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CR-2021-001966

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMPANIES COURT (ChD)

24 May 2022

Before:

MR JUSTICE LEECH

- -

B E T W E E N:

(1) LAWRENCE EWAN MCGAUGHEY
(2) NEIL MARTIN DAVIES **Claimants**

- and –

(1) UNIVERSITIES SUPERANNUATION SCHEME LIMITED
(2) THE INDIVIDUALS LISTED IN APPENDIX 1 TO THE CLAIM FORM
(3) THE INDIVIDUALS LISTED IN APPENDIX 2 TO THE CLAIM FORM **Defendants**

- -

Mr David E Grant QC and **Mr Gus Baker** appeared on behalf of the Claimants.

Mr Andrew Short QC and **Ms Helen Pugh** (instructed by **CMS Cameron McKenna Nabarro Olswang LLP**) appeared on behalf of the First Defendant.

Hearing date: 5 April 2022

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APPROVED JUDGMENT

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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I. Introduction

1. By Application Notice dated 28 October 2021 the Claimants apply for permission to continue the claim in this action under the common law principles analogous to section 261 of the Companies Act 2006. They also seek an order that the First Defendant (to which I will refer as the "**Company**") indemnify them against liability for costs both in relation to this application and the claim itself. I will refer to this part of the application as the application for a "**Prospective Costs Order**".

2. The First Claimant, Dr Ewan McGaughey, is a Reader in Law at the School of Law, King's College, London. The Second Claimant, Dr Neil Davies, is a senior research fellow in the Bristol Medical School specialising in statistical epidemiology. Both are members of the Universities Superannuation Scheme (the "**Scheme**") of which the Company is the corporate trustee. On 1 October 2008 the First Claimant became a member of the Scheme and on 1 October 2006 the Second Claimant became a member.

3. On 18 April 1974 the Company was incorporated under the Companies Act 1948 as a private company limited by guarantee and registered under company registration no. 1167127. Its registered office is at the Royal Liver Building Liverpool L3 1PY. By a trust deed dated 2 December 1974 the Scheme was established for the purpose of providing superannuation benefits for academic and comparable staff in universities and other higher education institutions in the United Kingdom.

4. Membership of the Scheme is offered to university staff who are employed by many universities and related institutions and it is described in the Particulars of Claim as "a hybrid multi-employer scheme with 343 participating employers". As at March 2020 there were 200,355 active members, 188,466 deferred members, 90,879 pensioners and 1,159 child pensioners. The Scheme is both a defined benefit (or "**DB**") scheme and a defined contribution (or "**DC**") scheme and it is the Claimants' case (as pleaded) that until 1 April 2022 it provided the following benefits for members:

> "A. Accrued entitlement up to and including 31 March 2016 is calculated on a final salary basis using pensionable salary and pensionable service immediately prior to this date. From that date, these accrued benefits revalue in line with increases in official pensions.
>
> B. Defined benefit accrual from 1 April 2016 onwards is on a Career Revalued Benefit basis for all members with a pension accrual of 1/75.

> C. For pensionable service from 1 October 2016 members build up Career Revalued defined benefit rights up to a salary threshold set for each academic year. The threshold for 2016/2017 was £55,000 and has increased annually with CPI. The threshold for 2021/22 is £59,883.65. On salary above that level, members build up Defined Contribution rights. Both members and employers contribute to the Scheme by a percentage of the member's annual salary…..
>
> D. Members can opt to pay additional contributions into the Defined Contribution section of which the first 1% is matched by the employer. As detailed below, the matching facility was removed with effect from 1 April 2019."

5. The Company's purpose as registered at Companies House is pension funding (65300). Article 71(1) of its Memorandum and Articles of Association which were adopted by written resolution on 12 February 2020 (the "**Articles**") provides that the objects for which the Company was established was to undertake and discharge the office of trustee for the benefit of university teachers or other staff of comparable status of universities and similar establishments.

6. As a company limited by guarantee the Company has no shareholders and Article 2 of the Articles provides that a person appointed as a director automatically becomes a member. The Company does not generate any profits but recovers its costs in accordance with the rules of the Scheme (as amended from time to time) (the "**Scheme Rules**").

7. Article 26(1) provides that the Company must have between ten and twelve directors of whom four directors are appointed by Universities UK ("**UUK**") (another company limited by guarantee representing over 100 university employers) and three from the University and College Union ("**UCU**") (a trade union representing over 130,000 academics and support staff across the UK). No more than two of the three directors from UCU may be persons who are not pensioner members (as that expression is defined) and the Company must have no less than three nor more than five independent directors.

8. Article 28 provides that the independent directors are to be appointed by the board of directors and Article 29(3) contains the sole power to remove directors. That power is also vested in the board of directors although before 14 December 2018 both UUK and UCU had previously been able to remove those directors whom it had appointed to the board.

9. The individuals identified as the Second Defendants in Appendix 1 to the Claim Form

were the directors of the Company as at the date of the Claimants' Application Notice (apart from Mr William Galvin, whom the Claimants assert is a shadow director). The individuals identified as the Third Defendants in Appendix 2 are former directors of the Company who were in office during the events giving rise to the claim. I will refer to all of these individuals collectively as the "**Directors**" throughout this judgment. But where I use this expression, I intend to refer to those individuals named in Appendix 1 or Appendix 2 who held office at the date or dates of the events to which I discuss.

10. Rule 64 of the Scheme Rules provided for the establishment of the Joint Negotiating Committee (the "**JNC**"), which consists of eleven persons of whom five are UUK appointees, another five are UCU appointees and one is an independent member, who also acts as the chair. The Scheme Rules confer important functions and powers on the JNC which include deciding whether to make contribution increases (or decreases) and benefit changes (as I set out below).

11. The Company also has an operating subsidiary, USS Investment Management Ltd ("**USSIM**"), which provides investment management and advisory services to the Company. Mr William Galvin is the Chief Executive Officer of the Company ("**CEO**") and he has been a director of USSIM since 1 August 2013. But he is not a director of the Company itself. The Claimants contend that he is a shadow director because of his position as CEO of the group and the control or influence which he exerts over the Directors.

12. On 26 October 2021 the Claimants issued the Claim Form in this action indorsed with the Particulars of Claim and on 28 October 2021 they issued the Application Notice supported by witness statements from both Claimants. In the Particulars of Claim they set out the following summary of the four claims which they ask for permission to continue against the directors and former directors:

> "(Claim 1) the current and former directors including a shadow director of the Company have been in breach of their statutory duties under the CA06 and/or fiduciary duties particularised below in certain ways concerning the valuation of the Scheme's assets which amount to a failure to act properly within the directors' powers, and a failure to promote the success of the Company whose purpose is to protect the interests of the beneficiaries of the Universities Superannuation Scheme (the "Scheme") of which the Company is the corporate trustee. As a result, the Company has suffered and will continue to suffer loss.

(Claim 2) by reason of the matters alleged in Claim 2, the change in benefit and contribution structure proposed by the current and former directors including a shadow director of the Company amounts to discrimination on the grounds of sex and/or age and/or race and has thus exposed or will expose the Company to claims for discrimination such as to amount to a breach of the statutory and/or fiduciary duties of the Directors and/or shadow director.

(Claim 3) – in breach of statutory and/or fiduciary duty and/or negligently, the current and former directors including a shadow director of the Company have overseen dramatic increases in internal and external asset manager costs which the Claimants calculate as a 1318% increase for internal asset manager costs since 2008 and 320% increase in total operating costs.

(Claim 4) – the failure of the current and former directors including a shadow director of the Company to create a credible plan for disinvestment from fossil fuel investments (as defined below) has prejudiced and will continue to prejudice the success of the Company."

13. I will refer to each of the four claims in the same way. On 13 December 2021 I dismissed the Claimants' applications on paper. However, on 28 February 2022, the Claimants renewed their application orally under CPR Part 19.9A(10) when Mr Grant appeared on their behalf. After hearing his oral submissions, I set aside the original order and directed that the Company be joined as a party to the application.

14. On 11 March 2022 the Company served the witness statement of Mr Mark Atkinson, a partner in CMS Cameron McKenna Nabarro Olswang LLP ("**CMS**"), and the witness statement of Mr Dominic Gibb, the Group Chief Financial Officer of the Company, and on 18 March 2022 the Claimants served the third witness statement of Dr Davies and draft Amended Particulars of Claim.

15. The contested application was initially listed to be heard on 28 March 2022 and before the benefit changes to which I refer (below) took effect. However, because Mr Grant became seriously ill with Covid 19 I adjourned the application and I finally heard it on 5 April 2022. I am pleased to say that Mr Grant had recovered and he appeared with Mr Baker on behalf of the Claimants. Mr Short and Ms Pugh appeared on behalf of the Company.

16. I am grateful to both counsel and their teams for the excellent quality and focus of their submissions. Mr Grant properly drew my attention to the fact that the amended Application Notice had not been served on the Company in time. But Mr Short took no objection to this. Nor did he object to the Court hearing the application on the basis that

the Claimants' case was as set out in the draft Amended Particulars of Claim and I heard the application on that basis. Where I refer to the "**Particulars of Claim**" or "**POC**" below, therefore, I intend to refer to the draft amended version (unless I state otherwise).

II. The Legal Framework

A. Multiple Derivative Claims

17. The Companies Act 2006, Part II, Chapter 1 contains a statutory regime for a member to bring a derivative claim. Such a claim must be brought by a member of the company on whose behalf the claim is made or a person entitled to shares in that company by transfer or transmission: see *Boston Trust Co Ltd v Szerelmy Ltd* [2021] EWCA Civ 1176 at [14] (Sir David Richards). It is common ground that the claim in this action is not a derivative action for the purposes of the statutory definition.

18. There are, however, cases in which members of a holding company have been permitted to bring proceedings on behalf of a subsidiary or where the members of the ultimate holding company have been permitted to bring proceedings even though there are a number of intermediate companies holding shares in between. In *Boston Trust* (above) Sir David Richards described a claim in the first category as a "double derivative claim" and a claim in the second category as a "multiple derivative claim": see [13]. In *Universal Project Management Ltd v Fort Gilkicker Ltd* [2013] Ch 551 Briggs J (as he then was) distinguished between "ordinary" and "multiple" derivative actions: see [24].

19. For present purposes, I will use the term "**double derivative claim**" to refer to a claim in the first category identified by Sir David Richards in *Boston Trust*, namely, where the application for permission is made by a member of a company on whose behalf the claim is issued. I will also use the term "**multiple derivative claim**" to refer not only to claims in his second category (i.e. where there are multiple holding companies) but also to any other claims which do not fall within either the statutory definition or the first category. Finally, I will use the term the "**subject company**" to refer to the company on whose behalf the claim is made and the claimant who applies for permission to bring the claim as the "**derivative claimant**".

20. It was also common ground that a double derivative claim or a multiple derivative claim is governed by common law rules rather than the statutory test although it is the settled

practice of the Court to require the derivative claimant to obtain permission to continue the claim and to apply by analogy the practice in CPR Part 19.9 when hearing that application: see *Boston Trust* at [20]. Briggs J described the common law rules in *Fort Gilkicker* as "obscure, complicated and unwieldy" but he held that the Companies Act 2006 did not do away with multiple derivative claims even though Parliament could easily have legislated to include them in the statutory definition: see [34] and [44] to [49]. I must, therefore, apply the common law rules.

21. Finally, it was also common ground between counsel that the category of multiple derivative claims is not closed and that the derivative claim is no more than a procedural device to avoid the injustice which would occur where a wrong is suffered for which no redress could be claimed by an affected party. The obvious example is where the company is controlled by the wrongdoer against whom the claim could be brought and Sir James Wigram VC recognised this himself in *Foss v Harbottle* (1843) 2 Hare 461 at 491-2. In *Wallersteiner v Moir (No 2)* [1975] 1 QB 375 (which involved both a derivative claim and a double derivative claim) Lord Denning MR stated this at 390B:

> "But suppose [the subject company] is defrauded by insiders who control its affairs - by directors who hold a majority of the shares - who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress."

22. There is a statement to the same effect in *Nurcombe v Nurcombe* [1985] 1 WLR 370 at 378F-G (Browne Wilkinson LJ). In *Fort Gilkicker* (above) Briggs J cited *Nurcombe v Nurcombe* at [24] and then continued as follows:

> "Once it is recognised that the derivative action is merely a procedural device designed to prevent a wrong going without a remedy (see *Nurcombe v Nurcombe* [1985] 1 WLR 370, 376A) then it is unsurprising to find the court extending locus standi to members of the wronged company's holding company, where the holding company is itself in the same wrongdoer control. The would-be claimant is not exercising some right inherent in its membership, but availing itself of the court's readiness to permit someone with a sufficient interest to sue as the company's representative claimant, for the benefit of all its stakeholders."

B. The Common Law Test

23. The Company submitted that the authorities establish that permission will be granted at common law only where the derivative claimants satisfy the following four requirements:

(1) They have sufficient interest or standing to pursue the claims on a derivative basis on behalf of the company or other entity;

(2) They establish a *prima facie* case that each individual claim falls within one of the established exceptions to the rule in *Foss v Harbottle*;

(3) They establish a *prima facie* case on the merits in respect of each claim; and

(4) It is appropriate in all the circumstances to permit them to pursue the derivative claim or claims.

24. The Claimants did not challenge the four limbs of the test as such and the real difference between the parties was how the Court should apply it and whether it was satisfied in the present case. Nevertheless, I begin with the test itself. *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 is often treated as the source for the common law test: see, e.g., *Fort Gilkicker* (above) at [53] (Briggs J) and *Abouraya v Sigmund* [2014] EWHC 277 (Ch) at [16] (David Richards J). In *Prudential* the Court of Appeal identified the following two-limbed test at 221G-222B:

> "In our view, whatever may be the properly defined boundaries of the exception to the rule, the plaintiff ought at least to be required before proceeding with his action to establish a prima facie case (i) that the company is entitled to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in *Foss v. Harbottle*. On the latter issue it may well be right for the judge trying the preliminary issue to grant a sufficient adjournment to enable a meeting of share-holders to be convened by the board, so that he can reach a conclusion in the light of the conduct of, and proceedings at, that meeting."

(1) Standing or Sufficient Interest

25. Although the Court of Appeal did not identify standing as a threshold condition, it is implicit in the second limb of the *Prudential* test that the derivative claimants must have a sufficient interest in the proceedings to permit them to bring or continue the claim. In *Daniels v Daniels* [1978] Ch 406 Templeman J identified the four exceptions to the rule

in *Foss v Harbottle* at 408G-H:

> "The exceptions are four in number, and only one of which is of possible application in the present case. The first exception is that a shareholder can sue in respect of some attack on his individual rights as a shareholder; secondly, he can sue if the company, for example, is purporting to do by ordinary resolution that which its own constitution requires to be done by special resolution; thirdly, if the company has done or proposes to do something which is ultra vires; and fourthly, if there is fraud and there is no other remedy. There must be a minority who are prevented from remedying the fraud or taking any proceedings because of the protection given to the fraudulent shareholders or directors by virtue of their majority."

26. In *Harris v Microfusion 2003-2 LLP* [2017] 1 BCLC 305 McCombe LJ (with whom Christopher Clarke and Jackson LJJ agreed) approved this passage and I return to that decision in considering the scope of the fourth exception. In the present context the Company submitted (and I accept) that the last sentence of this passage is really directed to the question of standing. There must be a minority of shareholders or equivalent stakeholders who have been prevented from remedying the wrong or taking proceedings. In *Boston Trust* Sir David Richards (who had appeared as counsel in *Daniels*) made that threshold requirement explicit at [42]:

> "The claimants' standing to bring the present proceedings is, as the judge correctly said, "the threshold question". As the claimants were not members of Tellisford, and did have not standing on any other basis, they had no basis in law on which to bring the proceedings. It is only if a claimant has standing, that the issues as to whether the court should give permission for the proceedings to continue arise, however strong on those issues the claimant's case may appear to be. Unless a claimant can cross the threshold, there is no warrant for examining and deciding the issues that are contingent upon it. As Henderson LJ observed in argument, by granting permission, albeit conditionally, the judge was accepting that there was a state of facts to justify the grant of permission at that very point, but that was to beg the question of whether there was standing to make the application at all."

27. There is no authority dealing with the circumstances in which it is permissible for a multiple derivative claim to be brought on behalf of a company limited by guarantee. The Claimants relied on *McDonald v Horn* [1995] ICR 685 as authority for the proposition that a member of a pension scheme had sufficient standing. In that case the applicants relied on the analogy with derivative claims to justify the grant of a prospective costs order. They submitted that this procedure which had been imported into company law from the law of trusts should be "re-exported to trust law" to cover the position of a

beneficiary who is suing on behalf of a fund in which he and many others have interests: see 697G. Hoffmann LJ accepted that submission and he stated this at 698B-F:

> "On the other hand, if one looks at the economic relationships involved, there does seem to me a compelling analogy between a minority shareholder's action for damages on behalf of the company and an action by a member of a pension fund to compel trustees or others to account to the fund. In both cases a person with a limited interest in a fund, whether the company's assets or pension fund, is alleging injury to the fund as a whole and seeking restitution on behalf of the fund. And what distinguishes the shareholder and pension fund member on the one hand from the ordinary trust beneficiary on the other is that the former have both given consideration for their interests. They are not just recipients of the settlor's bounty which he, for better or worse, has entrusted to the control of trustees of his choice. The relationship between the parties is a commercial one and the pension fund members are entitled to be satisfied that the fund is being properly administered. Even in a non-contributory scheme, the employer's payments are not bounty. They are part of the consideration for the services of the employee.
>
> Pension funds are such a special form of trust, and the analogy between them and companies with shareholders is so much stronger than in the case of ordinary trusts, that in my judgment it would do no violence to established authority if we were to apply to them the *Wallersteiner v. Moir* procedure. Mr. Sher, who appeared for the defendants, said that this court had no jurisdiction to do this. He referred us to the statement of the limits of the court's inherent jurisdiction over trusts in the decision of the House of Lords in *Chapman v. Chapman* [1954] A.C. 429. But I say that the jurisdiction is to be found in section 51 of the Supreme Court Act 1981, which is subject only to rules of court and established principles. For the reasons I have given, I think that no such rule or principle would be violated."

28. The Company did not submit that there could never be a case in which members of a pension scheme could bring a multiple derivative claim and, in my judgment, it was right not to do so. One can think of fairly extreme examples where the directors of the corporate trustee conspire to misappropriate the scheme's assets on an industrial scale. If the company was limited by guarantee and the directors were also the only members, I very much doubt that the Court would refuse permission in such a case on the grounds that the members did not have standing.

29. The Company's submission, however, was that the members of a pension scheme would only have standing if the loss which the subject company (or the scheme) is claimed to have suffered is reflective of their own loss. It relied on *Abouraya* (which the Court of Appeal also approved in *Harris v Microfusion*). In that case David Richards J (as he then was) relied on the observations of Lord Millett NPJ in *Waddington Ltd v Chan Chun Hoo*

Thomas [2009] 2 BCLC 82 (a decision of the Court of Final Appeal in Hong Kong). I can do no better than repeat [74] and [75] of Lord Millett's judgment:

> "[74] As I have said, the question is simply a question of the plaintiff's standing to sue. This would have been obvious when the procedure was for the proposed plaintiff to apply to the court for leave to use the company's name. On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of person wishing to bring a multiple derivative action is plainly 'Yes'. Any depletion of a subsidiary's assets causes indirect loss to its parent company and its shareholders. In either case the loss is merely reflective loss mirroring the loss directly sustained by the subsidiary and as such it is not recoverable by the parent company or its shareholders for the reasons stated in *Johnson v Gore Wood & Co* [2002] 2 AC 1. But this is a matter of legal policy. It is not because the law does not recognise the loss as a real loss; it is because if creditors are not to be prejudiced the loss must be recouped by the subsidiary and not recovered by its shareholders. It is impossible to understand how a person who has sustained a real, albeit reflective, loss which is legally recoverable only by a subsidiary can be said to have no legitimate or sufficient interest to bring proceedings on behalf of the subsidiary.
>
> [75] This is not to allow economic interests to prevail over legal rights. The reflective loss which a shareholder suffers if the assets of his company are depleted is recognised by the law even if it is not directly recoverable by him. In the same way the reflective loss which a shareholder suffers if the assets of his company's subsidiary are depleted is recognised loss even if it is not directly recoverable by him. The very same reasons which justify the single derivative action also justify the multiple derivative action. To put the same point another way, if wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity."

30. I therefore accept the Company's submission that in order to establish that they have standing or a sufficient interest to continue the present claim, it is essential for the derivative claimants to demonstrate both that the subject company has suffered a loss and that this loss is reflective of their own loss. Moreover, Lord Millett's observations stress that the principal reason why shareholders have standing to bring a derivative claim is that they will be unable to bring a direct claim against the wrongdoers themselves (because of the principle of reflective loss).

31. The Company also submitted that derivative claimants have no standing to bring a multiple derivative claim where they have direct claims against the wrongdoer even if the alternative claim is less convenient or attractive for procedural or funding reasons. It submitted that a multiple derivative claim was only available where it was necessary to

prevent injustice and not just inconvenient to do so.

32. The Claimants submitted that the availability of an alternative claim or remedy was a matter for the Court to consider at the fourth stage of the test when deciding whether it is appropriate in all the circumstances to permit the derivative claimant to continue the claim. They relied on *Fort Gilkicker* at [53] to [61] (which I consider in more detail below). But they also submitted that the test for necessity was satisfied in the present case because it was only the Company which could bring a claim for breach of the Directors' statutory or fiduciary duties.

33. On this issue I prefer the Claimants' submissions. I accept that in *Fort Gilkicker* Briggs J referred to the "necessity of a derivative claim": see [55]. But he did not consider that the existence of an alternative claim for breach of contract or unfair prejudice barred the multiple derivative claim and went on to consider whether either of the claims was "of sufficient substance" to displace the multiple derivative claim: see [56]. But in any event, I am not satisfied that an independent claim for breach of trust would prevent a derivative claimant from bringing a derivative claim where he or she had suffered a loss as a shareholder which was reflective of the subject company's loss. I prefer, therefore, to deal with the Claimants' alternative claim in the context of the fourth requirement (below).

(2) Prima Facie Case: The Fourth Exception

34. The Claimants relied on the fourth exception to the rule in *Foss v Harbottle*, namely, that a fraud has been committed and the minority (or other interested stakeholders) are prevented from remedying the fraud because the subject company is controlled by the wrongdoers. In *Daniels* Templeman J considered that the fourth exception extended to the following breaches of duty at 413H-414D:

> "The authorities which deal with simple fraud on the one hand and gross negligence on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of a breach of duty which they owe to the company, and that breach of duty not only harms the company but benefits the directors. In that case it seems to me that different considerations apply. If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous—particularly as fraud is so hard to plead and difficult to prove—if the confines

> of the exception to *Foss v. Harbottle*, 2 Hare 461, were drawn so narrowly that directors could make a profit out of their negligence. Lord Hatherley L.C. in *Turquand v. Marshall*, L.R. 4 Ch.App. 376, 386, opined that shareholders must put up with foolish or unwise directors. Danckwerts J. in *Pavlides v. Jensen* [1956] 1 Ch. 565 accepted that the forbearance of shareholders extends to directors who are "an amiable set of lunatics." Examples, ancient and modern, abound."

35. Following *Daniels* the leading authorities all state that unless the derivative claimants can establish a prima facie case of "actual fraud" then they must establish a prima facie case that the wrongdoers benefitted themselves from the breach of duty: see, e.g., *Abouraya* (above) at [25] and *Bhullar v Bhullar* [2015] EWHC 1943 (Ch) at [34]. However, although David Richards J used the term "actual fraud" in the first case and Morgan J used the same term in the second, it was not necessary for either of them to attempt an exhaustive definition of what it meant in this context.

36. The Claimants submitted that fraud in the sense used by Templeman J in *Daniels* is not limited to deliberate and dishonest breaches of duty but extends to "equitable fraud" and "fraud on a power". They cited *Fort Gilkicker* where Briggs J stated that fraud includes "a variety of equitable wrongs, including a breach of fiduciary duty, although not mere negligence": see [18]. But the principal authority upon which they relied was *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2 which I must now consider.

37. In that case the GLC sold twelve flats in a block of sixty flats to purchasers on long leases (and entered into contracts for sale with other purchasers). At the same time the council entered into an agreement with the subject management company under which it was to collect the service charges on the council's behalf and to take a superior lease of the entire block on the sale of the last remaining flat. A covenant in the agreement provided that the council would use its best endeavours to dispose of all of the flats on long leases. On completion of each long lease the council also transferred a share in the subject company to each purchaser.

38. A change of policy took place and the council decided to let the remaining flats to high priority applicants on its housing list. The subject company's directors had already issued a claim to enforce the covenant but at an extraordinary general meeting the council voted for the subject company to withdraw it. One of the purchasers applied for permission to

continue the action and Sir Robert Megarry V-C. granted the application. The council submitted that there was no fraud on the minority as explained in *Daniels* and the judge dealt with this submission at 12F-13A:

> "Apart from the benefit to themselves at the company's expense, the essence of the matter seems to be an abuse or misuse of power. "Fraud" in the phrase "fraud on a minority" seems to be being used as comprising not only fraud at common law but also fraud in the wider equitable sense of that term, as in the equitable concept of a fraud on a power. Now of course *Daniels v. Daniels* [1978] Ch. 406 was a case on acts by directors as such, rather than by shareholders, and I do not forget this. At the same time it seems to me to be useful as preventing "fraud" from being read too narrowly. Suppose, too, the decision to sell the land had been made not by the husband and wife qua directors, but by a resolution of the company carried by their votes: could it then be said that the minority could not sue? Is this exception from the rule in *Foss v. Harbottle* open to easy evasion by directors who hold the majority of votes in general meeting if they take care to reach their decisions not by voting as directors but by voting as shareholders? I think not.
>
> In considering whether there is a fraud on a minority in this case in the sense which this phrase has acquired, and whether Mr. Brodie has made good his main contention, certain matters seem plain enough. First, I do not think that it can reasonably be said to have been established that it is, or could reasonably be thought to be, for the benefit of the company that the action should be discontinued. This is not a case of a trading company, seeking to make a profit. The company is a non-profit-making company, and so the test cannot be the financial benefit of the company. The company was formed for a particular purpose, namely, to manage the block of Flats under the control of the purchasers of the flats; and the covenant by the council with the company was part of the mechanism for securing this result. On the face of it I do not think that it can readily be said to be for the benefit of a company to stultify a substantial part of the purpose for which it was formed. Of course, there may be difficulties about obtaining the necessary funds to support the litigation, and if these difficulties are not overcome it will be impossible to carry out the company's purpose: but it is one thing to say that it is not for the company's benefit for it to attempt to carry out its purpose, and another thing to say that although it is for the company's benefit to do this, unfortunately it has become impossible. Further, where, as here, a member of a minority seeks to litigate on the company's behalf, the question ceases to be merely one of the adequacy of the company's funds."

39. Sir Robert Megarry V-C reached the conclusion that the council was actuated by its desire to put into effect its new housing policy even though that plainly and admittedly involved a breach of contract. He also found it impossible to accept that the council had voted in favour of discontinuing the action because it believed it to be in the best interests of the subject company. He continued at 15G-16B:

> "As I have indicated, I do not consider that this is a suitable occasion on which to probe the intricacies of the rule in *Foss v. Harbottle* and its exceptions, or to attempt to discover and expound the principles to be found in the exceptions. All that I need say is that in my judgment the exception usually known as "fraud on a minority" is wide enough to cover the present case, and that if it is not, it should now be made wide enough. There can be no doubt about the 12 voteless purchasers being a minority; there can be no doubt about the advantage to the council of having the action discontinued; there can be no doubt about the injury to the applicant and the rest of the minority, both as shareholders and as purchasers, of that discontinuance; and I feel little doubt that the council has used its voting power not in order to promote the best interests of the company but in order to bring advantage to itself and disadvantage to the minority. Furthermore, that disadvantage is no trivial matter, but represents a radical alteration in the basis on which the council sold the flats to the minority. It seems to me that the sum total represents a fraud on the minority in the sense in which "fraud" is used in that phrase, or alternatively represents such an abuse of power as to have the same effect."

40. In *Harris v Microfusion* a member of a limited liability partnership applied for permission to bring a number of claims against two limited companies which were designated members of the LLP. His Honour Judge Pelling QC granted permission to bring two claims but refused permission to bring a third in relation to a rebate agreed by the partners with two Czech partners. Counsel for the derivative claimant did not suggest that any of the breaches of fiduciary duty in question was deliberate or dishonest but he submitted that David Richards J had stated the fourth exception too narrowly in *Abouraya*. In support of that submission he relied on *Estmanco* and the dictum of Briggs J in *Fort Gilkicker* (above).

41. McCombe LJ described *Estmanco* as a very unusual case. He considered it a case in which the majority was seeking to use the alleged breach of duty to further its own ends and "in that sense to gain a personal benefit, albeit political rather than financial": see [29]. He also rejected the submission based on the dictum in *Fort Gilkicker* on the basis that Briggs J was considering a different issue, namely, whether Parliament had done away with the double or multiple derivative action altogether: see [30]. McCombe LJ expressed his conclusions at [31] to [33]:

> "31. I do not think that either of these cases (*Estmanco* or *Gilkicker*) supports Mr Harper's wider proposition that the exception to the rule in *Foss v Harbottle* is "opened up" in cases, short of deliberate and dishonest breach of duty, in the absence of personal benefit to the party allegedly in breach of duty. For my part, having reviewed the authorities, with the helpful assistance of counsel, I consider that the extent of the relevant exception to the rule is

> indeed as stated by David Richards J in *Abouraya*. 32. While the authorities to which I refer are all authorities at first instance, they are decisions of judges with the deepest of knowledge of our company law and I would not be inclined to depart from them except for very good reason. I can find no good reason to do so. 33. On the contrary, it seems to me that Miss Anderson was correct to say that principle supported her submission as to the extent of the exception. Essentially, people are free to join as members of corporate entities upon whatever terms they choose, formulated in articles of association, partnership deeds for LLPs or shareholders' agreements. They are bound by such arrangements and if majority rule is provided for, the minority is bound by the wishes of the majority. The majority can choose to excuse breaches of duty by directors, provided that the majority have not used their voting powers to confer benefits upon themselves in breach of duty and are not using the self-same powers to prevent the company from recovering the loss caused to it, in effect expropriating the minority in the process. The constraints imposed by equity make an exception to the rule in *Foss v Harbottle* in cases where the controlling members are precluded from ratifying the relevant breach by exercise of their majority votes. Thus, the "fraud on the minority" exception prevents directors from improperly benefitting themselves at the expense of the company."

42. The Claimants sought to distinguish *Harris v Microfusion* on the basis that a limited liability partnership was very different from a company limited by guarantee and that the members were free to choose their constitution and that they can agree to majority rule: see [33] (above). I am not satisfied that this is a true basis for distinguishing the decision. McCombe LJ was doing no more than restating the rationale for the fourth exception, namely, that parties are free to choose majority rule and that equity will only step in where the majority have abused that power to excuse their own dishonest and deliberate breaches of duty or to excuse their actions in improperly benefitting themselves at the expense of the subject company.

43. In my judgment, *Harris v Microfusion* is clear authority for the proposition that a derivative claimant must establish a prima facie case that the defendants have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the company (although the nature of that benefit need not be exclusively financial). I find support for that proposition in *Homes of England Ltd v Sellman (Holdings) Ltd* [2020] EWHC 936 (Ch) where Zacaroli J applied the following test at [46] (and it is clear from the context that his first question was concerned with reflective loss):

> "Applying the test as identified in *Abouraya* on the facts of this case, the following three questions arise: (1) did Holdings' actions cause financial loss

> to the members? (2) is fraud in the sense of deliberate and dishonest breach of duty pleaded? (3) is it alleged that Holdings acquired a personal benefit at the expense of BRD?"

(3) Prima Facie Case: The Merits

44. There was also some debate between counsel about the test to be applied on the merits. In *Abouraya* David Richards J stated that a prima facie case is a higher test than a seriously arguable case and that the Court had to be satisfied that in the absence of an answer by the defendant, the derivative claimant would be entitled to judgment: see [53]. In *Bhullar v Bhullar* Morgan J also gave the following description of how the Court should apply that test in practice at [25]:

> "It is one thing to ask whether the claimant has shown a prima facie case in the absence of an answer from the defendant and another thing to ask whether the claimant has still shown a prima facie case when one takes into account the suggested answer. If the facts relied upon by either the claimant or the defendant are not disputed, there may be little difficulty. But what if the claim and the suggested answer depend, as they often will, on disputed facts? Further, what if the resolution of that dispute will in due course require the trial judge to reach conclusions as to the credibility of witnesses? I consider that the court has to recognise that it cannot resolve disputes of fact at a hearing which does not involve any cross-examination of witnesses and which takes place in advance of any formal disclosure of documents. It will not be unusual to find that the claimant can establish a prima facie case, if one ignores the evidence relied upon by the defendant, but yet the claimant would fail at trial if the defendant's evidence were to be accepted. In such a case, I consider that it is still open to the court to hold that the claimant has made out a prima facie case because it would be wrong to assume that the defendant's evidence will be accepted at the trial and it may simply not be possible to predict with any degree of confidence whether the defendant's evidence will be so accepted."

45. I find this is a helpful gloss on the test in a case where the real question which I have to consider is whether to accept the detailed evidence adduced by the Company in answer to the application without the necessity for a trial. It seems to me that the appropriate course is to find that a prima facie case has been made out only where I am satisfied that there are issues of fact on which it would be wrong to accept the Company's evidence without cross-examination.

(4) Discretion

46. In *Fort Gilkicker* the subject company conceded that there was a prima facie case which

satisfied the common law test but argued that it was not an appropriate case to permit the derivative claimant to continue the claim because it had alternative remedies, namely, a claim for breach of a joint venture agreement and an unfair prejudice claim. For various reasons which I need not set out Briggs J rejected that submission. But he explained his approach at [53]:

> "I have recorded the concession by Miss Smith that the particulars of claim and the evidence in support of them disclose a sufficient prima facie case of a wrong done to FGL to satisfy that part of the common law test. None the less CPR Pt 19 , and in particular paragraph 1(a)(i) of the Practice Direction 19C supplementing Part 19 make it clear that the permission regime applies to "derivative claims, whether under Chapter 1 of Part 11 of the Companies Act 2006 or otherwise", and it is common ground that the court has a discretion whether or not to permit any common law claim to continue which is not limited to a cold analysis of whether the common law requirements set out, for example, in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 are met."

47. The Company submitted that even if my "cold analysis" led to the conclusion that the first three requirements of the test were satisfied, the Claimants still had to satisfy me that it was appropriate to permit them to continue the claim given the alternative remedies available to them. It also relied on *Abouraya* where David Richards J accepted that a derivative claimant did not have an automatic entitlement to continue the claim. He stated this at [26]:

> "Satisfaction of the requirement for the claimant to establish a prima facie case both that the company is entitled to the relief claimed and that the action falls within the proper boundaries of the exception to the rule in *Foss v Harbottle* does not automatically entitle the claimant to permission to commence or continue the action. The court exercises a discretion whether to grant permission and will have regard to all relevant factors. This is illustrated by the authorities which establish that a claimant who has been involved in the alleged wrongdoing or who seeks to bring the proceedings for an ulterior purpose will not be regarded as an appropriate claimant and will not be given permission: see *Nurcombe v Nurcombe* [1985] 1 WLR 370 at 376 per Lawton LJ, *Barrett v Duckett* [1995] 1 BCLC 243 at 250 per Peter Gibson LJ. Above all, it is illustrated by the requirement that a reasonable board of directors would consider it to be in the best interests of the company to pursue the proceedings."

C. The Pensions Act 2004

48. I turn now to the Pensions Act 2004. Section 1 created the Pensions Regulator ("**TPR**")

whose main objectives include protecting the benefits of members under occupational pension schemes and reducing the risk of situations arising which may lead to compensation being payable under the Pension Protection Fund: see section 5. TPR also has functions under Part 3 (below).

49. Section 221 provides that the provisions of Part 3 apply to every occupational pension scheme Section 222 defines the "**statutory funding objective**" of each occupational pension scheme and its "**technical provisions**" as follows:

> "(1) Every scheme is subject to a requirement ("the statutory funding objective") that it must have sufficient and appropriate assets to cover its technical provisions. (2) A scheme's "technical provisions" means the amount required, on an actuarial calculation, to make provision for the scheme's liabilities. (3) For the purposes of this Part– (a) the assets to be taken into account and their value shall be determined, calculated and verified in a prescribed manner, and (b) the liabilities to be taken into account shall be determined in a prescribed manner and the scheme's technical provisions shall be calculated in accordance with any prescribed methods and assumptions."

50. Section 223 introduces the concept of a "**statement of funding principles**" and it provides that the trustees of a pension scheme must prepare, review and (if necessary) revise the statement. Moreover, it provides that the primary purpose of such a statement is to record the trustees' policy for securing that the statutory funding objective is met:

> "(1) The trustees or managers must prepare, and from time to time review and if necessary revise, a written statement of— (a) their policy for securing that the statutory funding objective is met, and (b) such other matters as may be prescribed. This is referred to in this Part as a "statement of funding principles" (2) The statement must, in particular, record any decisions by the trustees or managers as to– (a) the methods and assumptions to be used in calculating the scheme's technical provisions, and (b) the period within which, and manner in which, any failure to meet the statutory funding objective is to be remedied. (3) Provision may be made by regulations– (a) as to the period within which a statement of funding principles must be prepared, and (b) requiring it to be reviewed, and if necessary revised, at such intervals, and on such occasions, as may be prescribed. (4) Where any requirement of this section is not complied with, section 10 of the Pensions Act 1995 (c. 26) (civil penalties) applies to a trustee or manager who has failed to take all reasonable steps to secure compliance."

51. Section 224 provides that the trustees or managers of an occupational pension fund must obtain actuarial valuations at one year or three year intervals (depending on whether they also obtain actuarial reports):

> "(1) The trustees or managers must obtain actuarial valuations– (a) at intervals of not more than one year or, if they obtain actuarial reports for the intervening years, at intervals of not more than three years, and (b) in such circumstances and on such other occasions as may be prescribed. (2) In this Part– (a) an "actuarial valuation" means a written report, prepared and signed by the actuary, valuing the scheme's assets and calculating its technical provisions, (b) the effective date of an actuarial valuation is the date by reference to which the assets are valued and the technical provisions calculated, (c) an "actuarial report" means a written report, prepared and signed by the actuary, on developments affecting the scheme's technical provisions since the last actuarial valuation was prepared, and (d) the effective date of an actuarial report is the date by reference to which the information in the report is stated."

52. Sections 225 to 230 contain detailed provisions for the certification of technical provisions, the preparation of a recovery plan (if the statutory funding objective is not met), matters requiring the agreement of employers and matters to be dealt with in actuarial valuations. Section 231 confers the following powers on TPR where the trustees or managers do not comply with sections 224 to 230:

> "(2) In any of those circumstances the Regulator may by order exercise all or any of the following powers– (a) it may modify the scheme as regards the future accrual of benefits; (b) it may give directions as to– (i) the manner in which the scheme's technical provisions are to be calculated, including the methods and assumptions to be used in calculating the scheme's technical provisions, or (ii) the period within which, and manner in which, any failure to meet the statutory funding objective is to be remedied; (c) it may impose a schedule of contributions specifying– (i) the rates of contributions payable towards the scheme by or on behalf of the employer and the active members of the scheme, and (ii) the dates on or before which such contributions are to be paid. (3) No modification may be made under subsection (2)(a) that on taking effect would or might adversely affect any subsisting right of– (a) any member of the scheme, or (b) any survivor of a member of the scheme."

53. These provisions are supplemented by the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378). Regulation 4 (which is headed "Investment by trustees") provides as follows:

> "(1) The trustees of a trust scheme must exercise their powers of investment, and any fund manager to whom any discretion has been delegated under section 34 of the 1995 Act (power of investment and delegation) must exercise the discretion, in accordance with the following provisions of this regulation. (2) The assets must be invested— (a) in the best interests of members and beneficiaries; and (b) in the case of a potential conflict of interest, in the sole interest of members and beneficiaries. (3) The powers of investment, or the discretion, must be exercised in a manner calculated to

> ensure the security, quality, liquidity and profitability of the portfolio as a whole. (4) Assets held to cover the scheme's technical provisions must also be invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the scheme. (5) The assets of the scheme must consist predominantly of investments admitted to trading on regulated markets. (6) Investment in assets which are not admitted to trading on such markets must in any event be kept to a prudent level. (7) The assets of the scheme must be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and so as to avoid accumulations of risk in the portfolio as a whole. Investments in assets issued by the same issuer or by issuers belonging to the same group must not expose the scheme to excessive risk concentration."

54. In *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd* [2015] PLR 239 Asplin J (as she then was) considered the relationship between the various duties of a pension fund trustee. She stated that the "best interests of the beneficiaries" should not be viewed as a paramount standalone duty or separate from the proper purposes principle. She then continued (at [228] and [232] to [233]):

> "228. It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests. As a result, I agree with his conclusion that ' . . to define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different words a trustee's obligation to promote the purpose for which the trust was created.'"
>
> "232. In this case, of course, the Scheme is closed to new membership and the continued accrual of benefits and is in severe deficit. However, given the uncertainties inherent in the administration of a pension scheme and the fact that a surplus or deficit is to some extent merely the product of the actuarial assumptions which have been applied, it seems to me that it would be wrong and entirely artificial to conclude that different duties arise depending upon whether there is a surplus or a deficit. In this case, given the extent of the deficit and the urgent need for deficit contributions in order to secure the benefits, it seems to me that the relevance of the position of the Employers capable of making such contributions and their interests is much the same as the circumstances which Chadwick LJ was considering and in the same way, it is perfectly legitimate for the Trustee to take such matters into account when exercising its powers for the purpose of promoting the purposes of the Scheme.
>
> 233 Accordingly, in my judgment, as long as the primary purpose of securing the benefits due under the Rules is furthered and the employer covenant is sufficiently strong to fulfil that purpose, it is reasonable and proper should the Trustee consider it appropriate to do so, to take into account the Employers' interests both when determining whether to widen the pool of those liable to contribute and when considering whether to seek to reduce the element of cross-subsidy. In such circumstances, it seems to me that it is legitimate to

> take into account the relative burdens placed upon the Employers as commercial competitors."

55. The Company relied on these paragraphs in support of the proposition that there was no paramount or standalone duty to act in the interests of all of the beneficiaries of the Scheme (particularly where groups of beneficiaries might have competing interests) and that the primary purpose of the Company was at all times to secure the benefits due under the Scheme. The Claimants did not dissent from this proposition as a matter of law or principle but they placed much greater emphasis on the overall purposes of the Scheme as set out in its constitutional documents.

D. The Scheme Rules

56. Rule 5.1 of the Scheme Rules provides that subject to certain exceptions a member shall contribute 8% of salary in respect of any period of membership after 1 April 2016. Rule 5.2 provides for the apportionment of contributions and rule 5.7 provides that the Company may require or permit a member to make contributions at a different rate. As I have explained, Rule 64 provided for the functions and constitution of the JNC. Rule 64.10 is headed "Cost Sharing" and it provides as follows:

> "If the trustee company determines, on actuarial advice, following an actuarial investigation under rule 76, that either an increase or a decrease in the aggregate contribution rate payable by employers is required towards the cost of benefits under the general fund, whether in respect of the cost of providing for such benefits for future service and/or in respect of the cost of remedying any deficit in the fund, the JNC shall decide how the cost of that increase, or the saving from that decrease, is to be addressed, either by increases or decreases in the rates of contributions payable under sub-rule 5.1 (Ordinary member contributions) and/or sub-rule 6.1 (Ordinary employer contributions) and/or by changes in benefits under the scheme. If the JNC does not agree, within the period allowed under sub-rule 76.4.2, how that cost, or that saving, is to be so addressed, the cost sharing arrangement under sub-rules 76.4 to 76.8 shall apply."

57. Rule 76 is headed "Actuarial Investigation" and consistently with section 224 it provides for an actuarial investigation and report by the actuary appointed for that purpose (the "**Scheme Actuary**") at intervals of not more than three years:

> "76.1 There shall be an actuarial investigation of the scheme by the actuary appointed for that purpose at intervals of not more than 3 years. Following each actuarial investigation, the actuary shall report to the trustee company

on the financial condition of the scheme and shall make such recommendations as the actuary shall think fit, including as to the contributions to be payable by the employers under rule 6 (Ordinary employer contributions).

76.2 The actuarial valuation and actuarial statement to be prepared by the actuary shall comply with Part 3 of PA 04 and be sufficient to enable the trustee company to comply with its obligations under that Part.

76.3 In the event of the actuarial investigation disclosing that an alteration in or addition to the scheme is desirable, the trustee company, in consultation with the JNC and in accordance with rule 79 (Amendment), shall take such steps as it shall consider appropriate to achieve such alteration or addition.

76.4 In the event that: 76.4.1 the trustee company determines on or after the effective date, on actuarial advice, following the actuarial investigation, that an increase in the aggregate contribution rate payable by employers is required towards the cost of benefits under the fund, whether in respect of the cost of providing for such benefits for future service and/or in respect of the cost of remedying any deficit in the fund; and 76.4.2 the JNC does not decide, within a period of 3 months from the date on which the actuary's report on the actuarial investigation under sub-rule 76.1 is received by the JNC, or such longer period as the trustee company may allow, how the cost of that increase is to be addressed under sub-rule 64.10; then, if an increase in the aggregate contribution rate payable by employers is required towards the cost of such benefits, the rate of matching contributions payable by the employers to members' DC accounts under sub-rule 6.3 is to be prospectively reduced to the extent necessary, as determined by the trustee company, to meet that increase.

76.5 If that rate of matching contributions is extinguished under sub-rule 76.4, the JNC will consider a reduction in the rate of contributions payable by the employers to members' DC accounts on salary in excess of the salary threshold under sub-rule 6.5, among other potential changes.

76.6 Before the JNC makes any decision regarding any such reduction in the rate of those contributions payable under sub-rule 6.4.2 or any other such change, there shall first be a consultation in accordance with sections 259 to 261 of PA 04.

76.7 Following any such consultation referred to in sub-rule 76.6, the JNC may decide that the rate of contributions payable under sub-rule 6.4.2 is to be reduced, so far as is necessary, as determined by the trustee company, to meet the increase in the aggregate contribution rate payable by employers required towards the cost of benefits under the general fund.

76.8 If, after the application of the relevant foregoing provisions of this rule, there remains an increase in the aggregate contribution rate payable by the employers required towards the cost of such benefits, or there is a decrease in that aggregate contribution rate so required and a consequent saving in relation to the cost of such benefits, that cost (or that saving) shall be shared in the ratio 35:65 between members and employers, so that: 76.8.1 35% of that cost (or that saving) shall be applied to increase (or decrease) the contributions payable by each member under sub-rule 5.1; and 76.8.2 65% of

> that cost (or that saving) shall be applied to increase (or decrease) the contributions otherwise payable by each employer under sub-rule 6.1, provided that nothing in rules 76.4 to 76.8 shall affect the powers of the trustee company under sub-rule 6.1 (Ordinary employer contributions)."

58. The Scheme Actuary appointed under section 47 of the Pensions Act 1995 is Mr Aaron Punwani FIA, chief executive officer of Lane Clark & Peacock LLP. Rule 76 (above) illustrates the importance both of the Scheme Actuary and the JNC in making benefit changes and changes to contribution rates.

59. Rule 79 is headed "Amendment" and it provides that the Company may by deed repeal, alter or add to the Scheme Rules. Subject to certain exceptions (which are not material to the present dispute) the Company has the power to change the benefit structure and rate of contributions subject to the written consent of the JNC. Rule 79.7 also provides as follows:

> "Where the JNC recommends to the trustee company any amendment of the rules, the trustee company shall, in accordance with this rule, take steps to implement the recommendation, unless it appears to the trustee company, acting on actuarial advice, to: 79.7.1 prejudice unfairly any one or more groups of members or former members when compared with another or other groups; 79.7.2 impose any unfair liability upon any one or more of the institutions or upon the trustee company; 79.7.3 be likely to result in HMRC having grounds to de-register the scheme under section 157 of FA 04; 79.7.4 be inconsistent with the constitution of the scheme as an irrevocable trust; or 79.7.5 be undesirable for any other reason which the trustee company shall notify in a reasoned written statement to the JNC."

III. The Claims

E. Claim 1: The 2020 Valuation

60. The Scheme's triennial valuation process had historically been initiated by the Company one to two years ahead of the valuation date and the process included a series of assessments and consultations which it would take into account in fixing the valuation assumptions. As a consequence, the statutory actuarial valuation as at 31 March 2014 led to the benefit changes which are set out in [4] (above).

61. For the consultation process before the 2017 statutory actuarial valuation the UCU instructed the First Actuarial group to produce a report on the technical provisions and in its report dated 17 November 2017 it expressed the views that the current contribution

rates were prudent and should be continued; that the likelihood that the Scheme could achieve the break-even return (i.e. the return required to fund the past service benefits without any additional deficit contribution) was high and well below the expected returns on equities and property; and that the Company's low risk approach gave rise to the prospect of a vicious circle which undermined the rationale behind it.

62. For 2017 the then Scheme Actuary produced a statutory actuarial valuation (the "**2017 Valuation**") showing that as at 31 March 2017 the total DB assets amounted to £60.0 billion and total liabilities to £67.5 billion producing a funding level of 89% and a shortfall of £7.5 billion. At that time employer contributions were 18% of a member's salary and member contributions remained 8% of salary.

63. After the 2017 Valuation the following changes were announced for the Scheme: removal of the 1% employer DC "match" with effect from 1 April 2019; a planned phased increase in employee contributions from 8% to 11.4% over the period up to 1 April 2020; and a planned phased increase in employer contributions from 18% to 24.2% over the period up to 1 April 2020: a total of 35.6%.

64. On 16 September 2019 the Scheme Actuary produced a statutory actuarial valuation as at 31 March 2018 (the "**2018 Valuation**") which showed that total DB assets amounted to £63.7 billion and total liabilities amounted to £67.3 billion producing a 95% funding level and a shortfall of £3.6 billion. Although there was a reduction in the estimated deficit under the 2018 Valuation, the following changes were announced for the Scheme with effect from 1 October 2019: employer contributions were increased from 21.1% to 23.7% from 1 October 2021; member contributions were increased from 9.6% to 11.0% from 1 October 2021: a total of 34.7% from 1 October 2021.

65. The Company was not required as a matter of law to carry out a statutory actuarial valuation under section 224 of the Pensions Act 2004 until the third anniversary of the 2018 Valuation, i.e. as at 31 March 2021. However, the Company chose to undertake a statutory actuarial valuation of the assets and liabilities of the scheme as at 31 March 2020 (the "**2020 Valuation**"). That valuation forms the basis of Claim 1.

(1) The Claimants' Case

66. In March 2018 and following industrial action the UCU and the UUK set up the Joint

Expert Panel ("**JEP**") which produced two reports in September and December 2019. The Claimants rely on the following passages from the second report and the JEP's statement that a failure to take forward its recommendations would mark "a failure for members, employers and the sector":

> "[T]he valuation, whilst important, is only one part of the overall stewardship of the Scheme. Of much greater importance is the process that underpins the valuation and the governance of the Scheme itself. It is these which drive the culture and tone of the interaction between the Stakeholders and therefore the way in which the valuation is conducted, and its outcome enacted.
>
> Currently in USS, it appears to be the other way around: the valuation and its methodology drive all else, including the relationship between the Stakeholders and between the Stakeholders and the Trustee. As we said in our first report, this leads to a valuation outcome which is 'test-driven'. The relationship issues appear to be reinforced by the Scheme Rules which do not foster a cooperative environment within which the Stakeholders can work well together."

67. On 1 March 2021 the Scheme Actuary issued a report under Rule 76.1 setting out his recommendations in respect of future contributions and considered three separate scenarios based on differing levels of employer covenant support. (The Claimants rely on an earlier draft provided to TPR on 18 February 2021 but nothing turns on this.) On 3 March 2021 the Company issued an update (the "**3 March Update**") which provided a summary of the three separate scenarios and illustrative examples of potential benefits. The Claimants' pleaded case in relation to the 3 March Update is as follows:

> "68. The Company's Update on the 2020 Valuation dated 3 March 2021 states that *"...market conditions in early 2020, and their impact on the Scheme's funding position, is something we would have had to address even if we had not already made a commitment to hold a 2020 valuation. A valuation would have been required by 31 March 2021 at the very latest in any event."*
>
> 69. The Update predicted a technical provisions deficit of between £14.9 and £17.9 billion depending upon the three scenarios previously outlined in the draft Rule 76 report and proposed that, to remedy this, contributions must rise, or a deficit reduction plan through cuts to benefits is necessary. In summary the Company proposed inter alia that: a. Under scenario 1, with deficit recovery contributions assumed to be 19.2% of pay, it was "*difficult to envisage any meaningful defined benefit pension being provided under the hybrid structure"*, with the result that members would only have defined contribution entitlements. b. Under scenario 2 "*Very significant changes would be required to both the defined benefit and defined contribution elements to maintain total contributions at 30.7%."* e.g. reduced the defined benefit salary threshold from £59,000 to £40,000. c. The accrual rate for career average salary could be reduced from 1/75 to 'between 1/155ths and

> 1/170ths' (under Scenario 2) or "between 1/100 and 1/115ths" (under Scenario 3).
>
> 70. Misleadingly, the Update went on to state: *"In sharing these illustrations, we are not proposing a view on the most appropriate response in terms of contribution rates or benefit changes. These are primarily matters for UUK and UCU via the JNC."* (p.18)
>
> 71. By setting out alternative scenarios all of which cut pension benefits, the Directors framed the choice between options all of which were prejudicial to the interests of active members while ignoring the relevant consideration that Scheme assets had recovered from March 2020 to March 2021 to such an extent that assumptions on which the proposals were based no longer existed (even if they ever had been).
>
> 72. Contrary to the statement in the 3 March 2021 briefing, the Directors have apparently ignored the post 31 March 2020 Scheme experience documented in the Company's monthly Financial Management Plan Monitoring report (which is used by the Company to track the financial development of the Scheme) whereby the assets of the Scheme had more than recovered to the pre-pandemic level been completely restored, and more. According to the Scheme's FMP Monitoring bulletin of July 2021, the assets of the pension scheme by July 2021 had risen from £66.5 billion in March 2020 to £87.8 billion in July 2021: a rise of £21.3 billion: *FMP Monitoring – End July 2021.* This would largely if not completely remove the estimated £17.9 billion future deficit (in its worst-case scenario) This is contrary to the Company's approach in response to adverse market movements in October to December 2018 which the Company took into account when valuing the Scheme in January 2019 as at March 2017."

68. On 3 March 2021 the Company also produced a briefing headed: "Why we decided to proceed with the 2020 valuation" (the "**3 March Briefing**"). It stated that when the Company filed the 2018 Valuation in the autumn of 2019 it had made a commitment to carry out another valuation in 2020. The Claimants rely on the following passage and footnote 2 from the briefing:

> "Firstly, TPR expressly cautioned trustees of schemes with valuation dates on or around 31 March 2020 against 'cherry-picking' more favourable dates in its 2020 Annual Funding Statement."
>
> "Trustees should consider very carefully why they believe [changing the valuation date] is in the best interest of their members and the impact of any such change on member security, for example if the current conditions prevail for a long period. If they decide to change the valuation date they should do so having <u>obtained and considered legal and actuarial advice</u>, and consider taking account of changes in the investment markets and employer's covenant since the new date of the valuation. <u>Trustees who take this decision can expect us to question their reasons for the change</u>." (Emphases added.)"

69. On 30 September 2021 the Scheme Actuary issued the 2020 Valuation and Mr Galvin signed the statutory statement of funding principles under section 223 on behalf of the Company. The Claimants' pleaded case in is as follows:

> "79. On or about 30 September 2021 the 2020 Valuation was finalised. In the process of finalising the 2020 valuation in September 2021, the Company has assumed a discount rate of 0.29% growth in assets above CPI inflation for the next 30 years. 80. Contrary to various statements made previously, post-evaluation date experience was not considered in the Schedule of Contributions finalised on 30 September 2021 prepared pursuant to section 227 PA04 where the Scheme Actuary says in his concluding notes: "*Furthermore, I have taken no account of either adverse or beneficial outcomes that have become known to me since the effective date of the valuation*."

70. On 26 October 2021 the Claim Form was issued. By that stage the Company had already proposed that employer contributions should increase from 21.1% to 21.4% and member contributions should increase from 9.6% to 9.8%. The Claimants also relied on illustrations showing that proposed benefit changes would reduce the predicted annual pension of employees aged between 37 and 51 and currently earning between £30,000 and £70,000 by between 10% and 18%. The Claimants then allege as follows:

> "81. In the circumstances, at all material times since at least 2018 the Directors have:
>
> A. Decided to maintain an "as at" 30 March 2020 valuation date despite: A.I. the absence of any legal need for a valuation as at this date; A.II. the unprecedented circumstances of the pandemic and its consequences on the performance of the stock market; A.III. the rise in asset values which occurred immediately after 30 March 2020.
>
> B. Assumed for the purposes of the proposed 2021 Valuation a reduced real future asset returns which offsets the asset value increase which had the consequence of inflating the funding deficit,
>
> C. Assumed in the valuation methodology that growth of assets would be 0.0% above CPI for 30 years without covenant support, increasing to 0.2% above CPI with covenant support assumed in the technical provisions consultation document, ignoring the relevant consideration that the Scheme assets had grown 32% in 16 months, namely from £66.5 billion in March 2020 to £87.8 billion in July 2021,
>
> D. Recommended to the JNC that it must impose contribution rises unless cuts were made to the defined benefit pension and accrual rates, ignoring the impact that this would have on members' entitlements, employers or the Higher Education sector, and that the burden of funding the cost of past service benefits would fall on new or existing members with ongoing service.

E. Failed to design a valuation methodology that protects and is in beneficiaries' best interests.

F. Failed to implement the recommendations of the final JEP report set out above including the reform of valuation governance.

G. Failed to have regard to the fact that the level of assumed risk must be reasonable and prudent having regard to the objective of providing an affordable but secure financial future for members and their families.

H. Adopted an imprudent assumption as to likely rates of return with the consequence that greater contributions are required by employers and members to maintain existing benefits or benefits reductions are required to avoid contribution increases.

I. Ignored the fact that short-term and long-term perspectives are important and ignored that, as a scheme not closed to future defined benefit accrual, the Scheme is relatively immature for funding perspectives.

J. Ignored the fact that intergenerational fairness is paramount in determining what, if any, contributions increases should be considered and whether benefit reductions are required to contain cost.

K. Ignored the fact that it was possible to avoid raising contribution rates and reducing benefits by i) adopting reasonable assumptions as to investment returns, ii) making allowance for the unprecedented circumstances of the pandemic and/or iii) the subsequent investment performance of the Scheme and asset recovery since March 2020.

L. At all times been apparently concerned primarily with the fact that TPR could be expected to question the Company's reasons for the change of a valuation date and/or actuarial assumptions ignoring the facts that the question is one for the Company's independent judgment which could be justified on legal, economic, actuarial and other grounds having regard to the following: L.I. adhering to a 31 March 2020 valuation and failing to update for experience would have profound long-term consequences for members; L.II. the sponsoring employers have an interest in retaining employees and maintaining security in retirement for employees; L.III. increasing contributions is likely to lead to more employees opting out and more employers from exiting the Scheme thus increasing the funding strain on remaining employees and/or employers.

82. By reasons of the matters set out above, the Directors and the shadow director have acted in breach of statutory and/or fiduciary duty:

Particulars

A. Acting beyond their powers by ignoring relevant considerations and/or taking into account irrelevant considerations.

B. Failing to act in good faith in the way most likely to promote the success of the Company.

C. Failing to exercise independent judgment.

D. Fettering their discretion by committing in advance to an as-at 31 March 2020 valuation date.

> E. Failing to revisit the committal to an as-at 31 March 2020 valuation date.
>
> F. Failing to comply with Regulation 5 of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 by failing to justify the change from the method or assumption used on the previous occasion on which the Scheme's technical provisions were calculated by a chance of legal, demographic or economic circumstance.
>
> 83. The above breaches of statutory and/or fiduciary duty by the Directors have caused and will continue to cause the Company loss constituting the loss of assets and increased Scheme deficit identified in the as-at 31 March 2020 valuation, the need to recover such deficit, the loss of revenue as employers and members leave the Scheme and new members do not join, the loss of future investment return and other associated consequences of responding to this position."

71. In relation to Claim 1 the Claimants seek declarations that the Directors proceeded with the 2020 Valuation in breach of their statutory duties and an injunction to restrain them from implementing the benefit changes and contribution increases (which had not yet taken effect when the Claim Form was issued):

> "(A) Declarations that, by reason of one or most aspects of the conduct set out at paragraph 81 above, one or more of the individuals constituting the Second and/or Third Defendants has been in breach of statutory and/or fiduciary duty in one or more of the ways alleged at paragraph 82. (B) Declarations that such breach(es) have caused or will cause the First Defendant loss as alleged at paragraph 83. (C) An injunction preventing the Second and/or Third Defendants from taking steps to implement the proposed accrual salary threshold, accrual rate, cap on annual increases, and/or contribution increases."

(2) The Proposed Amendments

72. The amendments which the Claimants propose to make in the current draft of the Amended Particulars of Claim appear under the heading "Equitable Fraud, conflict and furthering one's own interests". Their case in relation to Claims 1 and 2 is as follows:

> "106. The breaches in relation to Claim 1 and Claim 2 constituted equitable fraud and/or an impermissible furthering of the Directors' interests for the following reasons.
>
> 107. The Directors' breaches listed at paragraphs 81 to 83 above were done with the aim of reducing future defined benefit accrual in the Scheme.
>
> 108. The improper use of the power of the Company as trustee to conduct and control valuations of the Scheme assets to achieve the above aim constituted equitable fraud. Pursuing a policy of reducing future defined benefit accrual under the Scheme to achieve a result that is discordant with the object of the

> Company is a misuse of the Directors' powers. It is to be inferred that the Directors pursued their own interests/benefits when undertaking the breaches at paragraphs 81 to 83 because no other explanation for their actions makes rational sense.
>
> 109. The Directors' actions at paragraphs 81 to 83 were perverse. The only rational reason why the Directors would want to project a large deficit in the Scheme ignoring substantial subsequent increases in the Scheme's assets was to force the JNC to cut the terms on which benefits would be accrued in future.
>
> 110. The reduction of future accrual in the Scheme was in the Directors' interests because: a. those Directors who are trustees of universities who participate in the Scheme have an interest in reducing the future potential liabilities of their university to the Scheme; b. a reduction in the rate of future accrual reduces the risk of TPR intervention in the Scheme and the consequences of such intervention on the Scheme and the Directors; c. Mr Galvin has previously expressed the view that "DB pensions in the UK have failed. This is not controversial." Especially in light of the fact that the Scheme is authorised by TPR as a master trust provider (a master trust being defined in the Pension Schemes Act 2017 as, inter alia, a scheme which provides money purchase benefits), the reduction in rates of future accrual is consistent with and in the furtherance of Mr Galvin's belief that defined benefit pensions are undesirable."

(3) The Claimants' Evidence

73. The Claimants relied upon the 2020 Valuation and the fact that the Directors proceeded with a statutory actuarial valuation at that date even though they were not required by law to do so. They also relied on the fact asset values had significantly increased between 31 March 2020 and 31 March 2021 and statements in the 3 March Update, the 3 March Briefing and the Statement of Funding Principles which appeared to suggest that the Company (and the Scheme Actuary) had not considered whether to change the valuation date and had taken no account of the increase in asset values.

74. The Claimants placed significant reliance upon the Company's Corporate Governance Framework Policy which was updated on 12 October 2021. Page 75 contained a job description for the Directors which summarised their duties and powers as follows (the "**Job Description**"):

> "As a director of the Trustee the principles of trusteeship impose certain fiduciary duties and responsibilities on the board and each individual director. TPR's Trustee guidance provides a general overview of the duties and responsibilities. These are broadly summarised below:
>
> • To act within the framework of the law and the regulatory requirements and in accordance with the Scheme Rules and other documents that govern the

> scheme;
>
> • To act in the best interests of members and beneficiaries. A duty to balance fairly the interests of different groups, to act impartially between different classes of beneficiaries (not necessarily to act equally) and to not act with any sense of "constituencies". Once appointed, all directors share the same responsibilities to the entire membership;
>
> • To pay benefits on time and correctly;
>
> • To act prudently, honestly and conscientiously, with the utmost good faith;
>
> • To take advice on technical matters and on any other matters with which the director is not fully familiar. Decisions should be taken only by persons with the right skills, information and resources needed to take them effectively;
>
> • To derive no personal gain from the scheme (other than as a member or where payments have been authorised by the board, such interest having been declared where known);
>
> • To invest and ensure the safe custody of the scheme's assets; and
>
> • To ensure that proper records and accounts are kept and that information is communicated and disclosed as legally required."

75. They also placed reliance upon the following statements as evidence that the purpose of the Directors in proceeding with the 2020 Valuation at depressed asset values was to prioritise the position of those members with accrued benefits:

> "Nobody underestimates the scale of the issues to be resolved in this valuation, but our duty as trustees – it is, indeed, our primary legal duty – means that our first priority is the security of our members' benefits."
>
> (Dame Kate Barker, 10 December 2020)
>
> "First and foremost, the trustee must ensure that the existing benefits to members can be paid: i.e. to ensure that the scheme is sufficiently well funded to secure the benefits due under the rules and to make these payments now and in the future."
>
> (2020 Valuation Principles for Decision Making)
>
> "Our **primary** objective and statutory duty as Trustee is to ensure that the benefits our members have already built up can be paid as and when they fall due……At the same time, we want to protect the sustainability of the Scheme; for it to remain affordable and open; for the benefits to remain valuable; and for contributions to be relatively stable. But this secondary objective can only be considered to the extent it doesn't conflict with our primary duty."
>
> (Methodology and risk appetite for the 2020 valuation)
>
> "We have been guided throughout this process by our primary legal duty to ensure that the Scheme can meet its obligations to pay the benefits that members have already been promised. We have also sought to ensure that contributions and investment strategies are appropriate for securing new

> promises."
>
> "As Trustee, our legal obligations and fiduciary duties mean our primary objective is to protect the benefits our members have already built up."
>
> "In an extreme downside scenario, we want to be in a position to move to a self-sufficiency approach to protect accrued benefits, should we decide it is necessary to do so. This is consistent with our primary objective and legal duty."
>
> (The consultation for the 2020 valuation)

76. Dr Davies exhibited to his third witness statement minutes of meetings and annual reports in which individual Directors appointed by UUK made declarations of interest that they were also members of the board of the Company. He also stated that the Directors had an incentive to minimise the risk of action against them personally by TPR, that there was a risk of harm to their reputations if investments went wrong and that they "had a strong interest to offload as much of the risk in the Scheme onto members as they can".

77. Finally, the Claimants relied on a statement made by Mr Galvin at an "away day" on 1 March 2019 that: "DB pensions in the UK have failed. That is not controversial." Dr McGaughey exhibited an email dated 2 March 2019 in which Professor Jane Hutton had reported this statement to Sir Andrew Cubie, the chair of the JNC. However, he also exhibited the minutes of a meeting of the board of directors of the Company on 16 May 2019 which record that Mr Galvin said that his statement had been taken out of context and that he was concerned that he had been misrepresented and his position undermined.

78. The Claimants had to recognise that their case against individual Directors was based on inference and in their Skeleton Argument they asked the Court to draw the following inference from the facts which I have set out above:

> "The Court is asked to draw an inference from the conduct of the Directors as detailed above. The inference that the Court is invited to draw is that the Directors wished to over-estimate the Scheme deficit in order to force the JNC to reduce rates of future accrual against the threat of marked contribution increases. No other explanation for the Directors' conduct makes sense."

79. Finally, I add that although the Company had not implemented any changes either to contribution rates or to the benefit structure when the Claimants issued these proceedings, the Company did not suggest that the changes which it has now implemented (and which I set out below) were materially different from those which the Claimants had already anticipated in the Particulars of Claim.

(4) The Company's Evidence

80. It was Mr Atkinson's evidence that as part of the 2018 Valuation process the Company made a commitment to carry out a statutory actuarial valuation as at 31 March 2020 after engagement with the UUK, UCU and TPR. He exhibited the relevant correspondence and his evidence was confirmed by the 3 March Briefing, which stated that the original reasons for the decision were to recognise TPR's concerns about the economic backdrop at the time and to give UCU and UUK the chance to consider the JEP's second report. This evidence was not challenged.

81. On 26 March 2020 a board meeting of the Company took place. Item 3.1 of the board minutes record that the 3 March Update was put before the board and a number of advisers (including the Scheme Actuary) joined the meeting to discuss it. Item 3.1.8 then records as follows:

> "The Board noted that the Joint Negotiating Committee ("JNC") had formally requested that the Board consider deferring the 2020 valuation. The Board discussed that:
>
> 3.1.8.1 Whilst the 2020 valuation was being undertaken earlier than a triennial valuation would be required under statute, given that (i) TPR had indicated that the 2018 valuation was on the cusp of the level of risk that TPR would consider unacceptable and (ii) the affordability threshold metric had been triggered, that if the Trustee was not currently undertaking a valuation it would be likely to conclude that it should consider undertaking one;
>
> 3.1.8.2 If the Trustee was not undertaking a full valuation as at 31 March 2020 it would still need to complete an actuarial report as at 31 March 2020 which would likely raise many of the same questions and issues as would need to be considered in the 2020 valuation;
>
> 3.1.8.3 If the 2020 valuation was deferred the Trustee would likely still need to consider taking actions in relation to potential change to its investment strategy or consider increasing contributions as a response to the current circumstances. The 2020 Valuation process would provide a more robust grounding for these considerations. It was observed that increasing contributions at the current time (for example by accelerating the contribution increases scheduled for October 2021) would increase short-term cash-flow pressure on employers so would appear not to be the most sensible course of action, especially if it was ultimately concluded that COVID-19's impact on the HE sector was short-term only. It was reported during this discussion, that Alistair Jarvis of UUK had informally indicated to Mr Galvin that UUK would prefer for the 2020 valuation to continue rather than the October 2021 contribution increases be accelerated;
>
> 3.1.8.4 There may be some risk that stakeholders could challenge the validity of undertaking the valuation as at 31 March 2020 because of the current

> market volatility and uncertainty as to the long-term outlook. The Board observed that it would be open to the Trustee to take account of post valuation experience and that rather than defer the valuation it may be preferable to extend the timetable for completing it. This would also give flexibility should stakeholders wish to have some additional time to discuss benefit reform;
>
> 3.1.8.5 TPR was due to make an announcement about schemes with a 31 March 2020 valuation date in early April and that it was therefore sensible not to take any decisions to defer the 2020 valuation until after that announcement; and
>
> 3.1.8.6 The Trustee should therefore continue to proceed with the 2020 valuation."

82. On 28 August 2020 the Company produced a consultation document for the 2020 Valuation (and the Claimants rely on a statement from it which I have set out above). It was intended for consultation with UUK, as the representative of the employers, but it also contains an explanation why the Company had continued to proceed with the 2020 Valuation. In the Foreword, the Directors repeated that they had given careful consideration whether to defer the 2020 Valuation but that it remained their position that they should continue with the valuation for the following reasons:

> "Proceeding as planned with the 2020 valuation allows us to pursue a calm and considered response to these unprecedented circumstances and a deteriorating funding position. The only other options available were increasing the employer contributions or other covenant support commitments to the Scheme or, if those were not available, considering the need to accelerate the de-risking planned under the 2018 valuation. The 2020 valuation will also reflect the significant work we have done since filing the 2018 valuation. In that time, we have carried out a comprehensive review of our methodology. We have reflected on both JEP reports. We have engaged extensively with our stakeholders on the approach we will take, the process we will follow, and the critical issues that need to be addressed. This is reflected in the proposals we set out here for consultation, as trailed in our Discussion Document: the dual discount rate (DDR) approach, the removal of 'Test 1', the covenant assessment, questions of risk capacity and appetite and the associated investment strategy."

83. In section 8 they set out the detailed assumptions which they had used to calculate the Scheme's technical provisions. They stated that there were investment management benefits from managing the Scheme's assets as a single portfolio but that they proposed to adopt the dual discount rate approach based on pre-retirement and post-retirement benefits. Table 8.2 contained the expected 30 year investment returns for the individual components of the portfolio and table 8.3 compared those with the analysis of the Scheme

Actuary. The conclusions which they reached were as follows:

> "Given the financial market conditions at 31 March 2020, and consistent with the regulator's recent guidance, both the pre- and post-retirement discount rates relative to gilts are higher than the Scheme Actuary would expect to recommend in more normal markets. The post-retirement discount rate of gilts+1% at 31 March 2020 is supportable due to the large credit spread on investment-grade corporate bonds on that date. Whilst not explicitly formulated as such, the post-retirement discount rate could be viewed as gilts+0.75% plus an additional allowance for this higher credit spread. The credit spread will vary over time but it is expected to fall from its elevated position at 31 March 2020. The pre-retirement discount rates we are consulting on reflect expected returns at 31 March 2020. These are higher relative to gilts than we would expect to use in more typical market conditions, including at both 31 December 2019 and 30 June 2020. This is due to the particular circumstances at that date. In deciding the discount rates to propose, we also took account of broader market practice. The Pensions Regulator publishes information on this annually in its analysis of scheme funding. Its analysis published in 2019 covers valuations with effective dates up to September 2017. See Appendix F for more information."

84. The Directors also stated that the discount rates which they had chosen to adopt had to be prudent under the Scheme funding legislation and that there was considerable uncertainty about levels of prudence as at 31 March 2020. On 3 March 2021 the Company later issued a separate briefing on prudence in the 2020 Valuation which provided the following additional explanation:

> "As we are using a dual discount rate approach for the 2020 valuation, there are actually two discount rates: one for valuing pension benefits after retirement and one for valuing benefits before retirement. This (along with other changes to the valuation methodology) makes it more challenging to compare prudence in the discount rate with past valuations. Nevertheless, we calculate a 'single effective discount rate' that averages the effect of both discount rates on all benefits. When viewed as a margin subtracted from our best estimate predictions, the impact of prudence in the discount rate on the TP liability in the 2020 valuation is very significant (around £15.4bn - £20.1bn). This corresponds to an 82% - 86% confidence level on the pre-retirement portfolio and 73% on the post-retirement portfolio. The range here reflects the indicative investment strategies being considered for the pre-retirement portfolio, as described in the Technical Provisions consultation document. Note that some of this prudence is essentially given back through the allowance for investment outperformance in the Recovery Plan (see below). No such allowance was made in the 2018 valuation."

85. In section 9 of the consultation the Directors addressed the potential range of technical provisions and stated that they intended to set them using a pre-retirement discount rate

of gilts +2.0% per annum. In table 1 they set out a potential range of technical provisions and contributions based on pre-retirement discount rates of between 2.0% per annum and +3.5% per annum and post-retirement discount rates of +1.0%. They then expressed the following view:

> "We have also considered the overall position of the Scheme as at 30 June 2020 in order to evaluate whether the 31 March position was a short-term, unrepresentative 'blip', and whether financial market changes since that date would result in a more representative improved position. If that were the case, there could be an argument for departing from normal practice and focusing the valuation discussions on the more recent figures. In practice, we have concluded that the deficit would be slightly larger on a like-for-like basis at 30 June 2020 than at 31 March 2020. This is because, despite asset markets recovering over this period, the outlook for future investment returns (derived from FBB analysis) has deteriorated. From 31 March to 30 June 2020, equity prices bounced back rapidly (recovering about two-thirds of the December to March loss), while government bond yields and credit spreads fell (so increasing bond prices). As a result, expected returns fell for both equities and bonds, due to higher starting prices for both and a weakened outlook for equities. We will continue to keep this under review but have decided to continue to focus the valuation discussions on the 31 March 2020 position. Overall, we believe we have taken a rounded approach to our choice of discount rates, reflecting a range of factors."

86. On 1 March 2021 the Scheme Actuary produced his actuarial report under rule 76.1 of the Scheme Rules (upon which the Claimants also relied). In section 3 he summarised the funding approach and the assumptions for determining the Technical Provisions. He recorded that the Company had determined to adopt the dual discount rate approach using one discount rate for benefits post-retirement (when members are pensioners) and another discount rate for benefits pre-retirement (for active and deferred members). He continued:

> "The dual discount rate approach does not drive the investment strategy, so the actual portfolio need not be a combination of the two notional portfolios. To be consistent with the actual investment strategy, the expected returns on the combined notional portfolios assumed for the dual discount rate approach must be no higher than the expected return for the actual investment strategy. After input from its investment advisors taking into account possible alternative views of covenant strength, the Trustee previously selected two alternative notional portfolios to underly the dual discount rate methodology which were described in the TP consultation document as the "40% growth assets" and "55% growth assets" options (where the percentage of growth assets refers to the investment portfolio as a whole)."

87. He stated that in the light of the consultation with UUK and discussions with TPR the Company had settled on three pre-retirement discount rates depending on assumptions about covenant support. He also stated that in each case the post-retirement discount rate would be gilts +1.0% per annum. He then stated:

> "Market conditions as at 31 March 2020 were unusual compared to periods both before and after that date on account of elevated credit spreads and lower equity markets. This helps to justify higher investment return assumptions (taking the discount rate and additional investment return assumptions together), relative to gilt yields at that date than would be derived on a consistent basis at other dates. For the purposes of monitoring the funding position going forwards it should not be assumed that the same discount rates relative to gilt yields would remain appropriate."

88. On 23 July 2021 the Company produced a further briefing considering the likely outcome of a 2021 valuation in response to requests both from UUK and UCU (the "**23 July Briefing**"). It recorded that the Directors had formed the view that they would not expect the outcome of a 2021 valuation to be materially different from the 2020 Valuation for the following reasons:

> "Market conditions at 31 March 2020 were extraordinary, fuelled by the initial impact of the COVID-19 pandemic on the global economy. But they were not universally negative for the valuation: asset prices crashed, which affected the deficit in respect of pensions already promised – but lower market prices meant the outlook for future investment returns was unusually high. We compensated for these extraordinary conditions in the 2020 valuation principally through the:
>
> • discount rate – higher than normal (compared with low-risk returns) but moderated prudently
>
> • proposed deficit Recovery Plan – significant, enduring investment outperformance over 18 years
>
> At 31 March 2021, conditions had broadly normalised in a manner that supports the 2020 decisions: asset prices had recovered (allowed for in the proposed Recovery Plan) but, partly as a consequence, the outlook for future investment returns had reduced (allowed for in the discount rates). This is effectively a form of 'smoothing' that is consistent with our Fundamental Building Blocks (FBB) model for expected investment returns. In other words, the adjustments we made to take account of the exceptional market conditions as at 31 March 2020 (again, a form a smoothing) have been validated by 'more normal' conditions. But this means the same adjustments would not automatically carry over. That is why we would not expect the outcome of a 2021 valuation to be materially different.
>
> **What has changed?**

> Our assets have increased in value, but so have our TP liabilities. Asset prices have recovered, but the outlook for future investment returns has correspondingly reduced. Nominal gilt yields have increased and the expected rate of improvement in members' life expectancy is slightly lower but market expectations for UK inflation are higher. We would expect to use a 'more normal' Recovery Plan."

89. On 31 August 2021 and 2 September 2021 the JNC passed a number of resolutions. They were supported by the UUK appointees, opposed by the UCU appointees and ultimately passed by virtue of the independent chair's casting vote. Mr Atkinson described these as the "**Autumn JNC Resolutions**" in his witness statement (as do I) and he described their effect in the following terms, namely, that they:

> "(a) approved a benefit changes specification which detailed changes to the benefit structure of USS including a reduced DB accrual rate, a reduction in the salary cap up to which DB benefits apply and consequential increase in the contributions being paid into the DC Retirement Investment Builder for those people in the relevant salary ranges, subject to any amendments required as result of the outcome of the necessary statutory consultation by the Institutions with the active members (that consultation being necessary under statute because of the proposed reduction of benefits);
>
> (b) approved that contributions rates would be payable by members and employers from 1 April 2022 as set out in the benefit change specification proposed by UUK, subject to the outcome of the statutory consultation with the members; and
>
> (c) recommended the execution of a deed of amendment setting out provisions restricting when an Institution could exit USS that strengthened the covenant supporting USS, subject to the benefit changes not being withdrawn".

90. On 30 September 2021 the Scheme Actuary produced the 2020 Valuation itself. In the opening paragraph he stated that the main purpose of the report as required by the Pension Act 2004 was to set out the results and outcomes from the valuation. He also stated that Scheme members would receive a Summary Funding Statement relating to the valuation in due course. He continued:

> "The Trustee is responsible for the choice of assumptions for the valuation and for then setting an appropriate level of future contributions (having taken actuarial advice from me), in consultation with Universities UK ("UUK"), the body nominated for these purposes under the Scheme rules to act as the representative of the employers who sponsor the Scheme. The Joint Negotiating Committee ("JNC") is responsible for deciding how any change to the required overall contribution rate will be addressed, whether by way of change to member and employer contributions, changes to the benefit

> structure, or both.
>
> The JNC has recommended changes to future service benefits to apply from April 2022, which in due course will be the subject of consultation with members. In parallel, UUK has confirmed that the employers will provide an enhanced level of covenant support to the Scheme (including a 20-year moratorium on employer exits, which would be replaced by an interim moratorium lasting a single valuation cycle in the event that the JNC recommendation is revoked by resolution of the JNC and not replaced by a further JNC recommendation by 28 February 2022). The Trustee has determined that different assumptions should apply dependent on whether or not a deed has been entered into effecting the recommendation of the JNC on or before 28 February 2022. This report covers both possibilities."

91. The Scheme Actuary then set out the summary of agreed contributions on the alternative bases that either the recommended changes to future service benefits were applied from 1 April 2022 or they were not. If they were to be applied, the employer contributions were to be 21.4% of salary and member contributions were to be 9.8% of salary. If they were not applied, the employer contributions were to be 23.7% of salary rising to 38.2% of salary by from 1 October 2025 and member contributions were to be 11.0% of salary rising to 18.8% of salary from 1 October 2025.

92. In a section headed "Experience since the valuation date" he stated that he had considered the position as at 31 March 2021 on assumptions consistent with the Scheme's Statement of Funding Principles. He stated:

> "At this date expectations for future inflation were higher than at 31 March 2020. Gilt yields had increased, although expected returns relative to gilts on many asset classes were lower, and so the discount rates relative to gilts had decreased. The value of the Scheme's assets had also increased significantly. As a result, the technical provisions deficit was lower as at 31 March 2021 and the notional future service contribution rate was higher."

93. He then set out the position as at 31 March 2021 compared to the position as at 31 March 2020 in a table which I reproduce below (and on the basis that the Company entered into a deed of amendment giving effect to the Autumn JNC's Resolutions):

	31 March 2020	31 March 2021
Technical provisions (subject to JNC recommendation being implemented)		
Key assumptions		
CPI (single equivalent)	2.1% pa	2.5% pa
Pre-retirement discount rate	gilts +2.75% pa	gilts +2.45% pa
Post-retirement discount rate	gilts +1.0% pa	gilts +0.55% pa

Technical provisions	**£80.6bn**	**£86.2bn**
Assets	£66.5bn	£80.6bn
Technical provisions deficit	**£14.1bn**	**£5.6bn**
Self-sufficiency measure	**£102.0bn**	**£111.0bn**
Assets	£66.5bn	£80.6bn
Self-sufficiency deficit	**£35.5bn**	**£30.4bn**
Future service rate (revised benefits in line with JNC recommendation from April 2022) (% of Salary)	**24.9%**	**25.6%**

94. Below the table he also stated that the Company was aware of the position as at 31 March 2021 (as well as 31 March 2020) when it first provided the indicative contribution rate in relation to the new benefit structure and that the Company had continued to monitor the position:

> "The Trustee also adopted an interim monitoring framework which indicates that the technical provisions deficit as at 31 July 2021 was similar to that as at 31 March 2021, and the notional future service contribution rate at 31 July 2021 was higher than that as at 31 March 2021. This provides a directional indication of how the position has continued to change, although a full analysis of assumptions consistent with the Statement of Funding Principles has not been carried out at dates subsequent to 31 March 2021. I advised the Trustee that this is within the bounds of normal fluctuations which should be expected on a month-to-month basis and consequently the Trustee determined it was not necessary to revise its decision on the contribution rate."

95. On 30 September 2021 Mr Galvin also signed the schedule of contributions for the 2020 Valuation. It stated that if the Company entered into a deed of amendment reflecting the JNC Autumn Resolutions, then members' contributions would be 9.8% of salary and employers' contributions would be 21.4% of salary from 1 April 2022 to 31 March 2038 (subject to review following the next actuarial valuation). On 30 September 2021 the Scheme Actuary also signed a "certification of schedule of contributions" certifying the adequacy of the rates of contributions and adherence to the statement of funding principles (signed the same day). The penultimate paragraph of the notes to his certificate contained the note upon which the Claimants rely as evidence that he had ignored changes after the valuation date.

96. On 22 February 2022 the JNC resolved to confirm the proposed benefit reductions and to consent to a deed of amendment under Rule 79 (save for one minor point which remains subject to statutory consultation). On 24 February 2022 the Scheme Actuary

issued a note on the reform of the Scheme Benefits. He identified the changes and provided a brief commentary on their effect on members' benefits as follows:

(1) *Salary Threshold*: The salary threshold was to be reduced from around £60,000 per annum in the year to 31 March 2022 to £40,000 per annum in the year from 1 April 2022. Increases to the salary threshold on 1 April 2023 and 1 April 2024 would be capped at 2.5% per annum and there was to be no provision for increases from 1 April 2025 onwards. In isolation, the change had less impact on lower paid members.

(2) *Accrual Rate*: The accrual rate for the DB pension was to reduce from 1/75 to 1/85 (lump sum from 3/75 to 3/85). The change applied to all defined benefits and would have the same proportionate impact on all members. However, younger members with longer until retirement would be more affected than older members.

(3) *Inflationary Increases*: Increases to benefits before and after retirement (and increases in the salary threshold) would be capped each year at 2.5%, rather than the current higher cap, with some short term lifting of the 2.5% cap. All else being equal, this change would have a greater impact on younger members given their future pensions would expect to be more affected by future inflationary increases than for older members.

97. On 28 February 2022 the Company entered into a deed of amendment (the "**Deed of Amendment**") which gave effect to these changes and also to the increase in member contributions to 9.8%. Mr Short told me on instructions that on 1 April 2022 the Company implemented the provisions of the deed and that the changes to the benefit structure and contribution rates have now taken effect.

98. Mr Atkinson exhibited a letter from TPR to Dame Kate Barker as chair of the board dated 26 February 2021 which set out TPR's views on the valuation date and a Q&A regarding TPR's role in the process, which the Company published on the Scheme website. He also exhibited a letter dated 11 June 2021 from TPR to Dame Kate Barker showing that TPR was pressing for a higher contribution rate than the Company was prepared to agree. Mr Atkinson's evidence was that: "It is clear that, rather than simply act in accordance with TPR's wishes or directions, USSL took a very independent line."

99. It was also Mr Atkinson's evidence that although the Company did not agree with all of the JEP's recommendations, it is not plausible to suggest that the Company ignored them and he gave as one example moving to a dual discount rate. It was also his evidence that at all relevant times during the 2020 Valuation Process the Directors took detailed expert professional advice from the Scheme Actuary, from PricewaterhouseCoopers LLP on financial covenant strength, from EY-Parthenon on the economics of the higher education sector and from CMS on legal issues. USSIM also took independent actuarial advice from Mercer Investment Consulting. In relation to benefit changes Mr Atkinson gave the following evidence about the limited nature of the Company's role:

> "46. With regards to actuarial valuations, under the Rules the role of USSL as trustee is to commission a report from the Scheme Actuary and then determine whether any increase or decrease is required in the aggregate contribution rate. USSL does not have any power to amend benefits except in certain limited circumstances relating to minor elements of the defined contribution elements of benefits (none of which have been relevant in relation to the 2020 Valuation). Any proposed change to the benefits resulting from a valuation outcome is primarily a matter for the JNC in use of its powers under Rule 64.10.
>
> 47. Throughout the valuation process USSL has taken actions to assist the stakeholders within the JNC (UUK and UCU) by providing information, costings and assessment of whether particular proposals could practically be implemented. That has included providing examples of what benefit levels might be provided at example contribution levels (both employer and member) consistent with the valuation and what effect structural changes to the employer covenant might have on the valuation outcome. USSL was very careful to make clear that any information thus provided was in response to requests from stakeholders and did not reflect proposals from USSL itself; nor did USSL have any preference as to whether proposals from UCU or UUK might eventually be accepted by the JNC under its governance and then passed back to USSL as an exercise of the power under Rule 64.10."

100. Finally, it was also Mr Atkinson's evidence that the Company would incur additional liabilities of the order of £750m a year if the benefit structure was not changed (based on an assumptions basis broadly consistent with the 2020 Valuation). He also stated that if benefits accrue in line with the changes in the Deed of Amendment it would be possible to uplift those benefits if the Company took the view that they could have been provided on a more generous basis. This evidence was not challenged either.

F. Claim 2: Discrimination

(1) The Claimants' Case

101. It is the Claimants' case that the benefit changes which were proposed when the Claim Form was issued and then introduced by the Deed of Amendment indirectly discriminate against women, younger and black and ethnic minority members contrary to section 19 of the Equality Act 2010. They allege that the reduction in the salary threshold to £40,000 and the accrual rate to 1/85 have the following effect:

    (1) They will put women at a particular disadvantage because women will, on average, live appreciably longer than men, will have to fund more years of retirement and are more likely to have more risk of a pension shortfall than men because their DC pot will have to last longer on average.

    (2) They will put younger members at a particular disadvantage because they will, by definition, have longer until retirement and will suffer a greater reduction of DB entitlement and will be more reliant on their DC pot and thus assume more risk of a pension shortfall than older members in relation to future service. By contrast, older members will be less reliant on their DC pot which will constitute a smaller proportion of their overall pension entitlement.

    (3) They will put black and ethnic minority members at a particular disadvantage for the same reasons as women because they are statistically likely to be younger.

102. The Claimants also allege that the cap of 2.5% on any increase to benefit will indirectly discriminate against women, younger and black and ethnic minority members because it will exacerbate the effects of the threshold salary and accrual rate reductions and, in particular, will increase the risk that the pensions will not keep pace with increases in the cost of living.

103. Finally, the Claimants allege that these changes cannot be justified as a proper means of achieving a legitimate aim in relation to discrimination on the grounds of sex, age or race because there are less discriminatory measures which could be used to comply with the statutory funding objective and because there is no justification for reducing the deferred remuneration for new and existing active members (who are more likely to be female, younger, or black and ethnic minority). The Claimants then allege:

> "92. As the Company can only act through its agents, the changes are contrary to the Company's duty to act lawfully for proper purposes in accordance with the Scheme Rules and Articles and Memorandum of Association, subject to

> statute and have exposed the Company to claims of discrimination as set out above. There is no published evidence that the Company was considered the impact of the changes on different protected groups. This exposure to claims of discrimination and apparent failure to undertake an impact assessment is contrary to the interests the Company, both by exposing the Company to discrimination claims, and the absence of any indication that the Company has considered the impact of doing so. 93. By reason of the matters set out above, the introduction of each of the proposed salary threshold, accrual rate and cap on annual increases constitutes a breach of the Directors' statutory and/or fiduciary duties to the Company. 94. By reason of the above breaches of statutory and/or fiduciary duties, the Company has suffered loss from its exposure to claims by relevant Scheme members for indirect discrimination on the grounds of sex, age and/or race."

(2) The Claimants' Evidence

104. Mr McGaughey gave evidence about Claim 2 based on his experience as a union representative for the University and College Union at King's College London, where he had experience of action against unlawful discrimination under the Equality Act 2010 and international law. His evidence was as follows:

> "26. Across the university sector, the gender pay gap (average wages of men compared to women) was reported as 15.1% in 2019, while statistics are partial for the sector-wide ethnicity pay gap (average wages of white staff compared to black and ethnic minority staff). In the twenty-four 'Russell Group' universities, the ethnicity pay gap was reported to be as high as 26% in 2018…. 27. Across the UK as a whole, the gender pension gap (average male pension income compared to average female pension income) is approximately 40%, a figure that compounds the gender pay gap, and the fact that women tend to live approximately 4 years longer than men on average. We do not have data disclosed from the Company to determine what the gender or ethnicity pension gaps are in university pensions. 28. It is reasonably clear to me that the proposed salary threshold reductions, reduced accrual rates, and pension increase cap changes will have a particularly disparate impact upon female, younger and/or black and minority ethnic beneficiaries of the USS Scheme, compounding the existing inequality. This is true because: (A) less of the pension will be a defined benefit pension but rather a defined contribution pension, which runs out if people live longer; (B) women tend to live on average 3.9 years longer than men…….(C) in the case of younger beneficiaries, who are more likely to be black and minority members, the total benefits will be lower than for older beneficiaries who are further more likely to be white. 29. To my knowledge, the Company has neither conducted nor published an Equality Impact Assessment of its proposed changes. 30. The Company directors have failed to take into account both the relevant considerations of the particular disadvantages at which its proposals put women, young, and black and ethnicity members, and the exposure of the Company to claims for discrimination, to the detriment of all members."

105. Dr Davies also gave evidence that many employers had undertaken impact assessments including Bristol, Durham, Sussex and Loughborough. He exhibited the Durham impact assessment and quoted an extract. I set out the extracts from the impact assessment relating to the reduction in the accrual rate and salary threshold:

> "Negative impact across the board – negative effect on accruals. As detailed above, some groups who are more likely to be members will be more affected in terms of their accruals. For groups less likely to be members, the changes are likely to disincentivise joining. As the proposal reduces the amount of retirement income builder pension each member builds annually going forward, those with more service/closer to retirement will be less impacted. There is no direct discrimination as the proposals are the same for all. Also, the fall back position will likely exacerbate these issues to a greater degree. Therefore along with the considered financial necessity for reform, it may be possible to objectively justify indirect impact. However, as there are higher numbers of women than men in grades 6, 7, and 8, if this particular group is also proportionately younger than their male counterparts, they will potentially be more impacted by the changes due to the increased length of time that they will be accruing at a lower rate in comparison to their male counterparts. This combined with the salary threshold where reduction commences for the G8 earners, could disproportionately impact some women quite a bit, albeit indirectly."
>
> "The proposed reform will have a negative impact on all members earning over £40k per annum as they will build up a lower amount than with current provisions. At present, Durham University employs proportionally more men in higher earning positions (as detailed below) and therefore there will be a disproportionate impact. This is also likely to affect longer serving staff more in addition, in terms of those with a higher income. However, as there are higher numbers of women than men in grades 6, 7, and 8, if this particular group is also proportionately younger than their male counterparts, they will potentially be more impacted by the changes due to the increased length of time that they will be accruing at a lower rate in comparison to their male counterparts. This combined with the salary threshold The reduction which kicks in for the G8 earners, could disproportionately impact some women quite a bit, albeit indirectly. Conversely, those closer to retirement will be less impacted as there will a shorter period of time accruing on the lower rate of benefits. For groups less likely to be members, the changes are likely to disincentivise joining."

(3) The Company's Evidence

106. Mr Atkinson referred to Rule 79.7.1 which imposed a duty upon the Company to accept the recommendations of the JNC unless it would prejudice unfairly any one or more groups of members or former members when compared with another or other groups (or if one of the other exceptions in Rule 79.7 applied). He pointed out that Company

commissioned an impact paper which was presented to the Directors on 24 February 2022 and that the Company took actuarial and legal advice before implementing the benefit changes and contribution increases.

107. In his note dated 24 February 2022 which I used to explain the changes (above), the Scheme Actuary commented on the impact paper. Unsurprisingly, he stated that the calculations showed a reduction in benefits for future service with a bigger impact on pension. He also stated as follows:

> "There is a reduction of 17-25% in future service benefits for the sample members considered. Whilst the Trustee is taking legal advice on the way in which it should interpret "fairness" in this context, in our view this range does not indicate anything that on the face of it appears unfair between different groups of current active members from an actuarial perspective in relation to their future service. It is important to note that these figures are based on a range of assumptions, and the actual impact will only be known in the future, for example once the levels of future inflation are known."

108. The Company did not waive privilege in the legal advice which it received or the impact analysis which it had carried out. It was, however, Mr Atkinson's evidence that CMS advised the Directors that it would be reasonable to conclude that the amendments would not unfairly prejudice any group of members from a legal perspective and that this advice confirmed that the Directors could reasonably take the view that the proposed changes in the Deed of Amendment would not constitute illegal discrimination.

G. Claim 3: Costs and Expenses

(1) The Claimants' Case

109. As at 31 March 2007 the Company's total investment management personnel costs were £4,655,000, its total operating costs were £38,066,000, the Scheme's net assets were £30,358,100,000 and its total operating costs as a percentage of net assets were 0.125%. The Claimants compare this position with the position as at 31 March 2020 when total investment management personnel costs were £66,000,000 (an increase of 1318% since 2007), total Scheme overheads were £160,000,000 (an increase of 320% since 2007), the Scheme's net assets were £67,684,000,000 and total operating costs as a percentage of net assets were 0.236%.

110. The Claimants also rely on the fact that total operating costs rose from £9,752,000 in

1995 to £160,000,000 in 2020 (a 1540% increase and a relative increase in the Scheme's total operating costs as a percentage of the Schemes net assets from 0.099% to 0.236%) and also on the fact that individual salaries have increased. They single out the increase in the CEO's salary from £291,000 in 2013 to £756,700 in 2020 and the fact that it is related to performance under a long term incentive plan. It is the Claimants' case that these increases give rise to the following claim against the Directors:

> "99. By reason of the above, the increase in the total operating costs and/or investment management costs (including internal and external personnel costs) constitutes a breach of the Directors' statutory and/or fiduciary duties to the Company and/or is negligent to the personal advantage of the Directors. 100. By reason of the above breaches of statutory and/or fiduciary duties, the Company has suffered loss in the form of the significant total alternatively investment management costs, including personnel costs, paid since 2007. The increase in internal and external management costs is in breach of statutory, fiduciary or other duty harms the success of the Company and needs to be remedied and reversed by the Directors and shadow director. If costs were reduced to levels in comparable schemes, the discount rate, which includes an adjustment for investment costs, could be increased. If the saving from such reduced costs since 2007 had been invested on behalf of the Scheme, the returns would significantly set off the deficit identified by the Company and reduce the need for any change to the benefit structure of the Scheme."

111. The Claimants also propose to amend the Particulars of Claim to allege that the Directors generally and Mr Galvin in particular furthered their own interests by enjoying the benefit of these super-inflationary increases between 2007 and 2020 and that it was in the interests of the other Directors not to raise concerns about these increases because they were afraid of losing office. The relief which they claim is as follows:

> "(A) Declarations that one of more of the increases in costs set out at paragraphs 95 – 98 constitutes a breach on the part of one or more of the individuals constituting the Second and/or Third Defendant of their statutory and/or fiduciary duties to the Company and/or is negligent to the personal advantage of one or more of the individuals constituting the Second and/or Third Defendants as alleged at paragraph 99. (B) Declarations that such breach(es) have caused or will cause the First Defendant loss as alleged at paragraph 100."

(2) The Claimants' Evidence

112. The Claimants rely on the Directors' reports and audited accounts of the Company for the figures in 1995, 2007 and 2020. Dr McGaughey also gave evidence about the increase

in costs in his first witness statement:

> "34. While the Company is proposing to increase the proportion of the defined contribution pension, and shrink the guaranteed income (defined benefit) pension, which will require members to purchase more in annuity products, its total operating costs have also inflated out of all proportion compared to the Scheme assets. 35. This has funded a substantial rise in asset management personnel, expensive offices on 60 Threadneedle Street, and higher pay packages for the senior managers and Chief Executive Officer, while delivering cuts to the beneficiaries. 36. My understanding is that a corporate trustee is required to manage beneficiaries' money in the interests of beneficiaries, not itself or its directors and managers. A trustee corporation's directors are not entitled to benchmark their costs to commercial asset managers who may or may not owe fiduciary obligations to their clients, and who deal at arm's length from their clients. A trustee's core fiduciary duty is to act in the beneficiaries' best interests, not its own. 37. The escalating costs at USS amount to self-serving negligence to the advantage of the directors of the Company. This is conduct pursuing interests that directly conflict with the interests of beneficiaries."

(3) The Company's Evidence

113. Mr Gibb addressed Claim 3 in his witness statement. He exhibited a table showing that total operating costs for the year ended 31 March 2021 were £147m and 0.179% as a percentage of net assets and that the average between 2007 and 2021 was 0.197% (including both the year ended 31 March 2007 and the year ended 31 March 2021).

114. It was his evidence that the Company's costs were divided into two categories for management purposes: investment management costs (83%) and pension administration costs (17%). The first category consists of internal and external third party personnel overheads for about 70% of USS investments and investment management fees including performance fees (and custody fees) where it is cost effective to pay for external investment management services or specialist services. The second category consists of operational expenses and group costs including legal, finance, IT and other central services, the management of triennial scheme valuations and ongoing reporting of the overall position of scheme assets and liabilities. He stated that the Company incurs higher costs on pension administration because of the complex governance structure of the Scheme.

115. Mr Gibb also gave evidence that an important method by which the Company assessed whether it was managing costs effectively was by participating in independent

benchmarking against its peers and that over the last five years, benchmarking reports showed that the Company had been assessed as being on average 24%[1] less expensive than the median investment management costs of its peers. He also gave the following evidence about the Company's cost control framework:

> "22. The cost control framework is part of the annual business planning cycle for USS. The planning cycle culminates in the USSL Board approving a suite of strategic objectives over a three-year time horizon, focused on improving employer and member outcomes. The cost required to run USS and deliver these strategic objectives is included in the business plan, with the first year's cost base proposal forming the budget for that year. 23. As noted above, the USSL Board each year receives an assessment of the value for money performance of USSL. This review assesses whether the overall hybrid scheme delivers value for money taking several elements into account including performance under the CEM Benchmarking assessment. The review also considers additional elements including benchmarking of the DC element of the scheme performed by Redington (a specialist pension consultancy firm) against five commercial Master Trusts; costs as reported under the Cost Transparency Initiative (an industry standard for reporting institutional investment cost data) and a self-assessment for the overall hybrid scheme designed with Crowe LLP (a specialist provider of value for money assessments to the pensions industry)."

116. Mr Gibb gave several recent examples of changes made by the Company to reduce costs. He also explained the systems and controls which the Company used to control and monitor costs. Finally, he dealt with the CEO's pay and Directors' fees. The Company has published a Governance Supplement on its website explaining how the CEO and directors' pay is set and that the Company had adopted the Wates Principles published by the FRC in December 2018 to the extent that they apply to a pension scheme. His detailed evidence about the way in which Principle 5 is applied was as follows:

> "The Governance Supplement explains how Principle 5 is implemented for USS [DIG1/163]. In summary: (a) USSL's remuneration framework is designed to ensure it has access to the right mix of skills and expertise to deliver USSL's long-term priorities and value for money for USS members. (b) Given the importance of attracting and retaining high-calibre employees in a competitive talent pool, fair and competitive salaries in comparison with our peers are offered. (c) Annual benchmarking is performed on salaries and total compensation levels. Two external benchmarking agencies are used for this: Aon McLagan and Willis Towers Watson. (d) USSL has an established Remuneration Committee, which is a subcommittee comprised of USSL directors responsible for reviewing the approach to and all elements of

[1] Mr Gibb's original figure was 32% but Mr Short corrected it to 24% in his oral submissions. He made it clear that this was an arithmetical slip. But in any event the correction was in the Claimants' favour.

> remuneration for USSL employees and, in conjunction with the USSIM Remuneration Committee, for USSIM employees. Last year, the Remuneration Committee adopted a new remuneration policy to document the group's overall approach to remuneration and reward."

117. The Remuneration Committee consists of four Directors and at least one from the UUK and one from UCU. It considers and approves the structure of compensation and all long-term incentive plans for the Scheme's staff and is responsible for reviewing and making recommendations to the Directors on non-executive director remuneration within an overall cap set by the JNC and in accordance with the remuneration policies and total fees, which are published each year and approved by the JNC.

118. Finally, Mr Gibb gave detailed evidence about the approval process for Directors' fees (and the reference to Mr Purcell below is to Mr Kevin Purcell, Chief People Officer at the Company):

> "40. Mr Purcell has informed me of the following description of the approval process for director remuneration. In 2013, the JNC agreed a framework under which it set an overall fee cap for USSL director fees, with the USSL Board granted authority to determine the distribution of fees within that cap. The cap was revisited in 2016, with a JNC working group undertaking a review of fees and the time expectations of board members. The JNC proposed an increase in the aggregate cap to reflect an increase in expected time commitment from 24 to 30 days a year and for an increase in the cap by CPI (backdated to 2013). The JNC proposed the amendment, which the Remuneration Committee considered and recommended to the USSL Board for approval. Since 2016, the fee cap has risen in line with inflation but no further increases have been discussed by the JNC. 41. The Remuneration Committee recommends the distribution of fees within the cap set by the JNC for the members of the USSL Board to both the JNC and the USSL Board, each of which must approve the fee arrangements. The Remuneration Committee is responsible for performing an annual assessment as to whether to undertake a review of fees for USSL Board directors (among other things). After performing any review of such fees, the Remuneration Committee recommends any changes to the USSL Board and JNC, as appropriate. From time to time, the Remuneration Committee has requested a benchmarking exercise be undertaken. A substantive exercise was undertaken in 2021 with the Remuneration Committee concluding that director fees appeared to be in the range for a normal year against available benchmarking data, but on the lower side against comparable peers when taking account of current valuation workloads. To address that, a one-off payment of £2,600 was paid to directors and this fell within the agreed fee cap."

119. Dr Davies criticised Mr Gibb's evidence because details of the benchmarking were not provided and because there should have been much greater economies of scale. He

suggested that because of its size as the largest UK DB pension scheme, it should also be one of the most efficient. He dismissed the reduction in costs in 2021 and gave the following evidence about Mr Gibb's table and the remuneration which it paid:

> "33. The table in Appendix 2 clearly shows an increase in costs from 2007 and 2008, when comparable costs were 0.125% and 0.140%. Thus between 2007 and 2008 total operating costs, even as a percentage of assets, have increased 43% and 28%, respectively. These increases occurred even though the USS's assets have substantially increased over this period and economics of scale, and analysis by TPR suggests larger funds should more, not less efficient at reducing costs. Thus, Gibb's statement does not provide evidence to rebut our claims that costs have unjustifiably inflated over time."
>
> "34. Finally, at paragraphs 30 to 37, Mr Gibb describes how the USS decides CEO and director pay. Mr Gibb does not dispute our claim… that the directors allowed the CEO's pay to substantially inflate from 2015 to 2020 while performance has led to continual cuts to benefits. 35. In summary, Mr Gibb's witness statement supports our claim on costs, that the USS directors have overseen super-inflationary increases in operating, management and investment expenses."

H. Claim 4: Fossil Fuels

(1) The Claimants' Case

120. The Claimants allege that the Scheme continues to invest directly and indirectly in fossil fuels and that although it announced on 4 May 2021 that its ambition was to be carbon neutral by 2050, the Directors have failed to form an adequate plan to deal with the financial risks involved in such investments. The Claimants' primary case is as follows:

> "The Scheme's continued investment in fossil fuels without any or any adequate plan for divestment constitutes a breach of the Directors' duty pursuant to, and on a proper construction of, sections 171 and 172 CA06 to act for proper purposes, including making investments that avoid significant risk of financial detriment to the Scheme, the beneficiaries and the Company, and to promote the success of the Company having regard inter alia to the Company's long term interests."

121. The Claimants advance an alternative case that the Directors have failed to take into account a number of relevant considerations in failing to have a plan and that in the light of these considerations (which include the Paris Agreement in 2015, the results of an ethical investment survey in November 2020 and calls by the UCU and individual universities to sell the Scheme's investments in fossil fuels) the Directors are in breach of sections 171 and 172 of the Companies Act 2006 by failing to make an immediate

plan.

122. The Claimants allege that these breaches of duty have prejudiced, and will continue to prejudice, the interests and success of the Company and that the Company has suffered loss as a consequence. They seek the following relief:

> "(4) In relation to Claim 4: (A) Declarations that the absence of any or any adequate plan to divest from investment in fossil fuels is contrary to the interests of the Company as set out at paragraphs [103] – [106] constitutes a breach on the part of one or more of the individuals constituting the Second and/or Third Defendant of their statutory and/or fiduciary duties to the Company as alleged in paragraph 105. (B) Declarations that such breach(es) have caused or will cause the First Defendant loss as alleged at paragraph 106."

123. Finally, the Claimants propose to amend the Particulars of Claim to allege that the Directors have furthered their own interests by the alleged breaches of duty. Their amended case is that:

> "The Directors' breaches with regards to fossil fuels at paragraphs 101 to 105 above furthered their own interests. The Directors' actions put their own beliefs with regards to fossil fuels above the interests of the beneficiaries and the Company."

(2) The Claimants' Evidence

124. Dr McGaughey relied on two articles from the Financial Times and an empirical study from Imperial College London as evidence that fossil fuel companies have performed badly since 2017 and that renewable energy portfolios have consistently performed better since 2010. He also gave evidence about the Company's ethical investment survey in November 2020 and the Company's failure to publish its results. Dr Davies also made a witness statement in reply to Mr Atkinson's evidence (below), in which he asserted as follows:

> "46. The risks and costs associated with USS's fossil fuel investments were recently highlighted when USS reported it had £0.5bn investments in Russia... A significant fraction of these investments is Russian fossil fuel companies, such as Lukoil. USS announced it would sell or otherwise divest these investments, but this illustrates that their action was too late, and is likely to prove challenging given the ongoing war in Ukraine. 47. A group that is unrelated to the claimants, named USS Divest, has been lobbying USS to divest from fossil fuels since at May 2015. In October 2018, USS Divest emailed the USS directors about the risks associated with climate change, and

> received only one reply, from Professor Hutton. In March 2019, USS Divest sent a letter from 20 academics requesting details of the sources USS had used to assess climate change risk, how they had taken climate into account in their planning, and the financial justification for continuing to invest in fossil fuel companies. USS sent no reply. Now it is potentially too late, and the fund may face substantial losses exemplified by its investments in Russian fossil fuel companies. 48. Thus, Mr Atkinson's witness statement proves our fourth claim that the directors have failed and continue to fail to have a credible plan for divestment from fossil fuel investments. 49. Some of the Directors had interests or backgrounds in organisations with strong links to fossil fuel extraction and they had a particular conflict and a strong interest in not deviating from widely held views among professional pensions trustees, lest they risk future directorships in other organisations."

(3) The Company's Evidence

125. Mr Atkinson's evidence is that although the Directors have responsibility for overall investment strategy, the Scheme Rules provide for an investment committee and day to day investment management decision making is delegated to USSIM. He also described in some detail how the Company has considered it best to exercise its investment powers over the last 20 years. In 2001 it published a discussion paper called "Climate Change - A Risk Management Challenge for Institutional Investors" and it is a member of the Institutional Investor Group on Climate Change. This is an organisation of over 370 members providing a forum for European institutional investors to engage with policymakers on the long-term risks and opportunities of climate change, which the Company co-founded. It has also twice published voluntary "Taskforce for Climate Related Financial Disclosures" Reports ahead of the statutory introduction of such obligations.

126. The Company has taken legal advice from CMS which was published on the Scheme website in March 2020 so that members would understand the framework in which investment decisions are made. It replaced and updated previous legal advice which had been made public for the same reason. The Company's decision making is governed by a set of investment principles set out in a document dated 26 March 2020 and in April 2020 it made a statement dealing with its responsible investment and legal obligations and the extent to which this influences decision making. It also has a responsible investment strategy and produces responsible investment or Stewardship Code reports on a regular basis.

127. In answer to the Claimants' allegation that the Company has failed to make an immediate plan to divest itself of fossil fuel investments Mr Atkinson's evidence was as follows (excluding references):

> "59. Annual updates are provided to the Board on climate change matters, along with annual Board training provided by USSIM. The most recent training takes the view that divestment from certain investments is not an appropriate way to achieve net zero (divestment has limited impact on climate change because if USS sells an asset, another investor will necessarily buy it, such transaction therefore having little if any impact on the underlying company or its carbon emissions); rather USS will have to play is role in engaging with the assets and the markets in which it invests.
>
> 60. In May 2021, USSL announced its ambition to be Net Zero for greenhouse gas emissions from USS's £82bn investment portfolio by 2050 at the latest. In doing so it outlined why immediate divestment from certain industries was not in the financial interests of the scheme or therefore the financial interests of the members, as well as the importance of stewardship rather than immediate divestment. To help USSL achieve this target, USSIM has put in place interim targets by which to measure progress. Further developments have been published on the USS website, including changes to more than £5bn of assets under management and to introduce a climate tilt to a portion of the Global Developed Markets Equity funds held and, for short-term changes, detail of those interim targets themselves.
>
> 61. USSL also has policies on engagement and working with the companies in which it invests to transition towards carbon neutrality. By way of example, USSL co-ordinates activities with other large asset holders and one of the entities with which it has taken a lead over recent times is Shell. Pressure by way of engagement has led to Shell committing to take additional action on climate change, including a commitment to achieve net zero emissions.
>
> 62. USSL has on occasions excluded investments where it believes environmental, social and governance factors provide a reason to consider that holding those investments will be financially disadvantageous for USS. Specific actions have also been taken in recent years regarding divestments following long-term investment reviews. By way of example, in June 2020 USSIM announced its intention to divest from tobacco manufacturing, thermal coal mining and companies who have ties to the production of cluster munitions, white phosphorus and landmines. Divestment has been adopted here for the reasons stated in that announcement, and also where continued shareholder engagement had been assessed as not useful."

128. Mr Atkinson also explained that the member survey was undertaken on an academic basis as part of a collaboration with Maastricht University and that it was agreed that its results would not be published until October 2021 at the earliest and that the Company had intended to publish its findings this summer. However, he also exhibited a presentation showing that 4,000 members responded and a selection of their responses.

IV. The Issues

129. The Claimants submitted that the Court should approach each of the four claims by addressing the following three questions: (1) Is the instant claim (when properly analysed) a multiple derivative claim? (2) What is the applicable test for granting permission to continue a multiple derivative claim concerning a not-for-profit company limited by guarantee? (3) Is the applicable test met on the material before the court? I, therefore, analyse each of the four claims by asking and answering those three questions (as the Claimants have requested me to do).

V. Analysis

I. Claim 1: The 2020 Valuation

(1) Is Claim 1 a multiple derivative claim?

130. In my judgment, Claim 1 is not a multiple derivative claim and my first instincts to refuse the application on paper were correct. The Company submitted that it was not a multiple derivative claim because it has suffered no loss which is reflective of a loss suffered by the Claimants themselves. In their Skeleton Argument, counsel submitted as follows:

> "The substantive remedy sought is an order prohibiting the introduction of the new benefits regime, see PoC, prayer, at ¶¶1(C) and 2(D). That is, primarily, what the Claimants seek to achieve from these proceedings. Although these paragraphs are addressed to the Directors, the reality is that they are seeking to prevent USSL from implementing the changes. That is not, in substance, a remedy being sought "*on behalf of*" USSL, still less a remedy that can only be sought by USSL. In substance, it is a remedy being sought *against* USSL."

131. I accept that submission. The Claimants may well be worse off as a result of the benefit changes and the contribution increases which the Company has introduced by the Deed of Amendment. But it is difficult to see how the Company itself has suffered a loss by carrying out the 2020 Valuation. The exercise of commissioning the Scheme Actuary to prepare a valuation has not increased or reduced the Company's assets or liabilities. Likewise, it is difficult to see how the Company has suffered a loss by entering into the Deed of Amendment. Indeed, by doing so, it has reduced its potential liabilities by approximately £750m per year (on Mr Atkinson's evidence) and if the JNC had not consented to the Deed of Amendment, the Company would have increased the

contribution rates to cover its future liabilities.

132. But even if the Company could be said to have suffered a loss because, say, it will incur future losses as a result of an investment strategy governed by assumptions in the 2020 Valuation, that loss is not one which is reflective of a loss suffered by the Claimants. Although the benefit changes will lead to a reduction in the Claimants' entitlements, it will also lead to a reduction (rather than an increase) in the liabilities of the Company. Likewise, although the contribution changes will lead to an increase in the amounts which the Claimants and their employers will have to pay into the Scheme, it will also lead to an increase in the assets held by the Company not a decrease. It follows, in my judgment, that the Claimants do not have a sufficient interest or standing to bring a multiple derivative claim on behalf of the Company against the Directors.

(2) What is the applicable test?

133. That is sufficient to dispose of Claim 1. But in case I am wrong and the Company has suffered a loss which is reflective of the Claimants' own loss, I go on to consider issues (2) and (3). The Claimants submitted that in the case of a not-for-profit company limited by guarantee, the fourth exception is engaged where the directors have been guilty of fraud on a power in the wider equitable sense. They relied on the passage from *Estmanco* at 12F: see [38] (above). They also submitted that Sir Robert Megarry V-C had in mind the wider equitable doctrine set out by Lord Parker in *Vatcher v Paull* [1915] AC 372 at 378:

> "The term fraud in connection with frauds on a power does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power."

134. The Claimants submitted that the principle emerging from *Estmanco* is that where those in control of a non-trading company abuse their power to pursue their own interests or agenda (even if those interests are not pecuniary), this constitutes an exception to the rule in *Foss v Harbottle*. They cited *McDonald v Horn* (above) as authority that the beneficiaries of a pension fund could bring a claim for abuse of powers by analogy with a derivative claim.

135. In my judgment, there is no specific test for a not-for-profit company limited by guarantee and the Claimants must satisfy the Court that there is a prima facie case that they fall within the boundaries of the fourth exception set out in the authorities which I have considered (above). In particular, they must satisfy the Court that there is a prima facie case that the Directors have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the Company: see [43] (above).

136. Moreover, I am not satisfied that it provides much assistance to adopt the analysis of a fraud on a power even in the present case. *Estmanco* was an unusual case (as McCombe LJ pointed out in *Harris v Microfusion*). Moreover, it is not surprising that Sir Robert Megarry V-C analysed the council's conduct by reference to the equitable doctrine of a fraud on a power. In the same passage in *Vatcher v Paull* Lord Parker pointed out that perhaps the most common instance of a fraud on a power is where the appointor seeks to exercise the power to obtain a personal benefit:

> "Perhaps the most common instance of this is where the exercise is due to some bargain between the appointor and appointee, whereby the appointor, or some other person not an object of the power, is to derive a benefit. But such a bargain is not essential. It is enough that the appointor's purpose and intention is to secure a benefit for himself, or some other person not an object of the power."

137. If the Claimants cannot demonstrate that there is a prima facie case that the Directors committed a dishonest or deliberate breach of duty, then they must establish a prima facie case that they improperly obtained a personal benefit from their decision to continue with the 2020 Valuation or to enter into the Deed of Amendment. *Estmanco* is authority for the proposition that in exceptional cases the benefit in question need not be a direct financial benefit. But in my judgment, it goes no further.

(3) Is the applicable test met on the material before the Court?

(a) Prima facie case: the fourth exception

138. If I am wrong, however, about the scope of the fourth exception, I go on to consider whether there is a prima facie case on the facts that the Directors have committed a fraud on their powers (in the extended equitable sense). By their proposed amendments to the Particulars of Claim, the Claimants allege that the Directors have committed the breaches

of duty in paragraphs 81 to 83 (above) for the purpose of reducing future DB accrual in the Scheme and that this was an improper purpose.

139. Mr Grant relied on Article 71 and the Job Description for the proposition that the Directors had a duty to balance the interests of different groups of members and to act impartially between different classes of beneficiaries. He also relied on the public statements which I have set out in [75] (above) as evidence that the Directors did not do so but used their powers to prioritise the position of those members with accrued benefits at the expense of those members whose defined benefits would be reduced in the future.

140. The Company did not dispute the fact that the Directors treated active members and deferred members or pensioners differently or that they took a very different approach to accrued and future benefits. Indeed, Mr Short took me through the 2020 Valuation and the other financial evidence to show me both how the dual discount rate worked and that its function was to provide a more prudent investment policy for accrued benefits (even though the assets of the Scheme were administered as a single fund). He submitted that the primary purpose of the Scheme was to secure benefits to which members are already entitled under the Scheme.

141. I accept that submission. It is little more than a tautology to say that the purpose of the Scheme is to promote the interests of the beneficiaries. In order to establish the purposes of the Scheme (and, perhaps more importantly, their hierarchy) it is necessary to examine the statutory provisions governing the Scheme in greater detail. As the Company submitted, the first function of the Directors identified in the Job Description was to act within the framework of the law and in accordance with the Scheme Rules.

142. Section 222 requires the Company to secure the statutory funding objective at all times and section 223 requires the Company to set out in the statement of funding principles its policy for securing that statutory funding objective. Moreover, although Regulation 4(2)(a) of the 2005 Regulations expressly provides that the Scheme's assets have to be invested in the best interests of members and beneficiaries, Regulation 4(3) also requires the Company to exercise its powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the investment portfolio as a whole.

143. The views which Asplin J expressed in the *Merchant Navy Ratings Pension Fund* case is consistent with that analysis and her decision provides authority for the proposition that

the primary purpose of a pension scheme is to meet the statutory funding objective and to secure the benefits already due under the Scheme Rules. In my judgment, the statements in [75] (above) do not support a prima facie case that the Directors were acting for improper purposes but are no more than a reflection by the Chair and the Directors as a board of their statutory duties and the Court's guidance.

144. Furthermore, even applying the broadest interpretation of *Estmanco*, the Claimants accept that they have to establish a prima facie case that the Directors were pursuing their own ends or motivated by a desire to further their own interests. They invite the Court to infer that the Directors must have been acting for personal reasons because it was irrational and perverse to ignore substantial increases in the Scheme's assets after the 2020 Valuation date. In particular, they allege that the Directors nominated by university employers had an interest in reducing their universities' contributions and that all of the Directors were concerned to avoid the personal consequences of an intervention by TPR and the risk of harm to their reputations. Finally, they rely on the statement by Mr Galvin that DB pensions had failed.

145. The Claimants have failed to satisfy me that there is sufficient evidence from which to draw the inference that the Directors were pursuing their own ends or motivated by their own personal interests. Moreover, I am not satisfied that they have a real prospect of persuading the Court to reach that conclusion after a full trial with cross-examination. I say that for the following reasons:

(1) For the reasons which I develop below, the evidence does not support the factual premise upon which the pleaded inference is based, namely, that the Directors ignored the increase in the Scheme's assets between 31 March 2020 and 31 March 2021.

(2) Article 26(1) provides for the UUK to appoint four Directors and the potential for a conflict of interest is necessarily built into the composition of the board. The various declarations of interest which Dr Davies exhibited do not provide evidence that any of the Directors have preferred the interests of UUK or their individual universities over the interests of the Company. They show only that the individual Directors were aware of the potential conflict of interest arising out of their appointments and considered it necessary to declare it. This is unsurprising.

(3) Furthermore, it is not self-evident to me that the university employers will benefit significantly from the changes made by the Deed of Amendment. The Claimants did not explain what effect the change in the benefit structure would have on the employers' overall liabilities and Mr Short told me that they made contributions of 30.7% under the old structure and will make contributions of 31.2% under the new one. The marginal increase does not justify the inference which the Claimants invite me to draw.

(4) There is no dispute that the Directors consulted TPR and took account of its views. In the 3 March Briefing, for instance, TPR cautioned trustees with valuation dates on or around 31 March 2020 against "cherry-picking" more favourable dates. But the Directors were open about the consultation and TPR's views and what weight they attached to those views. Moreover, Mr Atkinson provided evidence of at least one occasion on which the Directors took a different view from the TPR and the TPR accepted their decision.

(5) I accept that I cannot determine on this application what Mr Galvin meant precisely when he made the statement "DB pensions had failed" on 1 March 2019. However, even if he had a personal agenda, the Claimants could point to no evidence that he used it to influence the decision-making of the Directors over the following two and a half years leading up to his signature on the Statement of Funding Principles.

(6) But even if the Directors or Mr Galvin felt under pressure or that there was a risk of criticism by TPR or the press or members themselves and this led to them being too cautious in their decision-making, this is insufficient in my judgment to engage the fourth exception. There is a world of difference between private concerns of this nature and the decision taken by the council in *Estmanco* to discontinue a claim to enforce the Company's contractual rights to further its own policy and at the direct expense of the purchasers.

(b) Prima facie case: the merits

146. I turn next to the Claimants' factual case on the merits. It is their case that the Directors ignored the experience of the Scheme after 31 March 2020 and, in particular, the increase in assets from £66.5 billion to £80.6 billion by 31 March 2021. It is also their case that the Directors should have taken into account changes in the investment market and

employers' covenant since the valuation date.

147. Considered in isolation the Claimants' evidence supported their case. The decision to proceed with the 2020 Valuation called for an explanation because of the increase of £14.1 billion in the value of the Scheme's assets between 31 March 2020 and 31 March 2021. Moreover, the quotations from the documents upon which the Claimants relied suggested that both the Directors and the Scheme Actuary were refusing to reconsider the valuation date or to take into account changes in the investment market.

148. The Company's case in answer was that not only did the Directors keep the valuation date under review but also that they considered the effect of changes in the market as at 31 March 2021. Moreover, the documents which Mr Atkinson put before the Court provided clear support for the Company's case. I say this for the following reasons:

(1) The commitment to undertake the 2020 Valuation was taken during the 2018 Valuation Process to recognise TPR's concerns and to give the UUK the chance to consider the JEP's second report. There was no challenge to this evidence and no criticism of the original decision.

(2) The minutes of the board meeting on 26 March 2020 record that the Directors considered the JNC's request to defer the 2020 Valuation but decided to proceed nevertheless. The minutes suggest that the Directors considered the relevant factors both in favour and against deferral. The minutes also record that the Directors observed that it would be open to the Company to take account of post valuation date experience.

(3) The Company's consultation document dated 28 August 2020 records that the Directors had been asked to consider deferral again but had decided to proceed for a number of reasons. It also provides evidence that the Directors had considered the overall position of the Scheme on 30 June 2020 to see whether the position on 31 March 2020 should be treated as a "short-term, unrepresentative blip" but had concluded that the deficit would be slightly larger on 30 June 2020 on a like for like basis.

(4) The 23 July Briefing provides evidence that before the 2020 Valuation was completed the Directors were specifically asked to consider a 2021 valuation by

the JNC but formed the view that the outcome of a 2021 valuation would not be materially different from the 2020 Valuation. They also gave a logical explanation why the increase in the value of the Scheme's assets did not change the overall position. Asset prices had recovered but the outlook for future investment returns had reduced, nominal gilt yields had increased but market expectations for inflation were higher.

(5) On 30 September 2021 the Scheme Actuary produced the 2020 Valuation. It is clear from the table which I have set out above that he compared the position at 31 March 2020 with the position at 31 March 2021. Although his comparison showed that the value of the Scheme's assets was £14.1 billion higher at 31 March 2021 and that the technical provisions deficit was £8.5 billion higher, the future service rate as at 31 March 2021 was 25.6% compared with 24.9% as at 31 March 2020. Again, the Scheme Actuary gave a logical explanation for this position in the extract which I have quoted immediately above the table.

(6) The Claimants rely on the quotation from the Scheme Actuary in the notes accompanying the Schedule of Contributions. However, it is clear that this statement was taken out of context. The Scheme Actuary stated that he had taken no account of either *adverse* or *beneficial* outcomes since 31 March 2020. He was saying that if he had taken into account both outcomes, the overall position might have been worse rather than better.

149. In assessing this evidence I adopt the approach of Morgan J in *Bhullar v Bhullar* (above). I have considered whether it would be wrong to assume that these documents would be accepted at trial and that it will require the trial judge to reach conclusions about the credibility of the witnesses. However, to do so the Claimants would have to satisfy me that they have a real prospect of persuading the trial judge that the documents exhibited by Mr Atkinson were inaccurate or misleading and that they were intended to create a false narrative or paper trail. In this respect, the Claimants allege that the Directors made a misleading statement in the 3 March Update by suggesting that they were not proposing to take a view about contribution rates or benefit changes which were primarily matters for the JNC.

150. After taking account of the Company's evidence the Claimants have not satisfied me that

this is an issue on which a full trial with cross-examination is necessary. I have reached this conclusion for the following reasons:

(1) In my judgment, the statement in the 3 March Update was not misleading. Although the three options which they put forward involved cuts in benefits, the Directors were correct to state that contribution rates and benefit changes were primarily matters for the JNC.

(2) I am not satisfied that the Claimants have any real prospect of persuading the Court that any other contemporaneous documents are inaccurate either. For instance, they would have to show that the 23 July Update is wholly inaccurate and that the Directors did not undertake an exercise to consider the effect of a 2021 Valuation at the express request of the JNC and did not arrive at the stated conclusions.

(3) The Company's case is supported by the conduct of a number of independent third parties. Although the decision to carry out the 2020 Valuation was one for the Company and not the Scheme Actuary himself, his valuation supports that decision. Moreover, the Directors and USSIM also took independent advice from a number of expert advisers and there is no evidence that they ignored that advice.

(4) The Claimants allege that the Directors ignored the JEP's recommendations. Although Mr Atkinson accepted that they did not agree with all of the JEP's recommendations, his evidence was that they did accept some of the recommendations and there is no plausible evidence that they ignored them altogether. The Claimants may be disappointed that the Directors did not agree with the JEP but in my judgment they have no real prospect of persuading the Court that this decision fell outside the ambit of the discretion of a pension fund trustee.

(5) Finally, there is no evidence to suggest that the Directors improperly influenced the Autumn JNC Resolutions or the JNC's subsequent decision to enter into the Deed of Amendment. Rule 64.10 conferred the power to decide whether to change the benefit structure on the JNC and Rule 79.7 required the Company to implement those changes (subject to certain constraints). The Claimants did not suggest that the Company had any grounds for refusing to implement the JNC's decision.

(6) I fully accept the Claimants' case that the Directors could exert influence over the

JNC by choosing what information to provide and how to present it. But the decision to change the benefit structure was ultimately one for the JNC and it split on UCU and UUK lines and the independent chair had to exercise a casting vote. The Claimants did not explain how the Directors' conduct influenced this outcome or how that conduct might have amounted to a breach of their statutory or fiduciary duties.

151. For these reasons, therefore, the Claimants have not demonstrated a prima facie case that the Directors were guilty of the conduct alleged in paragraph 81 of the Particulars of Claim. For the same reasons, the Claimants have not satisfied me that there is a prima facie case that the Defendants have committed any of the breaches of statutory or fiduciary duty alleged in paragraph 82. Although both parties provided with me with an exhaustive analysis of the law relating to the breach of sections 172 to 177 of the Companies Act 2006 in their Skeleton Arguments, it is unnecessary for me to repeat that analysis in this already lengthy judgment because I am satisfied that the Claimants have not made out a prima facie case on the primary facts which underpinned each breach of duty.

152. But even if I were satisfied that the Claimants had made out a prima facie case that the Defendants had committed one or more of those breaches of duty, the Claimants do not allege that those breaches were deliberate or dishonest. I have already found that there is no prima facie case that the Directors were acting for improper purposes and for their own personal benefit. It follows that the Claimants have failed to persuade me that there is a prima facie case on the merits.

(c) Discretion

153. Given my findings on stages (1) to (3) I can deal with the question whether it is appropriate to exercise the Court's discretion to continue Claim 1 very briefly. The Claimants submitted that any complaint to the Pensions Ombudsman or breach of trust claim was fraught with difficulty, that a complaint to the Ombudsman was not suited to a group or class action of this kind and that a court claim by a beneficiary would face considerable and practical hurdles. In his oral submissions Mr Grant emphasised that beneficiary claims are rare (as opposed to employer or trustee claims) and that the practicalities involved in trying to ensure that 470,000 members were properly

represented meant that I could not be confident that it would be straightforward or that the Claimants would be able to make or fund a claim.

154. CPR Part 19.3 provides that where a claimant claims a remedy to which some other party is jointly entitled with him, all persons jointly entitled to the remedy must be parties unless the Court orders otherwise. The Company submitted that the need to give other members of the Scheme the opportunity to be represented (an opportunity denied to them on this permission application) was a reason to refuse permission not to grant it. It also submitted that the use of interest-based representation orders is commonplace in pension cases, that it would not increase the number of parties but reduce the number of Defendants and that it would not introduce complexity or cost. Finally, the Company reminded me that TPR regulates the Company and drew an analogy with the Charity Commission: see *Abdelmamoud v The Egyption Association in Great Britain Ltd* [2018] EWCA Civ 879 at [36] (Newey LJ).

155. Both counsel are very experienced in pensions litigation and the practical insight which they have gained from that experience lent considerable weight to both of their submissions. But on balance I prefer the Claimants' submissions on this issue. If I had found that the other requirements for a multiple derivative claim were made out, I would have considered it appropriate to grant permission to the Claimants to continue Claim 1 and I would not have refused permission because the Claimants had alternative claims for breach of trust. In my judgment, the Claimants were not overstating the difficulties which they would have faced in pursuing a trust claim (and which they may still face).

156. The issue which gave me greatest concern was whether the Claimants should be permitted to avoid CPR Part 19.3 by bringing a multiple derivative claim. They are only two members of the Scheme and although they have been able to crowd fund this application and appear to have wide support, it was not possible for me to assess whether they represented the majority of members or how many competing interests, other members might have. As the Company submitted, there is no binary distinction between active members and deferred members or pensioners. Active members have accrued benefits as well as future benefits to come. It cannot be assumed, therefore, that a majority oppose the benefit changes.

157. Despite this uncertainty I would still have granted permission to continue the claim. If

the Claimants had been able to bring themselves squarely within the fourth exception to the rule in *Foss v Harbottle*, then the constitution of a company limited by guarantee clearly lends itself to wrongdoer control. Moreover, *McDonald v Horn* provides authority (if it is needed) that the Court could give permission to members to bring a multiple derivative claim in those circumstances.

J. Claim 2: Discrimination

(1) Is Claim 2 a multiple derivative claim?

158. A member would ordinarily bring a claim for discrimination in the Employment Tribunal and, if successful, the Company would be liable to pay compensation. The Company accepted that a member could also bring a claim in the civil courts (the High Court or the County Court): see *Abdulla v Birmingham City Council* [2012] ICR 1419. The difference between a claim before the Employment Tribunal and a claim in the civil courts is that the former is a costs neutral jurisdiction (except in limited circumstances).

159. Whether the Company faces claims from members in the Employment Tribunal or the civil courts, I am not satisfied that Claim 2 is a multiple derivative claim and for the same reason as Claim 1. Counsel put their case this way in their Skeleton Argument (and the words in italics are a quotation from the Particulars of Claim):

> "“*loss from its exposure to claims by relevant Scheme members for indirect discrimination on the grounds of sex, age and/or race*” This is entirely circular. The alleged loss to USSL depends upon claims being brought against the Scheme. If such claims can be brought, there is no need for a derivative claim. In any event, neither Claimant has suggested that he has any claims arising (or has been caused any loss) from indirect discrimination."

160. I also accept their submission in relation to Claim 2. If an individual member brings a claim in the Employment Tribunal or a civil court, the liability of the Company to pay compensation is not reflective of any loss which the individual member has suffered because he or she has a direct claim against the Company. Moreover, the chose in action represented by that claim is an asset not a liability or loss. It is nonsensical to suggest that the liability of the Company to the member gives rise to a reflective loss.

161. Equally, the liability of the Company to the individual member is not reflective of a loss suffered by the Claimants themselves or any of the other members of the Scheme. The

fact that the Company may have been in breach of the Equality Act 2010 and is liable to pay compensation to another member does not give, say, Dr McGaughey a sufficient interest to bring a claim against the Directors (and whether or not they have committed a breach of duty). The Claimants do not allege that there is any causal connection between the Company's liability to pay compensation to members for indirect discrimination and the benefits to which the Claimants are entitled under the Deed of Amendment. In this respect Claims 2 and 4 are to be contrasted with Claim 3.

(2) What is the applicable test?

162. The Claimants made the same submissions in relation to Claim 2 as they did in relation to Claim 1 and alleged that the Directors had committed a fraud on their powers (in the extended sense). In my judgment, the Claimants must satisfy the Court that there is a prima facie case that the Directors have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the Company for the reasons which I have set out (above).

(3) Is the applicable test met on the material before the Court?

(a) Prima facie case: the fourth exception

163. But in any event the Claimants have not satisfied me that they have a prima facie case that the Directors committed a fraud on their powers (in the extended sense) and, in particular, that they knew or believed that the benefit changes involved indirect discrimination and were prepared to tolerate it to further their own interests (whether by promoting the interests of their employers or reducing the risk of personal criticism against themselves).

(b) Prima facie case: the merits

164. I turn next to the Claimants' factual case on the merits. The Claimants allege that the benefit changes amount to indirect discrimination for the purposes of section 19 of the Equality Act 2010 which provides as follows:

> "(1) A person (A) discriminates against another (B) if A applies to B a provision, criterion or practice which is discriminatory in relation to a relevant protected characteristic of B's. (2) For the purposes of subsection (1), a provision, criterion or practice is discriminatory in relation to a relevant

> protected characteristic of B's if— (a) A applies, or would apply, it to persons with whom B does not share the characteristic, (b) it puts, or would put, persons with whom B shares the characteristic at a particular disadvantage when compared with persons with whom B does not share it, (c) it puts, or would put, B at that disadvantage, and (d) A cannot show it to be a proportionate means of achieving a legitimate aim. (3) The relevant protected characteristics are— age; disability; gender reassignment; marriage and civil partnership; race; religion or belief; sex; sexual orientation."

165. The Claimants have to establish that the benefit changes will put active members who have a protected characteristic at a particular disadvantage in comparison to other members of the same group who do not share that same characteristic. The Claimants allege that women, younger and black and ethnic minority members will be particularly affected by the reduction in the salary cap not because they form a higher proportion of the highest earners now but because women live longer than men and because women and black and ethnic minority members are at greater risk in the future than older members who have already accrued benefits for much longer with the benefit of the higher salary cap. The Claimants make a similar argument in relation to accrual rate.

166. The Claimants have adduced no statistical evidence of indirect discrimination. The Scheme Actuary's note dated 22 February 2022 and the Durham University impact assessment both made the obvious point that the reduction in the salary cap will have an immediate impact on higher earners. The Durham University impact assessment also made the equally obvious point that because there is a higher number of women in the lower employment grades, the combined effect of the benefit changes will have a greater impact on younger members because of the length of time over which they will be accruing benefits at a lower rate. Neither the Scheme Actuary nor the authors of the impact assessment were able to produce any figures to show the impact on either group (and this is hardly surprising given the varying ages of members and the different periods over which they have already accrued benefits and will do so in the future).

167. Moreover, even if they were able to show that younger members have suffered a clear disadvantage, the Claimants also have to satisfy me that it is right to compare the benefits of younger active members (who are more likely to be women and black and ethnic minority members) with older active members who have already accrued benefits at a higher rate (and are more likely to be men and white). The Claimants cited no authority in support of this proposition and the Company submitted that these matters do not

establish indirect discrimination for the following reasons:

(1) A comparison between younger members and older members who have accrued better benefits in the past is not indirect discrimination because the need for more money than your comparators (even when this is for physiological, social or historical reasons) does not establish the disadvantage required for indirect discrimination.

(2) Section 23(1) provides that on a comparison of cases for the purposes of section 19 there must be no material difference between the circumstances relating to each case. The comparison between future pension accrual and past pension accrual is not a permissible comparison for these purposes because there is a material difference between an employee who was accruing benefits in, say, April 1992 and someone who did not.

(3) Finally, the benefit changes represent a proportionate means of achieving a legitimate aim, namely, securing the statutory funding objective and the security of all benefits (including those earned in the future).

168. The Company relied on *R (Delve) v Secretary of State for Work and Pensions* [2021] ICR 236. Between 1995 and 2014 Parliament legislated to equalise the state pension for women with that of men by raising the state pension age for women. The Pensions Acts created a number of different cohorts of women including women born before 6 April 1950 who reached pensionable age at the age of 60 and women born after 5 October 1954 but before 6 April 1960 who reached pensionable age at 66. The Claimants, who were two women born after 5 October 1954, applied for judicial review of the legislation on the basis of indirect discrimination. The Divisional Court dismissed their application and the Court of Appeal upheld that decision on the basis that there was an insufficient causal connection to establish indirect discrimination. The Court gave a single judgment in which they dealt with this issue at [81] to [83]:

> "81…..The claimants' argument is that the causal link between the withdrawal of the pension and the protected characteristic is established because (i) the availability of the pension matters more for the wellbeing of disadvantaged members of society than it does for better off people, and (ii) people with a protected characteristic are disproportionately represented in the cohort of disadvantaged people, therefore (iii) it is indirectly discriminatory to deprive them of that benefit even though (iv) the criterion

> for access to that benefit is equally capable of being satisfied by people with and without that protected characteristic.
>
> 82. We do not accept that the causal link needed to establish a claim of indirect discrimination can be satisfied by that chain of reasoning. If it were, then there may well be other groups with a different protected characteristic combined with age who can also show that because they have suffered disadvantage in the workplace over the course of their lives, they are more reliant on a state pension than comparator groups and so were adversely affected to a greater degree by the increases in pension age since 1995. To say that it is unlawful not to provide a state pension to every such group would turn the state pension into something which it is not; another means-tested benefit. The state pension is not a means-tested benefit but is linked to payments of national insurance contributions over the course of the claimant's working life. There are other benefits provided which are means-tested, such as universal credit for those below the state pension age and pension credit for those above. These are the benefits designed to achieve a minimum level of income for poorer people; that is not the function of the state pension.
>
> 83. In our judgment, therefore, there is no sufficient causal link here between the withdrawal of the state pension from women in the age group 60 to 65 and the disadvantage caused to that group. The fact that poorer people are likely to experience a more serious adverse effect from the withdrawal of the pension and that groups who have historically been the victims of discrimination in the workplace are more likely to be poor does not make it indirectly discriminatory to apply the same criterion for eligibility to everyone, if that criterion is not more difficult for the group with the protected characteristic to satisfy."

169. The Company submitted that the Court of Appeal in *Delve* rejected the argument which the Claimants advance in the present case and that it is not indirectly discriminatory to reduce the benefits of all younger active members because people with a protected characteristic are disproportionately represented in that cohort of disadvantaged people. It submitted that there is no causal connection between the benefit changes and the protected characteristics because the benefit changes apply to all active members with and without the protected characteristics. If this did amount to indirect discrimination, then the Company would never be able to reduce the benefits of younger members (or, for that matter, increase them at the expense of older members).

170. I am not satisfied that the Claimants have demonstrated a prima facie case on the facts that the Company committed breaches of section 19 of the Equality Act 2010 or that the Directors committed breaches of their statutory or fiduciary duties when they decided to proceed with the 2020 Valuation or entered into the Deed of Amendment. In particular, I am not satisfied that the evidence which they have adduced would (if unchallenged at

trial) lead to the conclusion that the Company has been guilty of indirect discrimination.

171. But even if they had adduced a prima facie case of indirect discrimination, they have failed to satisfy me that they have demonstrated a prima facie case that the Directors acted in breach of their duties. In particular, they did not challenge Mr Atkinson's evidence that the Directors received advice that the benefit changes did not constitute illegal discrimination before entering into in the Deed of Amendment or explained why they were not entitled to rely on that advice. Finally, once they had received that legal and actuarial advice, Rule 79.7 imposed a legal duty upon the Company to take steps to implement the JNC's recommendation. Again, the Claimants did not explain how the Directors could be said to be acting in breach of duty by complying with the Rules.

172. I have considered whether I ought to accept Mr Atkinson's evidence even though the Directors chose not to waive privilege in the legal advice which they received or the impact assessment on which it was based. The Company is, of course, entitled to assert legal professional privilege in relation to that legal advice and I would not be justified in drawing an adverse inference from the failure to disclose it. But in the absence of any credible evidence that the Directors had turned a blind eye to discrimination to further their own interests, there is no basis to continue Claim 2 or to require Mr Atkinson (or any other witnesses) to submit to cross-examination.

(c) Discretion

173. For these reasons, it is not necessary for me to decide whether, as a matter of law, there was a sufficient causal connection between the benefit changes and the disadvantage suffered by younger members with other protected characteristics to amount to indirect discrimination. This is an important issue of law and it would not be appropriate for me to express a view on it on an application for permission to bring a multiple derivative claim.

174. Moreover, this is a strong reason why it would not have been appropriate to give permission on Claim 2. If individual members have claims for discrimination, it is far better that they should make them directly against the Company either individually or in group litigation. If the Company is found to have been in breach of section 19, the Company and its members can consider the position (including any potential claims for negligence against the Directors or their advisers) in the light of the findings made by the

Employment Tribunal or the Court.

K. Claim 3: Costs and expenses

(1) Is Claim 3 a multiple derivative claim?

175. Counsel for the Company accepted in their Skeleton Argument that the wrongful depletion of the Scheme's assets would involve a loss to the Company and potentially a reflective loss to members if the Scheme was unable to pay promised benefits as a result. However, they submitted that there was no reflective loss in the present case because the Claimants' pleaded case is that the costs which the Company should have saved since 2007 would have reduced the need for the benefit changes (if properly invested). They submitted that the Claimants' underlying concern was the impact on the accrual of active members which is not reflective of the Company's loss (even though there would be a causative link between the two).

176. I do not accept that submission. If the Claimants had been able to establish a prima facie case that the fourth exception applied and a prima facie case on the merits (which I consider below), then in my judgment the causal connection between the breaches of duty and the changes in the benefit structure would have given the Claimants a sufficient interest to bring a multiple derivative claim. I distinguish Claim 3 from Claim 1 on the basis that the wrongful depletion of the Scheme's assets would have resulted directly in a loss to active members.

(2) What is the applicable test?

177. However, even if I had accepted Mr Grant's submission that there is a wider test for not-for-profit companies limited by guarantee, I would not have held that it applied to Claim 3. Claims against directors for excessive directors' fees or remuneration are relatively common (although the vehicle for such claims is often an unfair prejudice petition) and such claims do not give rise to the exceptional circumstances considered in *Estmanco*. It follows, in my judgment, that in the absence of an allegation of deliberate or dishonest breaches of duty, the Claimants must establish a prima facie case that the Directors improperly benefitted themselves at the expense of the Company.

(3) Is the applicable test met on the material before the Court?

(a) Prima facie case: the fourth exception

178. The pleaded allegation is that individual Directors and Mr Galvin "enjoyed the benefit of the super-inflationary increases". This may well be true in the sense that Directors' fees and Mr Galvin's salary are included in the costs and expenses which the Claimants challenge. However, I am not satisfied that this allegation is sufficient to bring the Claimants within the fourth exception. The Claimants do not allege that the Directors or Mr Galvin used their control over the Company to confer benefits on themselves through increased fees or salary. It is this kind of conduct which engages the fourth exception: see the extract from *Daniels* (above) at [34].

179. But even if the pleaded allegation is sufficient to bring the Claimants within the fourth exception, they have failed to satisfy me that there is any evidence from which to draw the inference that the Directors and Mr Galvin have used their control of the Company in this way. I have summarised Mr Gibb's evidence or set out the key extracts from it (above). His evidence demonstrates that the policies and procedures which the Company have in place prevent the Directors and Mr Galvin from being able to control the levels of their own fees or pay which are either fixed by the Remuneration Committee or overseen by the JNC.

180. Dr Davies did not challenge any of this evidence in reply and Mr Grant did not challenge it in his oral submissions either. Dr Davies was left with the assertion that Mr Gibb's evidence supported Claim 3 because "the directors allowed the CEO's pay to substantially inflate from 2015 to 2020 while performance has led to continual cuts to benefits". I do not agree that this supports his case. He may not agree with the salary which the Remuneration Committee has awarded to Mr Galvin. But in my judgment, it was well within the power of the Directors to appoint the Remuneration Committee to fix his salary and well within their discretion to set it at the levels which they did after taking into consideration Principle 5, the Governance Supplement and the Company's remuneration policy.

181. Finally, Dr McGaughey referred in his evidence to the removal of Professor Jane Hutton from the board of Directors following the disclosure of Mr Galvin's statement that "DB pensions have failed". I have considered whether the treatment of Professor Hutton demonstrates a prima facie case that Directors raised no objection to salary increases for

fear of being removed. After taking account of the Company's evidence, however, I am not satisfied that her treatment justifies a full trial with cross-examination. The Claimants would have to demonstrate that there has been a "climate of fear" for six years (at least) and Mr Gibb's evidence about the corporate governance, procedures and policies adopted by the Company satisfies me that the Claimants have not met this threshold.

(b) Prima facie case: the merits

182. I turn next to the Claimants' case on the merits. It is their case that the increase in the total operating costs and investment management costs (including internal and external personnel costs) constitutes a breach of the Directors' statutory or fiduciary duties to the Company. Considered in isolation a comparison between the figures for the year ended 31 March 2007 and the figures for the year ended 31 March 2020 together with increase in salaries called for an explanation.

183. The Company's case in answer was that there were perfectly legitimate reasons for the increases in costs and expenses which did not justify the inference that the Directors must have committed breaches of their statutory and fiduciary duties. Moreover, the documents which Mr Gibb put before the Court provided clear support for the Company's case that there was no "super-inflationary" increase in costs. I say this for the following reasons:

(1) The Company submitted (and I accept) that the 2007 figure should be adjusted for inflation and after increasing that figure by the CPI, a comparable figure for 2021 is £56m. In 2021 the Company's assets were 2.73 times greater than in 2007 and if the costs in 2007 are multiplied by 2.73 the resulting figure is £152m.

(2) Mr Gibb's table of figures shows that since 2009 total operating costs have been approximately 0.200% of net assets with a spread between 0.172% (2010) and 0.236% (2020). In 2021 total operating costs were 0.179% of net assets.

(3) The Company has benchmarked its costs and expenses over the last five years and has been assessed as on average 24% less expensive than its peers. It also has other costs controls in place including detailed procedures for setting remuneration. Mr Gibb gave a number of other reasons for the increase in costs over time (including the greater expenses on corporate governance).

184. Again, adopting the approach of Morgan J in *Bhullar* I have considered whether it is necessary to test Mr Gibb's evidence by cross-examination and whether it will be necessary for the trial judge to reach conclusions about his credibility (or the credibility of other witnesses). However, the Claimants have not satisfied me that Claim 3 requires a full trial with cross-examination for the following reasons:

(1) The Claimants have not provided any particulars of the individual breaches of duty which they allege the Directors have committed. Their pleaded case is based solely on a comparison between the figures and the Company has now explained those figures.

(2) Dr McGaughey's original criticism was that it was improper for the Directors to benchmark their costs to commercial asset managers (who owe no fiduciary duties to their clients): see [112] (above). Again, the Company has answered this criticism by producing its benchmarking figures.

(3) Dr Davies is left asserting that the Company ought to have achieved greater economies of scale because of its size. But this is insufficient to demonstrate that any of the Directors have committed breaches of their statutory and fiduciary duties and I am not prepared to permit Claim 3 to continue in the hope that the Claimants may be able to find and plead better evidence on disclosure.

(4) The Company also points out that claims relating to the costs and expenses incurred between 2007 and 2016 are barred by limitation and that the Company has no claim in relation to them even though it is seeking declaratory relief: see *Woodeson v Credit Suisse (UK) Ltd* [2018] EWCA Civ 1103 at [21] to [24] (Longmore LJ). It also submits that changes in costs and expenses since 2016 have not been dramatic and can largely be explained as the result of increases in the assets under management.

(5) The Claimants did not explain why they chose to compare the costs and expenses in the year ended 31 March 2007 with the year ended 31 March 2020 other than because it offered the most unfavourable comparison. Moreover, they did not explain why the Company's claims in relation to other operational costs and expenses incurred more than six years ago would not be barred by limitation.

(6) I would be slow to accept that there is a limitation period for the recovery of the Directors' own fees (see section 21(1)(b) of the Limitation Act 1980). But I can see no reason why a limitation period of six years should not apply to the Company's claims in relation to other operational costs and expenses incurred before 2016 given that they were published annually in its audited financial statements.

(c) Discretion

185. For the reasons which I have set out in relation to Claim 1, I would have been prepared to give the Claimants permission to continue Claim 3 if I had been satisfied that there was a prima facie case that the fourth exception to the rule in *Foss v Harbottle* was engaged and they had been able to demonstrate a prima facie case on the merits.

L. Claim 4: Fossil Fuels

(1) Is Claim 4 a multiple derivative claim?

186. The Claimants allege that in breach of sections 171 and 172 of the Companies Act 2006 the Directors have continued to invest in fossil fuels without an immediate plan for divestment contrary to the Company's long-term interests. They also allege that this has prejudiced (and will continue to prejudice) the interests and success of the Company which has suffered and will continue to suffer loss in consequence. However, no further particulars of this loss are given. The Claimants do not specify which investments the Company should have sold or when or what the consequences would have been. Nor do they plead why the Company would have avoided those consequences if it had adopted an immediate plan for divestment or specify the plan which the Company should have adopted.

187. The principal evidential support for this case is Dr McGaughey's evidence that investment in fossil fuels "has caused significant financial detriment to the interests of beneficiaries in recent years". He does not claim to have any expertise in expressing this view and his evidence is based on a selection of Financial Times articles. In his most recent witness statement Dr Davies also asserts that the Company's decision to sell Russian fossil fuel companies was too late.

188. The first point to note about Claim 4 is that the Claimants allege that the Company has suffered a financial loss (or that it will do so). They do not allege that the Company had a duty to sell its fossil fuel investments for ethical reasons. This is no doubt because the Court rejected such an argument in *Cowan v Scargill* [1985] Ch 270 where Sir Robert Megarry V-C made the following three points at 286H-287B, 287G-288A and 288D-G:

> "I turn to the law. The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their _ best financial interests. In the case of a power of investment, as in the present case, the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects of the yield of income and capital appreciation both have to be considered in judging the return from the investment."
>
> "This leads me to the second point, which is a corollary of the first. In considering what investments to make trustees must put on one side their own personal interests and views. Trustees may have strongly held social or political views. They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views that they hold."
>
> "Third, by way of caveat I should say that I am not asserting that the benefit of the beneficiaries which a trustee must make his paramount concern inevitably and solely means their financial benefit, even if the only object of the trust is to provide financial benefits. Thus if the only actual or potential beneficiaries of a trust are all adults with very strict views on moral and social matters, condemning all forms of alcohol, tobacco and popular entertainment, as well as armaments, I can well understand that it might not be for the "benefit" of such beneficiaries to know that they are obtaining rather larger financial returns under the trust by reason of investments in those activities than they would have received if the trustees had invested the trust funds in other investments. The beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources."

189. The second point to note is that the Claimants do not allege that the Company should have sold its investment in fossil fuel companies overnight or that if it had adopted a

long-term divestment plan, it would have avoided any immediate losses as a result of its holdings in Russian fossil fuel companies or, indeed, in any other companies. Although there is a general allegation that the Claimant has suffered loss in the past the Claimants' pleaded case is primarily directed at the Company's future conduct.

190. The third point to note is that the Claimants do not allege that they themselves have suffered any financial loss as a consequence of the alleged breaches of duty. Nor do they allege that their views about climate change would give them a sufficient interest to continue Claim 4. They may disagree with the Directors' approach to investments in fossil fuel companies on ethical grounds and, in particular, with their view that divestment is not the appropriate way to reach net zero. But they have not put their case on the basis of those objections but rather that the Company has suffered a financial loss (or will suffer a loss) by holding these investments.

191. In the light of this analysis the Claimants have not satisfied me that there is a prima facie case that the Company has suffered any immediate financial loss as a consequence of the Directors' failure to adopt an adequate plan for long-term divestment of investment in fossil fuels. But even if they had been able to establish a prima facie case that the Company had suffered an immediate loss, they do not suggest that this is reflective of financial losses which they themselves have suffered. In particular, they do not suggest that there is a causal connection between the investment in fossil fuels and the benefit changes. In my judgment, therefore, the Claimants do not have a sufficient interest or standing to continue Claim 4.

(2) What is the applicable test?

192. In my judgment, the Claimants must satisfy the Court that there is a prima facie case that the Directors have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the Company in relation to Claim 4 in the same way as Claims 1 and 2.

(3) Is the applicable test met on the material before the Court?

<u>(a) Prima facie case: the fourth exception</u>

193. If I am wrong, however, about the scope of the fourth exception, the Claimants have not

satisfied me that they have a prima facie case that the Directors committed a fraud on their powers (in the extended sense). They have pleaded that some of the Directors have put their own beliefs above the interests of the beneficiaries and the Company. However, Dr Davies asserts in evidence that some of the Directors have acted to avoid the risk that they might risk future directorships in other organisations. These are different allegations and I am not satisfied that there is any evidence to support either of them.

(b) Prima facie case: the merits

194. Again, I turn to the Claimants' case on the merits. For the reasons which I have stated (above) I am doubtful whether the Claimants have raised a prima facie case in relation to Claim 4 on the basis of their evidence alone and it is quite likely that the Court would have struck it out under CPR Part 3.4(2)(a) on the grounds that there were no reasonable grounds for bringing it. However, after considering the Company's evidence and applying the *Bhullar* test (above) the Claimants have not satisfied me that Claim 4 requires a full trial with cross-examination.

195. As I have stated, Regulation 4 imposes a duty upon the Company to exercise their powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. It also provides that the assets must be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and so as to avoid accumulations of risk in the portfolio as a whole. Regulation 4 is consistent with the Court's approach in *Cowan v Scargill* and the Claimants did not submit that it was no longer good law.

196. Mr Atkinson's evidence which I have summarised or quoted (above) provides evidence that the Company has complied with Regulation 4 in exercising its discretion to continue its investment in fossil fuel companies. In particular, his evidence is that the Company has taken legal advice, conducted a survey of members, adopted an ambition of Net Zero by 2050 and policies for working with the companies in which it invests in the meantime. The Claimants may disagree with this ambition and these policies but in my judgment they were well within the discretion of the Company in exercising its powers of investment. Moreover, Mr Grant did not identify any policy or decision which amounted to a breach of Regulation 4 and I can see no reason to subject that evidence to cross-examination at trial.

(c) Discretion

197. But even if I had been satisfied that there was a prima facie case on the merits, I would not have exercised my discretion to permit the Claimants to continue Claim 4 but would have left them to pursue a direct claim for breach of trust. The Claimants have not sought an injunction to compel the Directors to adopt an immediate plan for divestment or specified what plan they should adopt and I am not satisfied that the Court would be prepared to grant declaratory relief in the vague terms sought in the prayer for relief or, indeed, that any useful purpose would be served by doing so. In relation to Claims 1 and 3 I recognised the practical difficulties which the Claimants would have in mounting a claim for breach of trust. But in relation to Claim 4 I am satisfied that the appropriate course would be to leave them to pursue a direct claim against the Company despite those difficulties.

VI. Disposal

198. For these reasons I dismiss the Claimants application for permission to continue all four claims. I also refuse the Claimants application for a Prospective Costs Order both in relation to this application and the claim itself. I stress that in refusing permission to continue the four claims, I have not decided whether the Company committed breaches of trust but only that the Claimants have not established that a prima facie case either that the Directors have committed breaches of fiduciary and statutory duty or that those breaches of duty fell within the fourth exception to the rule in *Foss v Harbottle*. I have not decided either whether benefit changes introduced by the Deed of Amendment amounted to indirect discrimination against younger members with other protected characteristics. It follows that nothing which I have decided in this judgment should be treated as determinative of direct claims which individual members may have against the Company.

VII. Postscript

199. On 6 May 2022 I circulated this judgment to the parties in draft. On 10 May 2022 they submitted an agreed list of typographical corrections which I have adopted in this approved judgment. By letter dated 10 May 2022 Mr Grant also wrote to me submitting that the draft judgment did not address the submissions which he had made on behalf of the Claimants. I invited Mr Short to respond to his letter and on 18 May 2022 he provided

with a note on behalf of the Company in response to the letter. By email dated 19 May 2022 Mr Grant made one further point on behalf of the Claimant.

200. In his letter dated 10 May 2022 Mr Grant submitted that I had not dealt with a number of his submissions and that he was following the guidance given by Lord Phillips MR in *English v Emery Reimbold & Strick Ltd* [2002] 1 WLR 2409 to a party who intends to seek permission to appeal on the grounds that the judge has failed to give adequate reasons. That guidance was as follows:

> "If an application for permission to appeal on the ground of lack of reasons is made to the trial judge, the judge should consider whether his judgment is defective for lack of reasons, adjourning for that purpose should he find this necessary. If he concludes that it is, he should set out to remedy the defect by the provision of additional reasons refusing permission to appeal on the basis that he has adopted that course. If he concludes that he has given adequate reasons, he will no doubt refuse permission to appeal. If an application for permission to appeal on the ground of lack of reasons is made to the appellate court and it appears to the appellate court that the application is well founded, it should consider adjourning the application and remitting the case to the trial judge with an invitation to provide additional reasons for his decision or, where appropriate, his reasons for a specific finding or findings. Where the appellate court is in doubt as to whether the reasons are adequate, it may be appropriate to direct that the application be adjourned to an oral hearing, on notice to the respondent."

201. In his note Mr Short reminded me that a party should only ask the judge to reconsider their conclusions in exceptional circumstances. He drew my attention to *Egan v Motor Services (Bath) Ltd* [2008] 1 WLR 1589 where Smith LJ confirmed that it is only permissible in exceptional circumstances to ask the Court to reconsider a point:

> "49. I wish to add a few words to deprecate the practice which was adopted in this case of counsel writing to the judge, after a draft judgment has been provided, to ask him to reconsider his conclusions. It is a growing practice and in my view it should happen only in exceptional circumstances. 50. The purpose of the judge providing a draft of the judgment before hand down is to enable the parties to spot typographical, spelling and minor factual errors which have escaped the judge's eye. It is also to give the parties the opportunity to attempt to reach agreement on costs and to consider whether they wish to appeal. Consideration of such matters before hand down can save costs. Circulation of the draft is not intended to provide counsel with an opportunity to reargue the issues in the case. 51. Only in the most exceptional circumstances is it appropriate to ask the judge to reconsider a point of substance. Those circumstances might be, for example, where counsel feels that the judge had not given adequate reasons for some aspect of his/her decision. Then it may be appropriate to send a courteous note to the judge

> asking him/her to explain the reasons more fully. By way of further example, if the judge has decided the case on a point which was not properly argued or has relied on an authority which was not considered, the appropriate course will be to ask him/her either to reconvene for further argument or to receive written submissions from both sides. Letters such as the one sent in this case, which sought to reopen the argument on a wide variety of points, should not be sent."

202. Having considered the submissions of the parties I have made two minor changes to the draft judgment at [36] and [165] (above) to better reflect the Claimant's submissions and in both cases Mr Short did not object. But apart from those changes, I am not satisfied that this is a case in which I failed to give adequate reasons and that I should reconsider my judgment. Indeed, most parties and many judges will consider it far too long to deal with an application for permission to bring a derivative claim after a one day hearing. However, out of deference to the careful submissions of Mr Grant and the importance to the parties I have reconsidered each of Mr Grant's criticisms of the draft judgment.

(1) Sufficient Interest

203. Mr Grant submits that it was the Claimants' case that it was unnecessary for the Claimants to establish that the Company has suffered a loss because it is the only person who could bring the claims. However, the Claimants' pleaded case was that the Company <u>had</u> suffered financial losses and I did not understand him to be submitting that I should permit the Claimants to continue to the claim even if I was satisfied that it had suffered no loss: see, e.g, the Claimants' Skeleton Argument at ¶5(e) and the reference to "multi billion pound wrongs". But in any event, none of the existing authorities go anything like this far and it would have required a significant extension to the law to permit a multiple derivative claim in those circumstances.

(2) The Discount Rate

204. Mr Grant also submits that I failed to take into account the fact that Directors assumed 0.0% growth above CPI inflation for 30 years. However, that assumption formed the basis for the discount rate which the Company adopted and this clear from Dr Davies' evidence: see Davies 2, ¶14. I expressly considered the discount rate in deciding whether the Claimants had made out a prima facie case that they could bring themselves within the fourth exception: see [84] to [87] and [141]. Furthermore, I set out the basis of the 2020 Valuation at [93] and on which Mr Galvin signed the schedule of contributions.

(3) Claim 2

205. Mr Grant also submits that I should not have considered Claim 2 separately but considered it together with Claim 1. He also submits that if I had considered Claims 1 and 2 together, then "much of [158]-[174] falls away, in particular [162]-[163] concerning the Directors' actions, knowledge or belief". In my judgment, this amounts to an implicit admission that Claim 2 could not succeed by itself. If the Claimants did not wish the Court to consider whether they should have permission to continue Claim 2 (as pleaded), then they should have withdrawn it or asked for permission to amend.

206. Finally, Mr Grant complains that I did not mention in the draft judgment the third provision, criterion or practice ("**PCP**") which the Claimants allege was discriminatory, namely, the 2.5% cap on annual increases on pensions in payment. This is not correct. I recorded the Claimants case at [102]. Moreover, their primary case (as I recorded in that paragraph) was that the 2.5% cap exacerbated the effect of the threshold salary and accrual rate reductions: see the Particulars of Claim, paragraph 90A. I, therefore, approached this third PCP on the basis that if I was satisfied that first two PCPs were not discriminatory, then the third PCP would not be discriminatory either.

207. Nevertheless, I accept that Mr Grant gave it more prominence in his oral submissions and that I did not deal with this issue separately. Having reconsidered the point, however, I am satisfied that it was not necessary to decide whether the Claimants have a prima facie case that this PCP is discriminatory or that a decision on that issue would have affected my judgment on Claim 2. I found it unnecessary to decide whether individual members had claims for indirect discrimination under section 19: see [169] to [173]. Indeed, one of the reasons which I gave for refusing permission to continue to the claim was that it was far better for members to pursue their claims for discrimination directly.

208. Beyond the two changes which I have made, I decline to recall and revise my draft judgment on the grounds that I have failed to give adequate reasons for refusing permission to continue the claims. In case the matter goes further, I have recorded my reasons in this postscript to my original judgment.