

## Court of Appeal decision in IBM v Dalglish and others

Alert | 04 August 2017



### Introduction

On 3 August 2017, the Court of Appeal published its long-awaited judgment in the IBM case. The key issue to be decided was whether, in implementing its pension proposals, IBM was in breach of the implied duty of good faith.

### Key points

- Overturning the [decision of the High Court](#), the Court of Appeal found that, in implementing its pension proposals, IBM had not breached the duty of good faith.
- To determine whether the duty of good faith has been breached, a court should apply a “rationality test”, ie did the employer act in a manner which was “arbitrary or capricious”?
- Despite the unappealed breach, by certain of the IBM companies, of the duty to consult, the court decided it would be wrong to require those companies to undertake a new consultation process before implementing the pension proposals.

### The Facts

The facts of the case are complex and cover a lengthy period of time. However, in summary, they are:

#### Project Ocean

In 2004, IBM presented proposals (known as “Project Ocean”) to the Trustee in relation to the DB schemes which resulted in an increase in the member contribution rate for the contributory DB schemes and a reduction in the accrual rate for the non-contributory DB scheme. IBM also agreed with the Trustee to pay contributions to the DB schemes to reduce the past service deficit and a parent company guarantee in respect of company contributions was also put in place until 2014.

In explaining these changes to members, IBM issued a number of communications including a webcast by the HR Director and various Q&A and explanatory documents.



## Project Soto

In late 2005 and early 2006, IBM presented proposals (known as “Project Soto”) which, in essence, gave DB members an option to either:

- remain in the DB schemes and continue accruing DB benefits, subject to agreements which would result in only 2/3rds of future salary increases being pensionable, or
- transfer to the new Enhanced DC scheme to earn enhanced DC benefits from July 2006 but retain a final salary link in respect of past service DB benefits.

As part of the discussions surrounding these changes, IBM indicated that there were no further plans to change the pension arrangements and that these changes were therefore viewed as “long-term”.

## Project Waltz

In 2009, IBM presented a proposal for its pension arrangements known as “Project Waltz”, which contained five key elements:

- the closure of the DB Schemes to future accrual with effect from April 2011.
- entry by DB members into agreements by which future pay increases would not be pensionable (known as “non-pensionability agreements” or “NPAs”).
- an “early retirement window” from November to December 2009 during which those potentially eligible could apply for early retirement with the benefit of existing favourable discount factors.
- a new early retirement policy from April 2010 under which, save for “exceptional circumstances”, early retirement would only be allowed on cost neutral terms.
- allowing former active members of the DB schemes entry into the DC scheme.

Proceedings were brought to test the lawfulness of these proposals. The changes were effected, on a provisional basis, pending the court’s decision.

## What is the “duty of good faith”?

The “implied duty of good faith” is a concept that originates in the employment sphere in the context of the employer / employee relationship. It is effectively shorthand for an implied term in the contract between the employer and employee that neither party should take steps that would destroy or seriously damage the relationship of trust and confidence between them.

The application of the principle to pension schemes was first considered in the *Imperial Tobacco* case in 1990, which established that the same principle applies in the context of the sponsoring employer of a pension scheme and the members of that scheme. Whilst the duty of good faith has been taken into account in a number of employment related cases, IBM is only the second case since *Imperial Tobacco* to consider it in detail in the pensions context. In the *Prudential* case (2011), the High Court concluded that the test as to whether or not an employer had breached its duty was whether it had acted irrationally or perversely in taking a discretionary decision.

This is the first time the *Imperial* duty has been directly considered at an appellate level.



## High Court

Broadly, Mr Justice Warren considered that IBM's conduct and, in particular, its communications at the time of Project Ocean and Project Soto had created what he called, "Reasonable Expectations" for the active members of the schemes in relation to IBM's future pension policy (primarily that DB accrual would continue and that the early retirement policy would not change until 2014, unless there was a relevant justification).

A "Reasonable Expectation" was defined as "an expectation as to what will happen in the future engendered by the employer's own actions (and in relation to matters over which the employer has some control), which gives employees a positive reason to believe that things will take a certain course".

In Warren's opinion, the Project Waltz changes clearly conflicted with these Reasonable Expectations. Against this background he concluded that IBM had acted in breach of its duty of good faith in implementing the proposals.

## Court of Appeal

The Court of Appeal agreed that the existence of members' expectations was a relevant factor to be taken into account by IBM when making its decision. However, Warren J was not correct to give them "overriding significance" such that they could only lawfully be disappointed in a case of necessity.

The correct question was whether the decision taken was one which no rational decision-maker could have reached. Applying this test, IBM had not breached the duty of good faith as they had been aware of and considered member expectations as part of their decision-making process.

### **Non-pensionability agreements**

The court commented that "[f]ailure or refusal to offer a pay rise to which the employee is not contractually entitled may in some circumstances be a breach of the implied duty of trust and confidence...but the circumstances have to be extreme".

When determining whether the decision to impose an NPA as a condition of a pay rise is a breach of the duty of trust and confidence, the rationality test (see above) should be applied.

### **Consultation**

The High Court found that IBM was in breach of its statutory and contractual duty to consult on Project Waltz because of the manner in which it conducted the consultation. This was not disputed.

It fell to the Court of Appeal to determine whether to grant an injunction to prevent IBM from implementing Project Waltz without a further, compliant, consultation.

The court concluded that granting an injunction "would change the position of IBM and of the members of the Schemes far too radically" and, as such, would not be appropriate, in the circumstances. "It would not be a case of consulting again, in a proper manner, on the original proposals. It would not result in restoring the beneficiaries to the position they would have been in if a proper consultation had been carried out in 2009". However, the beneficiaries are entitled to claim damages against IBM for breach of the contractual duty in the conduct of the consultation.



## Impact

This decision will come as a relief to the many employers who have made extensive changes to their pension provision over the years. However, it remains important for trustees and employers to plan benefit changes carefully and to be judicious in their communications with members.

Sacker & Partners LLP  
20 Gresham Street  
London EC2V 7JE  
T +44 (0)20 7329 6699  
E [enquiries@sackers.com](mailto:enquiries@sackers.com)  
[www.sackers.com](http://www.sackers.com)

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should speak to your usual Sackers contact. © Sacker & Partners LLP August 2017