the VIP Interests.

107. A member could choose how to use his VIP Interest on retirement. There were various optional forms of benefit. The member could use it to pay extra life assurance premiums. Within permitted limits he could use it to provide a lump sum, or an additional pension for himself, or for a dependant. The Trustee had power, with the member's consent, to purchase an external annuity or insurance contract to secure his benefits. However, in practice there was "internal annuitisation" whereby the capital value of the member's VIP Interest was converted into an annual pension by the use of tables supplied by the Scheme actuaries and which was paid direct from the Scheme.

III. MoneyMatch benefits-April 1992

108. Schedule 3 to the 1998 Deed contained the rules for MoneyMatch members. MoneyMatch members paid a basic MoneyMatch Contribution at a rate of 3% of the relevant earnings. This attracted a corresponding MoneyMatch Credit from the employer in the same amount.

109. Members had the option of paying further MoneyMatch Plus Contributions up to a certain level depending on age and service. They attracted corresponding MoneyMatch Plus Credits provided by the employer. Members could also pay further Supplementary Contributions. Part of the contributions and credits were credited to a notional investment fund established by the Trustees for the purposes of MoneyMatch. It was called the Guaranteed Interest Fund (GIF). This applied to the basic MoneyMatch Contributions and Credits, any Opening Deposit and Conversion Bonus, and MoneyMatch Plus Credits up to the first 2% of Plan Earnings. The remainder could be invested in various investment funds at the option of the member. Those funds produced actual investment returns.

110. These various contributions and credits, together with investment return, made up the Member's Interest, which was used to provide benefits. For the part invested in investment funds the investment return was the actual return. In the case of the part credited to GIF, which did not exist as an actual investment fund but only as a notional one, the members did not receive an "actual" investment return. Instead, they received a rate of interest declared by the Trustee at 1% less than the rate available from a nominated building society. This rate could be increased by a bonus percentage in accordance with a formula.

111. The Member's Interest was first used to pay GMP. A member was entitled to a pension for life equivalent to a weekly rate of not less than the guaranteed minimum. The member could choose how to use the remainder in a number of ways, such as a lump sum, a pension for himself, a pension for a dependant and pension increases.

112. As in the case of VIP benefits, the Trustee had power, with the member's consent, to purchase an external annuity or insurance contract to secure his benefits. However, in practice, where a pension was provided, it was provided directly out of the Scheme assets by way of internal annuity.

113. The Report for the Scheme for the year ended 5 April 2003 revealed that the Scheme was treated as consisting of 2 main sections. One was the "defined benefit" section. The other was a "defined contribution" section, being the MoneyMatch section where members' and employers' contributions and credits accumulate to provide a fund which is used to purchase benefits at retirement. The value of the MoneyMatch Plus accounts and the value of VIP were recorded separately from the remainder of the Scheme assets.

IV. Summary

114. In short, the position is that two features of the Scheme might lead to a mismatch between the liabilities for MoneyMatch and VIP benefits and the assets held by the Scheme attributable to those benefits.

115. The first feature in the case of MoneyMatch is the notional investment return credited to the GIF. The value of the Member's Interest could be more or less than the value of the investments attributable to the contributions made by or in respect of that member.

116. The second feature in the case of both VIP and MoneyMatch is the use of internal annuities. The actual cost to the Scheme of paying the pension to the member would almost certainly be different from the value of the member's VIP Interest or the Member's Interest.

G. The 7 issues

General

117. We turn to the 7 issues in the appeal. They have been generated by a combination of the Trustee's application, the judgment below and the intervention of the Department. They also include a new point raised for the first time in the appeal. The good sense and co-operation of counsel produced an agreed table of the appeal issues, which served as an indispensable road map during the hearing.

118. We shall take the Voluntary Contributions issue first. It is special to the Scheme. It is distinct from the clutch of MP benefits issues. It is not governed by *KPMG* or any other authority. It relates to the contributions made by the employer that matched the voluntary contributions made by the employee, either by way of MoneyMatch Plus Credits or VIP Match. Pension benefits are derived from the MoneyMatch Plus Credits and VIP Match provided by the employer. Both matching payments are triggered by the payments by the member of MoneyMatch Plus Contributions or VIP Contributions. The question is: are the VIP and MoneyMatch benefits to be taken as "derived from the payment by any member of the scheme of voluntary contributions"? The wording of the question tracks s73(3)(a) which places voluntary contributions at the top of the order of priority in the winding up.

119. The Department stays silent on this issue. The contest is between the deferred members and the pensioner. The deputy judge ruled that the benefits fall outside s73. She held that the pension benefits are not, as respects the

employer's contribution, derived from the payment by any member of voluntary contributions. The pensioner seeks to uphold that result, the deferred members to overturn it.

120. The remaining issues relate to whether certain benefits are MP benefits. The pensioner and the Department argue that the benefits are *not* MP benefits and fall within s73, contrary to the deputy judge's order.

121. The Department and the pensioner also argue that, if they are MP benefits, they nevertheless fall either in whole (the pensioner) or in part (the Department) under s73. However, they seek to achieve those outcomes by different routes. The pensioner follows the route of underpin benefits by contending that all of the MoneyMatch benefits of members with pre-6 April 1997 rights (and therefore GMPs) and the benefits of VIP members are an underpin benefit (as held by the judge). Alternatively, the pensioner follows the route of "protected rights" which are expressly mentioned in s73(3)(c)(i) for the contention that the whole of the protected rights fall within s73. The Department, whilst accepting that the pre-6 April 1997 rights of MoneyMatch members are underpin benefits, argues that their post-5 April 1997 rights are not underpin benefits.

I. Voluntary contribution issue

122. Do "benefits...derived from the payment by any member of voluntary contributions" include benefits derived from the payment of matching contributions by the employer? The answer depends on the correct interpretation of s73(3)(a). It affects both members with MoneyMatch Plus benefits (and employer's Plus Credits) and those with VIP benefits (with employer's matching contributions VIP Match).

123. This was the only issue in the original notice of appeal by the deferred members. It was the last issue to be dealt with in the judgment below (paragraphs 167 to 178). It was argued last at the appeal hearing. However, it is convenient to deal with it first. As mentioned earlier, it arises on the first item at the top of the order of priority in s73(3)(a). It is discrete from the other points on MP benefits. It does not turn, as the other issues do, on the nature and extent to which the members' benefits are MP benefits falling outside s73.

124. This issue arises from the opinion formed by the Trustee and put into a resolution dated 10 May 2006 that the benefits "derived from" voluntary contributions by members encompassed the matching contributions of the employer in the form of MoneyMatch Plus Credits and VIP Match and the investment accretions to their contributions. They therefore fall within s73(3)(a) and enjoy first priority in the statutory order. The Money Match Plus Credits and the VIP Match by the employer were triggered by members' decisions to pay voluntary contributions to the Scheme. The employers' matching contributions were dependent and contingent on the contribution payments made by the members.

125. If the benefits attributable to contributions made by the employer are benefits *derived from* the payments by any member of the scheme of voluntary

contributions, the court should approve the Trustee's resolution. If they do not, as the deputy judge held, the court should decline to approve the Trustee's resolution. The deputy judge held that the Trustee had misdirected itself in law when forming the opinion in the resolution of 10 May 2006. The appellants, as deferred members, appeal against the part of the Order which is in the following terms:

> "AND THIS COURT DECLINES TO APPROVE the resolution of the Claimant dated 10 May 2006 to form the opinion, for the purposes of Section 73(3)(a) of the Pensions Act 1995, that the benefits derived from
>
> (a) Money Match Plus Credits paid under Rule 2.2 of Schedule Three to the 1998 Deed or any Scheme Rule in force prior thereto
>
> (b) VIP Match contributions paid under Rule 3.2 of Schedule Four to the 1998 Deed or any Scheme rule in force prior thereto
>
> are derived from the payment by Members of the Scheme of voluntary contributions."

126. The deputy judge summarised the rival contentions on the issue. It was ultimately conceded by the pensioner that the contributions paid by the member are properly regarded as voluntary contributions. The dispute is about the matching credits paid by the employer. Once the members had elected to pay a contribution, the employer had to match it. It is submitted on behalf of the pensioner that the benefits referable to such amounts payable by the employer were not "derived from" the voluntary payment by the member.

127. Against that it is argued that the payment of the credits by the employer was entirely dependent upon the contributions being made by the member in the first place. They are accretions to those contributions in the same way as investment returns are. Mr Simmonds QC submits that the conclusion of the deputy judge on this issue was wrong. It was concisely stated:-

> "177. Despite the wide definition of 'derived from' in the Oxford Dictionary…and its use in the tax legislation, I must construe it in the light of section 73(3)(a) and regulation 13(2), respectively, as a whole. In both those contexts, the phrase used is 'derived from the payment by any member….' I accept Mr Newman's submission that the member's voluntary contribution may be the cause of the employer's matching payment but that the sub-section requires the 'source' of the benefit in question to be payment by the member. Given the clear reference to the payment by the member, in my judgment, it cannot be construed to include benefits arising

from a payment by the employer, even if that payment is parasitic on the member's contribution."

128. For those reasons the deputy judge concluded that the Trustee misdirected itself in law. She could not approve that part of the resolution.

129. On the appeal Mr Newman QC seeks to uphold that decision. His submission focuses on "the single source" of the benefit. That is his expression, not Parliament's. He also argues for what he calls the fundamental test of whether benefits are the proceeds of, and represent, a member's voluntary contributions. He urges preference for that approach over the looser test of causation proposed by the deferred members to draw in the matching contributions of the employer. It is wrong, he says, to elide the concept of "source" with that of "cause." He accepts that the investment returns on the member's voluntary contributions are part of their proceeds, but contends that those returns are distinct from those referable to the employer's matching contributions. They are not part of the proceeds. They are a separate settlement which the employer is contractually obliged to provide.

130. Mr Newman QC also says that there were sound reasons for distinguishing in s73 between the treatment of member contributions and employer contributions. The important concept, he explains, is the voluntary nature of the contributions which are to be given priority under s73(3)(a). Only the contribution of the member is purely voluntary. It is made out of the member's own pocket. The employer's contribution is not voluntary. The employer has no choice in the matter. He has no discretion to make or to withhold the matching contribution. The purpose of according these benefits priority is to protect the members' contributions made voluntarily out of their own pockets. The matching employer contributions have not been purchased by the member. Though contingent on the members' contributions, they are not made in consideration of them. The judgment on this point, Mr Newman QC submits, was fair, as well as legally correct.

131. Against that Mr Simmonds QC submits for the deferred members that, on the true construction of section 73(3)(a), the judge ought to have approved the resolution of the Trustee. The provisions apply a loose, or looser, test of causation. The judge wrongly applied a narrower test by requiring the benefits to be the proceeds of the payment only by the member of voluntary contributions.

132. We turn to the language of the sub-section. In our judgment, the natural and ordinary meaning of benefits "derived from" the payment by any member of voluntary contributions encompasses benefits derived from employer contributions. As agreed when the new benefits were offered, the employer's matching contributions were triggered by the payment of the member's contribution. The error in the judgment below was in the search for "a single source" of the benefits. There is no mention in section 73(3)(a) of the "source" of the benefits any more than there is any mention of "cause", another concept that was invoked in submissions, though not mentioned in the subsection itself.

133. The concept of a "source" substituted by the deputy judge is more strict and specific than the legislative expression "derived from." We would make a similar comment on Mr Newman's "proceeds" argument. The draftsman chose a more general concept than source or proceeds. The "derived from" concept suggests a connecting link between, on the one hand, the benefits, and, on the other hand, the payments of contributions. There is a sufficient connecting link between the member's benefits and the employer's matching contributions to say that the former are "derived from" the latter, albeit via the decision of the member to pay voluntary contributions to the Scheme.

134. This interpretation gives full meaning to all the words used: in particular, the reference to the benefits derived from "*the payment*" by any member of voluntary contributions. It does not simply refer to the benefits derived from voluntary contributions of the member. It is the fact of the member's payment that brings in the benefit of a matching payment by the employer.

135. We agree with the deferred members that their interpretation, which was the same as that of the Trustee in forming its opinion under the provisions of the Scheme, is more consistent with the policy behind giving priority in the case of members who have voluntarily chosen to pay more towards a pension. The members did not have to make the payments as a condition of membership of the Scheme. As a matter of simple fairness their voluntary contributions should not be used to cross-subsidise the benefits of those members who have not made voluntary contributions. The members who made the voluntary contributions should get the extra benefits on the basis of which they have chosen to make, as part of a mutually agreed package, payments which produce corresponding benefits.

136. It is conceded by Mr Newman QC that the priority for voluntary contributions extends to the investment returns or accretions to the members' voluntary contributions. But investment returns are not themselves contributions *by the members.* They are payments or additions by third parties which are rightly conceded to be "derived from" the payment by the member of a voluntary contribution. In our judgment, it is consistent with that and with the overall policy of the provision that the priority should cover benefits derived from the matching employer contributions. Those contributions are triggered by the payment of a voluntary contribution by a member. They are an integral part of a mutual package which was offered to, accepted by, paid for and bought by the member who made a voluntary contribution.

137. We allow the appeal on Issue I. The Trustee made a proper resolution. The Order should be varied so as to uphold and approve the Trustee's opinion that benefits derived from MoneyMatch Plus Credits and VIP Match are within s73(3)(a) of the 1995 Act.

138. We should add that in his skeleton argument on this issue (paragraphs 32 to 48) Mr Simmonds QC impressively advanced no less than 11 reasons for holding that the judgment below was wrong on this point. In his skeleton argument Mr Newman QC responded to them seriatim. We do not think that it is necessary to have 11 arguments for holding that the deputy judge's construction was wrong. Instead we have concentrated on those arguments

which, in our judgment, are decisive in favour of allowing the appeal. No useful purpose would be served by dealing specifically in this judgment with all the other arguments point by point.

II. Are MoneyMatch benefits MP benefits despite the presence of the GIF?

139. This issue affects all members with MoneyMatch benefits. It does not affect those with VIP benefits. The point is whether, in order to be an MP benefit outside s73, the benefit derived from the payments into the Scheme must be the "direct" and "actual" product of the contribution payments and calculated *only* by reference to those contributions. The objection taken by the Department and the pensioner is that the investment return credited to the GIF is notional or guaranteed, not an actual or direct product of a Scheme asset contributed by way of payment into the Scheme. That element is not calculated by reference to contributions. That also involves the possibility of a mismatch between the MoneyMatch assets and the liabilities for MoneyMatch benefits. Such a mismatch (and a consequential deficit) should not exist in the case of MP benefits, according to *KPMG*'s rulings on the typical characteristics of MP benefits: see, in particular, paragraphs 170 and 171 of *KPMG*.

140. The deputy judge preferred the case of the deferred members that MoneyMatch benefits are MP benefits outside s73, despite the notional investment rate of return aspects of the GIF. The deputy judge held that, properly understood, *KPMG* did not prevent them from being MP benefits.

141. In paragraph (1) of the Order it was declared that:

> "(1) On the true construction of the 1998 Deed a Member's benefits derived from his
>
> (a) Member's Interest or
>
> (b) VIP Interest
>
> constitute money purchase benefits as defined in section 181(1) of the Pension Schemes Act 1993."

142. That reflects the deputy judge's conclusion in rejecting the pensioner's

> "136. ...assertion that the manner in which the investment returns are calculated under the notional Guaranteed Interest Fund means that the benefits arising from the Member's Interest cannot be calculated "only" by reference to the contributions and therefore satisfy the construction placed upon the expression ...in paragraph 171...in the *KPMG* case.
>
> 137. Despite the fact that the final rate of return to be applied to the Member's Interest is arrived at by the addition of a bonus percentage to the initial conservatively declared rate, in my judgment, it is merely a rate of return nevertheless. The mechanism by which the rate is arrived at is just that. The fact

> that one is required to have regard to returns on other funds over a number of years in order to determine the percentage to be applied is merely a product of the fact that the investment is only notional in the first place. In my judgment, its application does not prevent the benefits from being a direct product of the contributions.
>
> 138. Furthermore, the application of the bonus percentage in order to arrive at the investment return for the Guaranteed Interest Fund, envisaged in rule 3.1.1(c)(c) of Schedule 3, can be distinguished from the bonus regime under consideration in the *KPMG* case. In that case, if an actuarial valuation relating to the assets and liabilities of the entire scheme, revealed a surplus, the trustees had power to reduce contributions or increase benefits by the declaration of bonuses. In my judgment this is entirely different from the arrival at a percentage investment return on a notional fund by reference to the performance of a variety of investments."

143. The Department, supported by the pensioner but opposed by the deferred members, submits, as Ground 1 of its appeal, that MoneyMatch benefits are not MP benefits, because of the notional interest credited to the GIF. A rate of interest is declared regardless of the actual investment performance. It could be more or less than the actual investment yield. The guaranteed or notional nature of the return is relied on as the feature of the MoneyMatch benefits that prevents them from being MP benefits on the basis of the reasoning in *KPMG*. In the words of Mr Nugee QC, the notional nature of the return breaks the link between the contributions and the benefits: the benefits are not the "direct" and "actual" product of the contributions referred to in *KPMG*: see, in particular, paragraphs 31 and 32, as well as paragraph 171. The introduction of guaranteed returns on contributions, which may exceed or fall short of actual returns on investments, means that there may be a mismatch between the assets and liabilities of the Scheme. A notional rate of return does not reflect the actual performance of the investments. So the benefits derived from the Member's Interest are not MP benefits.

144. As stated in paragraph 94 above that approach to the definition of MP benefits is too literal a reading of that case and of the definition in s181. It involves reading into the statutory definition of MP benefits a legal requirement that the benefits must be the "direct" and "actual" products of the payments in order to be MP benefits. Those words are not in the definition. It is true that they were used in *KPMG*, but that was in the context of a very different scheme. In that case the liabilities to members turned on the application of tabulated multipliers to contributions. That calculation was a break in the link between the benefits and returns on invested contribution payments to that scheme.

145. In the case of this Scheme the level of a member's MoneyMatch benefits depends on the value of the member's interest in the pot when the member comes to draw benefits and the pot is converted into pension benefits. The use of notional returns on the invested contributions does not break the link

present in the calculation of benefits "by reference to" contributions that is a hallmark of MP benefits. We dismiss the appeal on Issue II.

III. Are pensions granted by way of internal annuities MP benefits?

146. This issue affects both MoneyMatch Benefits and VIP Benefits. The point is whether the inclusion of internal annuitisation provisions and the consequent use of actuarial factors in the process of calculating annuities on the conversion of the pension pot into benefits prevents the members' benefits from being MP benefits.

147. According to the evidence on behalf of the Trustee internal annuitisation of benefits is a common practice in occupational pension schemes. It is capable of benefiting all parties. By way of illustration reference was made to a precedent for the rules of a "defined contribution" scheme in the Encyclopaedia of Forms and Precedents (5th ed., 1999 Reissue) Vol 31. Annuity rates are used to convert the member's interest in the pot of contributions into pension benefits. It is not disputed that that ordinarily produces a higher level of pension than the purchase by the Trustee or by a member of an external annuity. The insurance company's profit element is eliminated. The funds remain in the Scheme instead of being paid out as capital sums to an external insurer.

148. The deputy judge held that the pensions granted by way of internal annuities are MP benefits. The deferred members agree. The pensioner is now neutral on this point, but the Department appeals against the ruling. It contends that the Scheme provisions for internal annuities (as distinct from the purchase of external annuities for an agreed capital sum) involve the use of actuarial factors. Use is made of such factors in the conversion of the Member's MoneyMatch Interest and the VIP interest into pension by way of internal annuities. That, according to Mr Nugee QC, means that the resulting benefits are not MP benefits in accordance with the criteria described in *KPMG*. The actuarial assumptions involved in the process of calculation of benefits break the requisite direct link between members' benefits and contribution payments into the Scheme by or in respect of them.

149. The conclusion reached by the deputy judge was that:-

> "135. ...in my judgment it should make no difference whether the Trustee secures such benefits by means of "internal annuitisation" or purchases an annuity in the market, whether in its own name or that of the Member. I accept [the] submission [of counsel for the deferred members] that to make such a distinction would create insupportable anomalies and leave the question of whether a benefit was money purchase in nature unanswered until the benefit was actually secured. Such uncertainty cannot have been intended and I reject [counsel for the pensioner's] submission that that very uncertainty renders all such benefits incapable of falling within the definition of money purchase benefits. If that were the case,

all such benefits would have to fall outside the definition even if ultimately an annuity was purchased in the market."

150. The Department criticises that conclusion. In submitting that, following *KPMG,* the presence of internal annuitisation as an element in the calculation of MoneyMatch and VIP benefits brings actuarial factors into play, the Department focuses on the actual moment of conversion of the Member's Interest from an MP benefit into an annuity. It contends that it does not matter whether the actuarial factors are built into the scheme, as they were in *KPMG,* or not, as here. What matters is how the benefit is calculated and whether the calculation could result in a mismatch between assets and liabilities of the scheme.

151. In our judgment, the deputy judge correctly distinguished *KPMG* from this case on the point whether the presence of actuarial factors was incompatible with MP benefits. In *KPMG* (see paragraphs 125, 131 and 148) there was no "pot" by reference to which pension benefits on retirement were calculated: the pension benefits were actuarially calculated by the application of an appropriate multiplier.

152. In the case of the Scheme here, however, the members have their own interests or notional accounts in MoneyMatch and VIP pots. Annuity tables based on actuarial calculations are applied only at the final stage of converting the pot into the purchase of benefits on retirement. The pension benefits are not defined by reference to actuarial calculations any more than they are defined by reference to the final or average salary of the member, or some other formula. They are calculated by reference to the amount in the member's notional fund, interest or account in the pot of contribution payments. We dismiss the appeal on Issue III.

IV. GMP issue: Are the MoneyMatch benefits of pre-6 April 1997 joiners MP benefits, despite the presence of GMP?

153. This issue only affects MoneyMatch benefits of members with pre-6 April 1997 pensionable service. By reason of the contracting out of SERPS under the provisions of the 1993 Act they are entitled to GMP. The Member's Interest is first to be applied to satisfy GMP. The issue does not arise in the case of VIP benefits.

154. The deputy judge concluded that the MoneyMatch benefits are MP benefits and the presence of GMP does not prevent them from being so. The Department and the deferred members agree with that conclusion.

155. The pensioner disagrees and appeals. Mr Newman QC contends that they cannot be MP benefits and that s73 must apply, as GMP is a final salary related element in the benefits. It is calculated in accordance with ss13 to 16 of the 1993 Act by reference to the level of the member's earnings while in contracted-out employment. It is not calculated by reference to the member's contribution payments. The pensioner's contention is that benefits arising from the Member's Interest are a composite benefit of not less than a minimum amount. The benefit is calculated by reference to a formula in which the

minimum salary related limit is an integral part of the Member's Interest. GMP is not a free-standing benefit. It is part of the mechanism for calculating the member's benefit. Mr Newman QC describes his submission as the "single composite benefit analysis". The benefit is not calculated "by reference to" contribution payments by or in respect of members. It does not therefore come within the definition of an MP benefit.

156. The deputy judge seems, in the following passage in her judgment, to have run together and briefly treated both the issue on GMP and a similar issue on the effect of the 1983 Guarantee on VIP benefits-

> "141. Next, it is necessary to consider whether the use of the Member's Interest first to satisfy the GMP where applicable and the potential application of the 1983 Guarantee to both the Member's Interest and VIP Interests, is fatal to the characterisation of benefits derived from them as money purchase benefits.
>
> 142. Although this is a complex issue to which I shall have to return, at this stage, it is sufficient to state that in my judgment, although it is not in dispute that both the Guaranteed Minimum Pension and the benefits under the "Old Rules" to which the 1983 Guarantee relates are salary related, the mere reference to Contracting-out Requirements in rule 4.1.2 of Schedule 3 and to the 1983 Guarantee cannot as a matter of principle render the benefits arising from the Member's Interest and/or the VIP Interest salary related or, conversely, exclude them from the definition of money purchase benefits."

157. On this point we agree with the conclusion reached by the deputy judge and with the submissions of the deferred members. GMPs are notionally satisfied from a money purchase pot. They are not in themselves pension or discrete parts of it. They are a notional pension corresponding to what would be paid under the SERPS. The function of GMP is to identify the minimum below which the pension calculated "by reference to" contribution payments by or in respect of members may not fall: see *Marsh & McLellan Companies UK Limited v. Pensions Ombudsman* [2001] PLR 51 at paragraphs 67 and 82. We dismiss the appeal on Issue IV.

V. 1983 Guarantee issue: Are the VIP benefits of those members with the benefit of the 1983 Guarantee MP benefits, despite the presence of that guarantee?

158. This issue only affects VIP Benefits with the benefit of the 1983 Guarantee (as described in paragraph 17 above). It is contended by the pensioner that VIP benefits under the Scheme include final salary elements covered by the 1983 Guarantee. The deputy judge held, however, that they are MP benefits. She relied on similar reasoning to that applied by her to the case of MoneyMatch benefits and GMP. The approach of the deputy judge was that, as with the case of GMP, the 1983 Guarantee did not alter the nature of the benefit provided to members. The effect of the 1983 Guarantee was that the members' VIP

benefits were not to fall below a certain value. That operated to enhance the value of the "pot" notionally allocated to the member and what it can buy internally or externally on retirement. But, in the view of the deputy judge, that did not take it out of the statutory definition of MP benefits.

159. The deferred members seek to uphold that decision on appeal. Against that the pensioner says that they are not MP benefits and appeals, contending that they fall within s73. The Department makes no separate submission on this issue.

160. The pensioner's contention is that the 1983 Guarantee is an element of the benefits derived from the member's VIP Interest. That guaranteed benefit is salary related. The pensioner relies on the "single composite benefit analysis" proposed in the case of GMP. The 1983 Guarantee thus forms part of the bundle of benefits derived from the VIP Interest. It should be considered collectively with the VIP Interest when applying the definition of MP benefits. It follows from that approach that, if the deputy judge had properly applied the test in *KPMG,* the correct conclusion is that the VIP Interest, where the 1983 Guarantee applies, is not an MP benefit. The benefits are not calculated "only" by reference to contribution payments by or in respect of members. They are not a direct product of them.

161. It is said that the deputy judge also fell into the error of regarding salary related benefits and MP benefits as a dichotomy. She failed to appreciate that a benefit can fail to qualify as an MP benefit without necessarily being a salary related benefit. The pensioner does not contend that the composite benefits derived from the VIP Interest are salary related. The contention is that, on the authority of *KPMG,* where a component of the process of calculation of the amount of the composite benefits derived from VIP benefit is not a product of contributions, then the entirety of the benefits do not qualify as MP benefits.

162. In our judgment, the deputy judge and the deferred members are correct on this point. On the proper interpretation of the definition of MP benefits and on a proper understanding of *KPMG*, the application of the 1983 Guarantee does not exclude the benefits arising from the VIP Interest from the definition of MP benefits. The VIP benefits are calculated "by reference to" the contribution payments to the Scheme by and in respect of members. They are not themselves final salary benefits. They do not become so as a result of the application of the 1983 Guarantee to set a value below which the VIP benefits must not fall. We dismiss the appeal on Issue V.

VI. The underpin benefits issue: Are the post-5 April 1997 benefits of Money Match members with GMP "underpin benefits"?

163. This is the most technical and intractable of the tangle of issues in the case. It was argued at length at the hearing and in written reply submissions put in at the request of the court after the hearing had to close. The underpin benefits point proceeds on the basis that the MoneyMatch benefits are MP benefits. It does not affect VIP benefits. It only affects members with MoneyMatch benefits who have accrued GMP benefits by reason of pensionable service pre-6 April 1997. It arises on the appeal because, like the deputy judge, we

have concluded that the MoneyMatch benefits are MP benefits and they are normally ring-fenced as such and excluded from s73. If, however, they are "underpin benefits" they fall back into s73 as an exception to that exclusion.

164. As the deputy judge said, reflecting the words of the definition in regulation 13(3)-

> "154. Underpin benefits....are money purchase benefits which are only paid if their value exceeds that of "other" benefits which are salary related."

165. This issue is whether all or any, and if the latter, which tranche, of the MoneyMatch benefits relating to members with pre- and post-6 April 1997 service fall within the definition of underpin benefits. In particular, are MoneyMatch benefits accrued *after* 6 April 1997 by members with pensionable service prior to that date "underpin benefits"?

166. The deputy judge held that the *whole* of the Members' Interest was an underpin benefit: all of it fell within s73, not just the part of it attributable to pre-6 April 1997 pensionable service. The Department appeals and the deferred members have amended their notice of appeal to appeal that decision. They contend that the post-6 April 1997 benefits of the MoneyMatch members with GMP are not underpin benefits.

167. Their appeals are against paragraph (3) of the Order, in which it was declared that:

> "(3) On the true construction of the 1998 Deed a Member's benefits derived from his Member's Interest constitute underpin benefits within the meaning of the 1996 Winding Up Regulations where that Member is entitled to a GMP as provided for by Schedule Six to the 1998 Deed but not otherwise."

168. The pensioner supports the conclusion of the deputy judge, contending that, save for protected rights, that part of the Member's Interest attributable to post-6 April 1997 service is available to meet GMP and is within regulation 13(3). The pensioner opposes the appeal by the deferred members and the Department. For the purposes of this issue the pensioner contends that GMP can be satisfied out of any of the benefits derived from the Member's Interest, other than protected rights.

169. On the appeal the deferred members support and adopt the submissions of the Department on this issue. The Department submits (as Ground 3 of the appeal) that, assuming that the MoneyMatch benefits are MP benefits, the underpin benefits brought into s73 by regulation 13(3) are only those benefits derived from that part of the Member's Interest attributable to pre-6 April 1997 pensionable service.

170. The deputy judge reasoned as follows in paragraph 155 of her judgment. It was not disputed that a Member's Interest must be applied first to satisfy the

Contracting-Out requirements. They refer to the provision of GMP in respect of service before 6 April 1997. Only Members with pre-6 April 1997 service will have accrued GMPs. It was not disputed that the GMP is calculated on a salary related basis, as is clear from ss13 and 14 of the 1993 Act. The critical question is whether the GMP is a "separate benefit" which satisfies the requirement of "other benefits" in the definition of underpin benefits in regulation 13(3).

171. Having regard to the terms of ss8(2) and 13(1) of the 1993 Act the deputy judge concluded that GMP "should be treated as a separate benefit rather than purely a method of calculation" and "as a result may amount to the 'other benefit' referred to in the definition of underpin benefits": see paragraphs 161 and 162 of the judgment. She also concluded that the lump sum, pension and other alternative benefits set out in rule 4.1.2 of Schedule 3, which will only be provided if their value exceeds GMP, were covered by the definition of underpin benefits.

> "163. ....Therefore, if the Member's Interest is of sufficient value, the money purchase benefits will be provided in addition to the GMP. It is not necessary for the purposes of 'underpin benefits' that the money purchase benefits are a complete alternative to the 'other benefits.' In my judgment, the regulation is wide enough to encompass the situation in which they are paid in addition, if there is sufficient money available.
>
> 164. Therefore, the effect upon those Members not only with Member's Interests but also with service prior to 6 April 1997, who were therefore entitled to GMPs, is that the entirety of their Member's Interest falls within the definition of an 'underpin benefit' and therefore, as a result of regulation 13, is subject to the section 73 regime....."

172. We allow the Department's appeal on this issue on the basis contended for by the Department. We regard the submissions of the Department as more persuasive than those of the pensioner.

173. Mr Nugee QC explains the workings of contracting-out that resulted in GMPs. In 1978, when it was salary related, the Scheme contracted out on the GMP basis. The Scheme provided at least GMP, which is salary related and is not therefore itself an MP benefit. If the pot is larger than GMP, the member gets MP benefits. Otherwise the member only gets GMP.

174. The GMP continued in 1983 and in 1992 when MoneyMatch was introduced into the Scheme. Some members continued to have salary related benefits. On 6 April 1997 GMP stopped accruing, though accrued rights to GMP were retained. After 6 April 1997 no more GMP accrued, though some members still had salary related benefits.

175. There were two different bases for contracting out by MoneyMatch members: there was one pre-6 April 1997 rights(GMP); and there was another for those

with post-5 April 1997 rights (protected rights, which are dealt with in the next issue). Only the pre-6 April 1997 MoneyMatch Interest is available to pay GMP and falls back into s73 as an underpin benefit. There is, according to the Department, a split. The deputy judge was wrong to hold that the whole of the Member's Interest falls back into s73 as underpin benefits.

176. The Department is prepared to accept that, as the deputy judge found, GMP are "other benefits", which are not MP benefits, because they are calculated by reference to salary rather than to contribution payments into the Scheme. But the Department contends that the deputy judge was wrong to hold that the underpin benefits include benefits attributable to post-6 April 1997 service. According to the Department, that part of the Member's Interest attributable to post-6 April 1997 service is not available to meet GMP. It is not within regulation 13(3) and so it is not an underpin benefit taken back into s73.

177. On the question of the effect of an MP benefit with a GMP underpin, we agree with the Department's submission that the Member's Interest in the case of a member with pensionable service pre-6 April 1997 should be regarded as split into 2 separate parts. First, there are the pre-6 April 1997 MoneyMatch Interests. They are underpin benefits taken back into s73. Second, there are the MP benefits for MoneyMatch members post-6 April 1997. They are not available to meet GMP and remain outside s73.

178. We are not persuaded by Mr Newman QC that the split into two parts is legally incorrect. He contends that it is erroneous to assert that there are two separate schemes, one comprising benefits accrued prior to 6 April 1997 and the other comprising benefits accrued after 6 April 1997. He asserts that the true division is between, on the one hand, protected rights and, on the other hand, benefits other than protected rights. He relies on s149 of the 1995 Act for the analysis that all the benefits derived from the Member's Interest are underpin benefits (other than the protected rights that fall within s73, not as underpin benefits but by reason of express provision in s73(3)(c)(i)). S149 provides a facility to make regulations for hybrid occupational pension schemes that include pensions which satisfy s9(2) of the 1993 Act and certain "other pensions." It contains provision for regulations to provide that Part III of the 1993 Act should have effect as if the scheme were two separate schemes. The pensioner challenges the Department's contention that all benefits accrued after 6 April 1997 are the "other pensions" for the purpose of s149. Mr Newman QC submits that there is nothing in the Contracting-Out legislation, or in the rules of the Scheme, that justifies the division between pre-and post-6 April 1997 benefits contended for by the Department. The pensioner's submission is that all benefits are underpin benefits (other than protected rights, as to which see section VII below). Whether the benefits accrued before or after 6 April 1997, they can be used to satisfy GMP. In the words of the definition in regulation 13(3) they are all provided in respect of a member only if their value exceeds GMP.

179. We do not accept that submission. In our judgment the Department correctly draws a distinction between benefits accrued before and after 6 April 1997. We allow the appeal on Issue VI to the extent indicated.

VII. Protected rights issue: Do protected rights fall within section 73 as modified?

180. The position of "protected rights" raised by the pensioner on the appeal was not argued below. It was not formally raised as an issue in the Trustee's claim form. It arises out of the Department's appeal on the MP benefits issues. The issue is contested by the deferred members and the Department. This court would not normally decide an issue on appeal which had not been raised at first instance. This is, however, a pure question of law. The deferred members and the Department, while disputing the issue, have no objections to this court deciding it.

181. The pensioner's point is that protected rights are rights to MP benefits. Contracting-out on a protected rights basis is permitted by s9(1) and (3) of the 1993 Act. Protected rights are described in s10 of the 1993 Act as rights derived from defined contributions, together with associated tax rebates. They are a separately identifiable MP benefit under the Scheme: see s27 of the 1993 Act and Schedule 7, rules 3, 4 and 5 of the Scheme.

182. The pensioner contends that protected rights cannot be underpin benefits, because they are not payable subject to a contingency, such as is the case where the value of a benefit exceeds the value of another benefit under the Scheme. Protected rights under the Scheme are benefits payable in any event: see Schedule 7, rule 5.4.

183. Even if protected rights are not and, on Mr Newman QC's analysis, cannot be underpin benefits, they are within section 73. That is not the result of going via the underpin benefits route back into s73. The reason why they fall within s73 is the simple one that they are expressly mentioned in s73 itself in subsection (3)(c)(i).

184. Both the Department and the deferred members disagree with that analysis. They submit that, if protected rights are rights to MP benefits, the exclusion in regulation 13 (1) applies to them in the same way as it applies to any other MP benefits. The starting point is that MP benefits are not within s73 in an unmodified state. S73 has to be approached as if modified by regulation 13. The effect of that modification is that benefits are within s73 either by virtue of not being MP benefits; or, if they are MP benefits, by virtue of being excepted as underpin benefits. So the only protected rights that are in s73 are those which are not excluded from it by regulation 13.

185. The Department also takes issue with the pensioner's case on the power under which regulation 13 was made. The pensioner contends that regulation 13 was made pursuant to s73(7) of the 1995 Act which provides that "Regulations may modify subsection (3)". S73(9) provides that section 73 shall "have effect with prescribed modifications." It does not permit, Mr Newman submits, a simple repeal of s73. The Department's case is that Regulation 13 was made under section 125 (2) of the 1995 Act. That confers a broader power to make regulations that apply Part 1 of the 1995 Act "with prescribed modifications to occupational pension schemes" which are not MP schemes, but provide some MP benefits i.e. hybrid schemes.

186. The pensioner further submits that protected rights are part of the minimum payments under a scheme. They are not treated more or less favourably than GMPs on a winding up. They are mentioned together in s73(3)(c)(i). They are a right to MP benefits. They are not underpin benefits within regulation 13 nor are they voluntary contributions. As they are expressly mentioned in s73 itself, the section and regulation 13 should be read as a coherent code. The general definition of underpin benefits in regulation 13 should not be construed as repealing express and specific provision relating to protected rights in section 73. Some meaning and effect should be given to such a specific reference in the primary legislation. It is submitted that that is done by an implied exception to regulation 13 in the case of protected rights. Force must be given to the reference to "protected rights" in s73. It is wrong to treat them as immediately overridden by the exclusion in regulation 13. The only reasonable inference is that that regulation is subject to s73 and that fulfils the policy objective of s73 that all contracted out benefits are to be treated in the same way.

187. On this point we are persuaded by Mr Nugee QC that the fallacy in the submission of Mr Newman QC is in not recognising the fundamental modification of s73 made by regulation 13. It excluded MP benefits. Protected rights are MP benefits. It only allowed underpin benefits back into s73. Protected rights are not underpin benefits. That is the effect of the modification, even though the words "protected rights" have not been expressly removed from the section. It is significant, in our view, that by regulation 3(5), the 1996 Regulations at the same time modified s73(3) by substituting subsection (3)(c)(i) with its particular reference to protected rights, and, more fundamentally, by providing by regulation 13 for the exclusion from s73 of MP benefits altogether, unless they are underpin benefits. Reading those provisions together, in the context of the whole 1996 Regulations, we conclude that effect must be given to regulation 13.

188. Accordingly we will make a declaration on Issue VII in terms to be settled by counsel so as to reflect the terms of our judgment.

H. Disposal

189. Counsel are requested to submit to the court for consideration an agreed draft order reflecting the terms of our judgment.