VERITY TRUSTEES AND THE LAW OF SEVERANCE – IS THERE A "SECOND CONDITION"?

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Introduction

The *Verity Trustees* case earlier this year raised a very large number of legal issues which will be of interest and practical significance to pensions practitioners. Perhaps the most interesting of those was the question of what the true test for severance of an excessive execution of an amendment power in a pension scheme is. The purpose of this article, which reflects the contents of a talk at Wilberforce Chambers' 2025 Nugee Memorial Lectures, is to seek to whet the reader's appetite for what the judgment, as and when it appears, may say on this topic, and why it matters to practitioners.

I should start out by explaining what, while dealing with severance, this article will *not* deal with. It will *not* deal with the analytically prior issue which arose in *Verity Trustees* about whether severance is the correct principle at all when there is excessive execution of a power. It will assume, contrary to the submission of the Rep Ben, that *IBM* in the Court of Appeal[1] is not binding authority for the application of the "second condition", as explained below. And it will not address the different issues that potentially arise where the reason for partial invalidity of the exercise of the power is non-compliance with the requirements of s.37 of the Pension Schemes Act 1993 and/or Regulation 42 of the Occupational Pension Schemes (Contracting-out) Regulations 1996.

[1] *IBM United Kingdom Holdings Ltd v Dalgleish* [2017] EWCA Civ 1212.

In an attempt to get the reader interested in this issue, I am going to try to do three things: first, explain what the practical problem is; secondly, explain the legal problem, and; thirdly, explain the possible solutions canvassed in *Verity Trustees*.

The practical problem

The problem arises where you have an exercise of a power of amendment which partially but not completely infringes a fetter on that power. The classic example is an attempt to reduce benefits not only for future service but also for a bit of past service, despite a fetter protecting accrued rights. Can you sever the valid part of the exercise affecting future service from the invalid part affecting past service?

On that example, I doubt anyone would lose too much sleep in advising that of course the reduction for future service would be valid. That achieves part of the objective of the amendment in the first place.

But it is not difficult to envisage, or to find in the authorities, more complicated examples, where the effect of the amendment depends on future events. Take a conversion from final salary benefits to CARE benefits, including for past service – the facts of *Avon Cosmetics Ltd v Dalriada Trustees Ltd*.[2] Whether that amendment leads to a reduction in benefits accrued by past service, in contravention of a fetter protecting accrued rights, depends on future events i.e. the respective trajectories of final salary benefits and CARE benefits. The traditional view – I put it that way because that view was challenged in another of the many issues in *Verity Trustees* – is that such a change engages an accrued rights fetter, but the 'bad' can be severed from the 'good' by allowing the amendment to operate subject to an underpin protecting past service rights on a final salary basis.

[2] [2024] EWHC 34 (Ch).

The problem is that that ends up giving members 'the best of both worlds' in respect of their past service: if CARE benefits are better than final salary benefits, the amendment operates and they get CARE benefits; but if final salary benefits are better than CARE benefits, the underpin bites and they get final salary benefits. What was no doubt originally conceived of as a cost reduction exercise ends up costing more than just retaining final salary benefits for past service. The result of severance is – at least arguably, and this was not accepted in *Avon Cosmetics* itself – not a partial version of what was intended, but something quite different.

The legal problem

That is the practical question: how to accommodate the 'best of both worlds' problem in the context of severance. Now on to the legal problem.

The legal problem is that there are two conflicting lines of authority. Precisely which cases form part of which line, and what those cases hold, was hotly controversial during the *Verity Trustees* trial, and in what is intended as a short introduction I am not proposing to venture into this controversy. The point for present purposes is simply to identify the conflicting strands, not to analyse each in detail.

The first line of authority holds that there is only one requirement for the 'good' part of an exercise of a power to be severed from 'the' bad part: that the good and the bad be conceptually severable.

That is a line of very respectable pedigree. It goes back to at least 1755, when Sir Thomas Clarke MR, said as follows in a case called *Alexander v Alexander*:[3] *"If the Court can see the boundaries, it will be good for the execution of the power, and void as to the excess."*

[3] (1755) 2 Ves Sen 640.

But it is also a line of authority with some pretty distinguished more recent support. The passage above was endorsed by the Court of Appeal in *Thames Water Authority v Elmbridge Borough Council*.[4] In modern pensions cases, you will find this approach adopted, for example, in *Betafence v Veys*.[5]

That line of authority has one major advantage, and one major drawback.

The major advantage is that it is very easy to apply. Working out if the 'good' can be conceptually severed from the 'bad' is not typically very difficult at all. It does not require any investigation into the circumstances surrounding the making of the original amendment itself.

The major drawback is that it does nothing to address the 'best of both worlds' problem. The 'good' will be allowed to take effect even if that produces an overall result which no one would ever have contemplated.

That takes us to the second line of authority. This is a much more recent line of authority, but of very distinguished parentage nonetheless – it comes from the decision of Neuberger J, as he then was, in *Bestrustees v Stuart*.[6] Having set out the requirement that the good and bad be conceptually severable, he went on to say as follows:[7]

> *It seems to me, however, that one must not only ask oneself whether they are easily severable conceptually, but also whether there is anything in the exercise of the power which leads one to believe that, had the trustees been told that they were not entitled to exercise the power retrospectively, they would not have exercised the power as they purported to do prospectively at all, or, in the alternative, in the way that they did.*

[4] [1983] QB 570.
[5] [2006] EWHC 999 (Ch).
[6] [2001] EWHC 549 (Ch).
[7] Ibid, at [48].

That passage introduces a further requirement: in order to effect severance of the 'good' from the 'bad', one has to enquire whether the donee of the power would have exercised the power to effect the 'good', had they known that the fetter prevented them from effecting the 'bad'. It is this requirement which I have been calling, consistently with the jargon of the *Verity Trustees* trial, "the second condition."

Again, this approach has one major advantage, and one major drawback.

The major advantage is that it can deal with the 'best of both worlds' problem. It invites consideration of what the donee of the power would have done if they had known about the existence of the fetter, and thus provides a route for avoiding results which the donee would not have intended had they known about the fetter.

The major drawback is that it is a recipe for complexity. On its face, it appears to require a counterfactual investigation into what the donee of the power would have done had they known of the fetter. If that is the correct approach, that requires in the first place a detailed investigation into the facts prevailing at the time of the amendment to get an understanding of the decision makers and the facts driving their action. Those may be many many years ago, with a patchy documentary record, and with the individuals involved at best possessing only a half memory, and at worst no longer being available. Even once that investigation is complete, it is unlikely to provide a direct answer to the problem – the whole point is that no-one thought about the impact of the fetter – perhaps necessitating an application to Court to resolve the uncertainty.

Thus the existence of this "second condition" is not good news for clients wanting a simple and cheap resolution to an excessive execution of a power.

Potential solutions?

As I noted above, there was a debate in *Verity Trustees* about whether *IBM* is binding authority for the application of "the second condition." If so, the question of a solution is moot at first instance. But if not, the Trustee's submissions in *Verity Trustees* presented two potential solutions to this practical and legal problem.

The first was to hold that the *Bestrustees* line of authority is wrong, and there is no "second condition": provided the 'good' and 'bad' are conceptually severable, they can and will be severed.

How does that solve 'the best of both worlds' problem though? It does not try to solve it through the principles applicable to severance. Rather, it locates the solution somewhere else: in the principles set out by the Supreme Court in *Pitt v Holt*.[8] On the face of it, the failure of the donee to take into account the existence of the fetter, and hence their inability to effect the 'bad' part of the exercise of the power, amounts to a failure to take into account a material consideration. Thus the severed exercise of the power is prima facie vulnerable to a *Pitt v Holt* attack on the basis of inadequate deliberations. On this approach, the proper place to debate the 'best of both worlds' problem is in the context of such an attack, not when considering the prior question of severance.

How, you might ask, does this differ in practice from simply applying the second condition? The answer is quite a bit. There are at least four important differences.

First, inadequate deliberations only render a decision *voidable*, not *void*. The second condition, by contrast, appears to be black and white – unless it is satisfied, the whole exercise of the power is void.

[8] [2013] UKSC 26.

What that means is that if this approach is correct it becomes much easier to advise trustees. The answer to whether the exercise of the power can be severed is straightforward. It is then up to someone else – a member or an employer – to bring a challenge on the basis of inadequate deliberations, and it is for that person to undertake the factual investigations necessary to launch such a challenge. Until that happens, the severed exercise of the power is valid, and the trustees can administer the scheme accordingly.

Secondly, there is a higher bar for a *Pitt v Holt* challenge – it requires the inadequacy in deliberations to be sufficiently serious to amount to a breach of duty.

Thirdly, the *Pitt v Holt* jurisdiction is subject to equitable defences, including for example laches.

And fourthly, and again in comparison to the 'black and white' nature of the second condition, relief under *Pitt v Holt* can be given 'on terms', e.g. requiring the trustees to enter into the transaction they would have entered into had they known of the fetter.

If that is right, not too great a violence has to be done to *Bestrustees* to get to this result. Neuberger J referred to 'the rule in *Hastings-Bass*', the precursor of *Pitt v Holt*, as his support in deriving the second condition, and at the time of his decision it was not clear if inadequate deliberations rendered a decision void or voidable. This approach recognises the validity of the concerns underlying the second condition, but addresses them via a different legal doctrine.

The second solution was to posit the approach adopted by HHJ Davis-White in the *Avon Cosmetics* case, who held that the second condition existed, but that it was to be applied objectively rather than subjectively.

Again, precisely what that means was controversial in *Verity Trustees*, but the point is that the objective approach does not invite or require a consideration into what the donee subjectively

would have done and hence avoids the need for the detailed historical factual investigations I mentioned above. Rather, it looks at the amendment objectively and asks whether the severed version could be regarded as achieving the substantial purpose and effect of the originally intended version. There was considerable debate in *Verity Trustees* about the practicality of this approach, which may be explored in due course in the judgment.

Conclusion

Inevitably this has only been the briefest of snapshots into the issue. But hopefully I have done enough to persuade you to look out with particular interest for the part of the *Verity Trustees* judgment addressing severance, which could have significant implications for the advice you give in future about excessive executions of powers.

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