Gallaher Ltd v Gallaher Pensions Ltd (1), C Foster (2), D Silver (3): Construction, rectification, Gibbon v Mitchell and Hastings-Bass

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Abstract This paper examines the case of *Gallaher v Gallaher*, looking at the components of the case and its impact of construction, rectification, *Gibbon v Mitchell* mistake, the rule in *Re Hastings-Bass* and subsequent decisions.

Keywords: *Re Hastings-Bass*; trustee duties; decision making; *Gibbon v Mitchell*; mistake; rectification; *Abacus v Barr*; *Drake Insurance plc*; *Sieff v Fox*

Unfortunately, it is not uncommon for pension scheme trustees and sponsoring employers to find themselves in the situation where their understanding of the scheme is not what is reflected in the scheme's official governing documentation. The scheme, however, must be governed in accordance with the documentation. So what can be done if this happens?

This paper examines the case of *Gallaher Ltd v Gallaher Pensions Ltd (1) C Foster (2) D Silver (3)*¹ known as '*Gallaher v Gallaher*' and looks at its impact on interpretation, rectification, the rule in *Re Hastings-Bass* and setting aside a document for mistake.

Gallaher v Gallaher: The facts

The case concerned the terms of various occupational pension schemes of which *Gallaher Ltd* was the principal employer

and *Gallaher Pensions Ltd* was the corporate trustee. *Foster* and *Silver*, the other two parties to the case were representative members of the schemes concerned. The case revolved around the provision in the scheme's governing documentation for increases to pensions in payment.

In 1978, when the state earnings-related pension scheme (SERPS) was introduced, *Gallaher Ltd*, a cigarette manufacturer, like many other employers decided to contract-out of SERPS and instead provide guaranteed minimum pensions (GMPs). An advantage of contracting-out was that for benefits accrued prior to April 1988, the state pays the increases to the GMP.

In 1980, *Gallaher Ltd* decided that it would use its discretionary powers in the scheme's trust deed and rules to only pay increases on pensions which were over and above GMPs and also that they

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would not provide any increase to GMPs above what the state was obliged to provide.

Documentation at the time, such as actuarial valuations and Gallaher Ltd's magazine, aptly called 'Smoke Signals', recorded that these increases only applied to the excess over the GMP. However, the policy of awarding increases only to the excess over GMP was not recorded in the company's minutes or other official documentation.

In 1987 the scheme rules were changed by a deed of amendment to introduce an obligation to pay increases. However, the deed and the minutes recording the execution of the deed merely provided that increases of x per cent would be made to 'pensions in payment' and no distinction was made between GMPs and pensions in excess of GMPs. Following the execution of the deed, administration of the scheme continued in accordance with the 1980 policy decision, and valuations and member communications were prepared on the basis that increases to pre-1988 GMPs were paid by the state and not by the scheme. However, it then became apparent that the 1987 deed could be interpreted that the scheme should pay an increase on the whole pension, not just on the excess over GMP. The position could not be agreed and the matter was brought to court.

The Principal Employer brought proceedings on four alternative grounds:

- a declaration that, on its true interpretation, 'pensions in payment' in the 1987 deed really meant pensions in payment in excess of the GMP;
- rectification;
- an order for the deeds to be declared void or set aside under the rule in *Re Hastings-Bass* (on the basis that the trustee had failed to take into account all relevant considerations); or
- an order that the amending deeds be declared void or set aside under the principle in *Gibbon v Mitchell* (on the basis that the principal employer was mistaken as to their effect).

The case was heard by Etherton J who decided as follows.

Construction claim

The claim failed on this ground. Previous cases have held that the meaning of a document is not necessarily the same as its words. Instead, a document can be held to mean what the parties could reasonably have understood them to mean.

Two years before this case, Etherton J had heard the case of *Hearn v Younger*.² In *Hearn v Younger*, the final salary scheme was governed by a Deed of Amendment dated 17th January, 1990. The claimant in that case applied for directions in relation to the winding up of the scheme where certain members had made claims against the scheme. The claims arose out of a similar situation where the scheme's rules were amended in May 1993 to guarantee increases in members' pensions following retirement at the rate equivalent to the annual increase in the Retail Price Index subject to a maximum of 5 per cent ('5 per cent LPI'). Some members claimed that this 5 per cent LPI increase was awarded to the whole pension, including the GMP element. Etherton J held in that case that when he looked at all of the documentation leading up to the decisions of the company and the trustees in April and May 1993, that when the company and the trustees referred to guaranteeing future increases to pensions in payment at 5 per cent LPI in the decision notice, and in the

minutes of the discussions held, that it was clear that they were using shorthand, and that all parties understood this shorthand to mean increasing the rate specified in rule 23.1 of the scheme rules to 5 per cent LPI. Therefore, any reasonable person having their background and knowledge would have understood this shorthand, and applying the usual objective test to the interpretation of contracts, both the company and the trustees intended and agreed to amend the rules by increasing the rate specified in rule 23.1 to 5 per cent LPI. It followed that there was never any agreement by the trustees to increase the GMP element of the pensions in payment by 5 per cent LPI.

In *Gallaher v Gallaher* Etherton J held that the same phrase here was not being used as shorthand, and that the ordinary meaning of the phrase ‘pensions in payment’ was the whole pension. The judge looked at the case of *ICS v West Bromwich Building Society*³ where it was held that documents should be construed in the context of the relevant background and what a reasonable man would have understood the language to mean. Where the particular meaning of the words is not clear, then there is an understandable reluctance on the part of the courts to interfere with the construction of documents for the sake of commercial certainty. Rimmer J perhaps took this to the extreme in the case of *Harwood-Smart v Caws*⁴ when he said that,

‘... if its language is clear, appears to convey an unambiguous meaning and does not produce a commercially absurd result then I do not see why it should not be taken at its face value and as meaning what it says.’

However, even on this basis, the construction that pensions in payment also included GMPs would not have

been a commercially absurd result given the scheme’s surplus and changes in legislation at that time. In *Gallaher v Gallaher*, the conduct of the parties prior to the time of the decision was not enough to change the interpretation of the words because there were plausible reasons which existed for a shift in position on the matter.

The argument for construction did not succeed in this case, but it highlighted that cases on the interpretation of trust documents can be based on the rules of construction rather than rectification, which might be a more costly exercise.

Rectification claim

The second claim was that the documents should be rectified. *Gallaher v Gallaher* confirmed that a successful claim needs to have the following elements:

‘convincing proof; that on the balance of probabilities; there was a continuing common intention of both the employer and trustees; and that by mistake, this common intention was not reflected in the deed.’

Gallaher v Gallaher examined the common intention and looked at the following:

- is trustee/employer accord necessary?
- is an outward expression necessary?
- how do you prove the common intention? and
- are events post-execution relevant?

Is accord necessary?

Looking at the first point, *Gallaher v Gallaher* examined whether or not the trustees and the employer needed to agree the common intention, or whether they just needed to share the common intention. Etherton J looked at previous case law on the point.

*Joscelyne v Nissen*⁵ was a contract law

case. This case said that there did need to be an outward expression of accord, as this was what was required for contract formation. The case has been criticised but was still good law. Then there was *Lansing Linde v Alber*⁶ which was a pensions case. While only obiter, in this case, the judge equated the exercise of a power of the employer acting with the consent of the trustees with contract cases, and said that therefore there needed to be an outward expression of accord between the employer and the trustees. The case of *AMP v Barker*⁷ qualified this. Lawrence Collins J stated in this case that the contractual position should not apply in cases where the employer of a pension scheme exercises the power of amendment with the consent of the trustees. Here, a valid exercise of the power of amendment would require that the wishes of the employer and the trustees are the same, but in order for the amendment to be valid, it is not required that they actually agree the amendment among themselves. Lawrence Collins J stated that therefore, as agreement was not necessary to exercise the power, agreement was not necessary to bring a claim for rectification. Etherton J confirmed this position in *Gallaher v Gallaher*.

This reasoning would only apply to cases where the power of amendment is expressed to be held by the employer with the consent of the trustees (or vice versa) but what would be the case where the power was expressed to be exercised by the employer with the 'agreement' as opposed to consent of the trustees? It is suggested that in this case, the word agreement really means consent rather than a true agreement with all of its contractual elements, therefore the position ought to be the same. But what if the power is granted to the employer and the trustees acting with

their joint agreement? This is more complicated and does not fall within the factual ambit of *AMP v Barker* and *Gallaher v Gallaher*. If, however, the reasoning in *AMP v Barker* is applied, the result would be that as a joint agreement was needed for there to be a valid amendment, then this would also be necessary in this case for rectification.

However in the light of the criticism that *Joscelyne v Nissen* has received, it was likely that a court might distinguish the exercise of a power of amendment from contractual agreements and not hold that agreement was necessary for rectification in those circumstances. This has been confirmed in *Drake Insurance plc*⁸ which was heard in the summer, after the decision in *Gallaher v Gallaher*. Therefore, even where there is a joint power of amendment, no accord is necessary.

Is an outward expression of a common intention necessary?

Although only obiter, it was stated in *Lansing Linde v Alber* that an outward expression of a common intention between the parties was indeed required. *AMP v Barker* confused the issue slightly by noting that some earlier cases on voluntary settlements had not required this, but then later on in the case spoke about AMP needing to convincingly show a continuing common intention, making the position unclear. *Gallaher v Gallaher* clarified the issue by stating that *AMP v Barker* had said that an outward expression of intention was not necessary, and as that case was not clearly wrong, Etherton J was bound by that decision. *Drake Insurance plc* followed *AMP v Baker* and *Gallaher v Gallaher* on this point. This does seem sensible, because if it is possible to prove that a common intention does exist, then to go on to require an outward expression of the common intention seems arbitrary and in most cases it is likely to be present anyway.

Intention

In *Gallaher v Gallaher* it was not necessary to show that the parties were consciously aware that an issue had been missed in the deed. In this case, all parties were aware of the policy decision in relation to GMPs. It was sufficient that it was in the back of their minds.

The relevant intentions are those of the parties to the decision. In this case, it would be the directors and the trustees who signed the deed. The question of whether or not a majority of those intentions would be sufficient arose in the case of *Drake Insurance plc* where it was stated that if the rules allowed majority decisions, then it ought to be enough if most of the directors and trustees had the intention, but a decision was not required on this point.

The intention could be evidenced in a variety of ways, including board minutes, announcements to members, actuarial reports and also oral discussions.

Post-execution events

Gallaher v Gallaher held that events which took place after the deed was entered into were admissible as evidence of both intent and also as evidence of an outward expression of intent if this was needed. Examples of post-execution events which were relevant in this case included: how the benefits were in fact paid; member communications; scheme booklets; and actuarial valuations. *Drake Insurance plc* added a caveat to this by saying that of themselves, post-execution events are not sufficient evidence to warrant rectification, if that is all that was available.

Delay was not necessarily a defence to a claim of rectification. Here, there had been a significant delay. However, no one had been prejudiced by the delay. Etherton J ruled that the claim for rectification be allowed. However, he did go on to consider the other

alternative claims and provide some useful guidance on those points.

Gibbon v Mitchell claim

The third alternative claim was for mistake under *Gibbon v Mitchell*.⁹ Etherton J went on to briefly consider whether he could set the deed aside because it had been entered into under a mistaken belief as to its effect. He found that the employer was indeed mistaken as to the effect of the deed and would have granted relief under this head had it been necessary to do so. Etherton J said that ignorance of the effect of the deeds was sufficient to show this type of mistake, and it was not necessary to show a positive belief that the deeds granted only increases in excess of GMP.

Hastings-Bass

Again, it was not necessary to consider this head of claim, but interesting comments were raised in discussion.

By way of background, Lord Justice Buckley set out the principle in the case of *Re Hastings-Bass (deceased), Hastings and others v Commissioners of the Inland Revenue*.¹⁰ This was a trust case concerning estate duty and perpetuities. The trustees had made an advance of a cash sum to another settlement which conferred a life interest and various remainder interests. It was accepted that the trusts, other than the life interest, were void for perpetuity under *Pilkington v Commissioners of the Inland Revenue*.¹¹ The question before the court was whether, as argued by the Revenue, the whole transfer including the life interest failed, resulting in no estate duty saving.

In his judgment, Buckley LJ enunciated what has become known as the rule in *Hastings-Bass*:¹²

- ‘Where ... a trustee is given a discretion as to some matter under which he acts in good faith, the court shall not interfere with his action notwithstanding that it does not have the full effect of which he intended, unless
- (1) what he has achieved is unauthorised by the power conferred on him, or
 - (2) it is clear that he would not have acted as he did
 - (a) had he not taken into account consideration which he should not have taken into account, or
 - (b) had he not failed to take into account considerations which he ought to have taken into account.’

The rule was transposed from a negative into a positive statement in the case of *Mettoy Pension Trustees Ltd v Evans*¹³ when it was summarised by Warner J as:

‘Where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account.’

The *Mettoy* case brought the application of the rule to a pension scheme which was winding up following the liquidation of the employer. The court was asked to determine a number of questions including whether or not a 1983 deed which gave the employer a discretion over any surplus was valid.

Warner J accepted that there was a principle which could be labelled the rule in *Hastings-Bass* and drew a distinction with rectification and mistake. He dismissed an argument that the rule can only apply where the trustees’ exercise of a discretionary power is partially ineffective because of some rule of law or because of some limit on their discretion which they have overlooked. He did however, emphasise that:

‘for the principle to apply however, it is not enough that it should be shown that the trustees did not have a proper understanding of the effect of their act. It must also be clear that, had they had a proper understanding of it, they would not have acted as they did.’

Etherton J in *Gallaher v Gallaher* considered whether the deed could be declared void or set aside under *Hastings-Bass*. This option is a useful alternative to rectification because it is possible to set aside only the part of an amendment which falls foul of the rule and keep the remainder in place, ie the right to increases on pensions in excess of GMPs would not have been lost. The rule in *Hastings-Bass* therefore represents a useful remedy that mimics rectification, but with a lighter evidentiary burden.

The rule in *Hastings-Bass* was further developed by the High Court case of *Abacus Trust Company (Isle of Man) v Barr*.¹⁴ One main point to be taken from *Abacus v Barr* was that Lightman J stated that the application of the rule results in a decision being held voidable instead of void. However, he also took the opportunity to limit the scope of the rule in order to address concerns that what had started as an attempt to undo a tax blunder had transformed into a significant cause of action. Lightman J limited the rule by stating that in order for the rule to apply, it must be established that the trustees failed to consider something that they were under a duty to consider, and therefore a breach of duty by the trustee was required.

Etherton J in *Gallaher v Gallaher* said that although he did not need to consider the point, he would have allowed the claim to succeed under the rule in *Hastings-Bass* on the basis that had the parties known the true effect and ramifications of the decision that they

were making (assuming that the documents were not rectified) then they would not have proceeded to execute the deeds. The failure of the trustee in not obtaining costings of the effect of the increase applying to the whole pension (again assuming that no rectification has taken place) would be a breach of fiduciary duty.

Interestingly though, Etherton J gave significant weight to arguments before him that Lightman J had been wrong to insist on there needing to be a breach of duty before the rule would come into play. It was argued that Lightman J had misinterpreted Warner J's comments in *Mettoy* and that Warner J had asked 'What were the trustees under a duty to consider? Had they failed to consider it?' which was different from requiring there to have been a breach of a duty. However, he declined to rule on this point.

The point was considered again recently in *Sieff and others v Fox and others*¹⁵ in June 2005. This case concerned a 2001 appointment made under a 1971 family settlement in respect of valuable chattels at Woburn Abbey and a reversionary lease of the estate. There were costly capital gains tax consequences which the trustees were not correctly advised upon. The trustees claimed that the appointment was not valid because of either the rule in *Hastings-Bass* or the doctrine of mistake.

In *Sieff v Fox*, Lloyd LJ re-examined the rule in *Hastings-Bass*. He accepted counsel's argument that the positive expression of the rule in *Mettoy*, might not have expressly encompassed the whole rule and put forward his own interpretation of the rule as:

'Where a trustee acts under a discretion given to him by the terms of the trust, but the effect of the exercise is different from that which he intended, the court will

interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account, or taken into account considerations which he ought not to have taken into account.'¹⁶

Lloyd LJ then went on to consider the 'would/might' debate. Lightman J had not considered this issue in detail in *Abacus v Barr* because it was clear in that case that the trustees would not have acted in the way that they did, had they known the settlor's true wishes. Lloyd LJ looked at cases such as *Stannard v Fisons*¹⁷ and *Kerr v British Leyland*¹⁸ and decided that a distinction should be drawn between situations where trustees are obliged to exercise their discretion, and situations where it is a matter for the trustees whether and when to exercise it. Only where the beneficiary could require the trustees to act should it be enough to show that they might have acted differently. This was because where the trustees acted under an obligation, the beneficiaries could require them to start again on the correct basis, but if they acted voluntarily the more demanding test of *would* should apply. He also said that in the case of pension schemes, the beneficiaries' entitlements derive from their contracts of employment and not 'pure bounty' as in family settlements, and in those circumstances he thought it was appropriate that given the inadequate information given to the trustees in the case that a relatively low threshold of relevance applied, ie *might* should be sufficient.

Lloyd LJ agreed with Lightman J that it would be sensible for the rule to render a decision voidable and not void. He said that if the consequence was to render the decision void, then this might have 'dramatic and potentially unfair disruptive consequences for the trustees and beneficiaries.' However, like in

Gallaher v Gallaher, Lloyd LJ did not agree with Lightman's insistence that there be a breach of duty in order for the rule to apply. Lloyd LJ goes further than Etherton J did and said:

'... it seems questionable whether the application of the doctrine should be regarded as depending on a breach of duty, and whether its consequences should be aligned to those of a breach of trust. It seems to me that it would have been hard to say that the trustees that made the advancement which was held to be completely ineffective in *Abrahams*¹⁹ acted in breach of their duty. What was wrong with their act was the application of the rule against perpetuities in a way quite different from that which seems to have been regarded as normal and legitimate at the time and which was held valid by Dankwerts J at first instance in *Pilkington*.'

Because of the difficulty which Lloyd LJ thought there was in finding a breach of duty in *Pilkington* or indeed in *Re Hastings-Bass*, he went on to say:

'... it seems to me that Lightman J's conclusion that the appointment was voidable is open to doubt, as also is his introduction of a factor, not previously mentioned in the cases, that the trustees or their advisers or agents must have been at fault in some way for the principle to apply.'

Lloyd LJ understood Lightman J's concern at the worrying breadth of the rule, but felt it would be better controlled by factors such as delay and acquiescence negating a claim.

The jury is still out on the final scope of the rule in *Hastings-Bass* and it remains to be seen whether Lightman J will be declared plainly wrong on his requirement for a breach of duty or whether in fact it will be held that Warner's J's comments and the earlier decisions do actually amount to a

requirement for a breach of duty, which following *Sieff v Fox* is looking less likely.

Closing thoughts

Things do go wrong with scheme documents, and when they do, there are various avenues of redress open to the employer and the trustees, including those explored in the case of *Gallaher v Gallaher*. Some of the principles set out in the case are not the final answer. For instance, will the limitations placed on the rule in *Hastings-Bass* in terms of a requirement for a breach of duty be removed? It will be interesting to see how that rule develops in future cases and whether the comments raised in *Sieff v Fox* are progressed.

All of these methods of putting mistakes right will come at a significant cost, and so ideally, the focus should be on how to avoid getting into that situation in the first place. Lessons can be learnt from *Gallaher v Gallaher*. The case highlighted the importance of clearly documenting decisions. Even when it is assumed that everyone understands short-hand terminology, the full terms should be used in official scheme documentation and corresponding minutes of meetings, unless it is made obviously clear in those documents what the term means.

In this case, a large amount of the evidence dated back to 1980, so it is important that all scheme documentation, including actuarial valuations, member booklets, announcements to scheme members, and minutes of all meetings are kept and not disposed of after a few years.

Professional advisers should examine new drafts of scheme documents carefully to find any potential short-hand terms and explain them fully, or better still substitute full wording.

It will not always be possible to have

witnesses who can give evidence of intentions at the time a document is executed. Therefore, as well as ensuring that written records of intentions are kept, the trustees and the principal employer of a scheme should take care in giving clear instructions to the person who is drafting the documentation, and then satisfy themselves that the document does in fact reflect their intentions before they execute it.

As *Drake Insurance plc* has already proved, *Gallaher v Gallaher* has been a useful case, clearing up uncertainties, confirming some principles and casting doubt on others and it will be interesting to see how the case affects future decisions.

References

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