

**May 2000**

## **IRREGULARITIES IN THE MANAGEMENT OF THE ELECTRICITY SUPPLY PENSION SCHEME**

### **Introduction and History**

The Electricity Supply Industry in England And Wales has provided the country with lighting) heating, transport and the means of production for over a century and the success of this enterprise has largely been due to the dedication of its staff and management over the years.

Over the years staff conditions were changed to provide pension schemes and to improve status generally in the workplace. These changes had benefits both for employer and employed and went a long way towards creating the reliability for which the industry has been renowned.

In 1990, after 43 years in public ownership the industry was returned to private ownership and many of the staff facilities and conditions were reviewed by the new owners in the light of their greater need for competitiveness and shareholder profits.

This document attempts to set out one aspect of these changes; namely those affecting the staff pension schemes.

Firstly, it must be said, that in 1990, when privatisation occurred, most staff were either in, or retired from, a "final salary" scheme called the Electricity Supply Pension Scheme (ESPS) to which they paid 6% of their working salary whilst the employing board paid an amount equal to 12%. Although membership is not now compulsory, it was a condition of employment for almost all pre-1990 ESPS members and the pension arrangement was recognised to be part of the employment package.

Secondly, in the political climate of 1990, neither the Government of the day nor the new employers wanted any employee disruption and therefore, in 1989, strenuous efforts were made to assure staff that their rights and conditions would be protected in the new organisation. Indeed, the Government issued a Statutory Instrument (S.I. 346 1990) for this purpose. A further S.I. (No.318 1990) set out the highly controversial amendments which the Government required to be made to the ESPS pension scheme.

This latter S.I. paved the way for the original single ESPS scheme to be split into what are now known as 24 Group schemes, each of which is closely identified with one employer. There are roughly 212,000 members in these schemes, with the largest portion now being pensioners.

From membership of a Scheme with assets of over £15 billion (bn), some members have now found themselves allocated to Groups with less than 1% of that figure and only one Group (National Power) has more than 10%. Many fear that their new Groups are less robust with limited potential for benefit improvement.

A more recent development has been the individual employers' decisions to close many existing Group " final salary " schemes and to set up new, cheaper to run " money purchase " schemes, which are offered to new employees. For political reasons, many employers will not acknowledge

this change; they assert that their original schemes are still open although, in fact, they are only open to staff taken over with similar, or protected rights conditions.

### **The Association of Electricity Supply Pensioners**

The Association was formed in 1995 by six ESPS members following a number of highly controversial Annual General Meetings of the ESPS at which officers refused to fully answer members questions about the use of fund monies, the future development and management of the scheme and disparities of benefits between one Group scheme and another. Members were told to take their queries to Group Scheme annual meetings, for which the Scheme rules then made no provision.

It should be remembered that the Maxwell scandal was also very much in evidence at that time.

The Association now has a very sizeable and expanding membership with membership drawn from each Group sector of the industry. It is a registered company limited by guarantee, currently with eight directors, and the financial position is secure. The Association's aims are to monitor the changes in ESPS, to take whatever action is possible to protect ESPS members' rights and to see as far as possible that the ESPS schemes are administered properly. (See paragraph 12)

The Association was born out of members' dissatisfaction with the scheme administration and have been attempting to correct some of these malpractices ever since.

### **Financial Matters**

The value of the total ESPS was £19.9bn at 31st March 1999. Membership and beneficiaries in the 24 Group schemes totalled 212,493 of whom only 51,113 were contributing members at that date (24.1%).

The Scheme rules require that the assets and liabilities be re-valued at 3 yearly intervals; this conforms to the 1995 Pensions Act and ensures that adequate funding is maintained. Reviews were carried out in 1992, 1995 and 1998 and on each occasion, a surplus was declared in all Groups. It is the disposal of these surpluses which has stimulated most objections from ESPS and AESP members.

At the date of Privatisation, 31 March 1990, the total fund had a value of £8,514m. The aggregated employer contributions from 1 April 1990 to 31 March 1992 were £779m. The fund surplus at 31 March 1992 was £956m, showing that the new employers' contributions were less than the surplus.

There is a strong feeling amongst our members that the new owners were attracted to the new Group structure because it brought a share of the Fund closer to them with the prospect of fund diversion to shareholders. Indeed, the employers' actions in setting the majority of these surpluses off against their contributory obligations for the last seven years has done little to resolve these objections.

With the speed and intensity of current take-overs, amalgamations, outright sales and new owners in the industry and the steep decline in the number of employees, pension schemes and trustees are experiencing enormous difficulty in maintaining the integrity of their funds. Members are being

transferred into, out of and between Group schemes and very large numbers are being made redundant.

It is the Association's belief that insufficient money is being contributed by employers to fund these movements and employers are thereby siphoning resources away by these indirect means. This generally disadvantages members and is contrary to the scheme rules.

## **Litigation**

Following the 1992 revaluation, two ESPS members of the National Grid Group Scheme objected to the Pensions Ombudsman about the company's use of pension fund surplus to finance redundancies and early pensions. Such costs had previously always been an employer expense. They further alleged that the employer had acted illegally in using funds which would normally accrue to the members.

The Ombudsman decided in the members' favour and National Grid was ordered to repay. At the same time, objections were raised about the National Power Group, which had distributed some surplus to members by way of lump sums.

National Grid decided to appeal against the Ombudsman's ruling and a High Court appeal was arranged. National Power meantime enjoined in the action seeking a declaration that their method was legal. This placed the two members in a difficulty; neither wanted to take on the companies as individuals as this would have exposed them to the companies' costs in the event that they lost the case.

In view of the national pension interest of the case, the two members then went to the High Court and successfully argued that their National Grid should to pay their costs. This pre-emptive costs award was a significant legal decision.

The main case was heard over four days by Mr Justice Walker in May 1997; he found in favour of the companies and declared that an employer had no duty to contribute to a pension scheme which did not need that contribution. He appeared totally to ignore the contributory nature of the scheme.

The two members appealed and, after a further Pre-Emptive Judgement in their favour, the matter went to the Court of Appeal in February 1999. The Court decided unanimously that the Ombudsman was right and dismissed the High Court Judgement.

The hearings then took another twist and the companies asked the Court of Appeal to determine whether they could use the Scheme rules to retrospectively change the very same rules, thus enabling them to nullify the effect of the Judgement. Not surprisingly the Court of Appeal refused. The Companies successfully gained leave to appeal to the House of Lords, where the companies' appeal is expected to be heard in October 2000.

The two members mentioned here are both Association members and one is also currently an Association Director.

Against this background, the Association feels that members are fully justified in their suspicions about the employers' management of ESPS.

## Trustees

Each Group scheme has appointed and elected trustees in the ratio 1:2. Elected trustees have one vote at meetings and the appointed trustees have 2 votes. The company appointed chairman has a casting vote.

This is unsatisfactory in a contributory scheme, where the members expect to be consulted and have a say in how their contributions are invested and how the scheme is being managed. It also mitigates against the principle of "whistle blowing" enshrined in the 1995 Pensions Act as the employers are not always willing to give trustees all the information needed for them to carry out their functions.

In some cases, the composition of the elected trustees is considerably biased in favour of employed staff and does not truly reflect the actual numbers of pensioner members who now considerably exceed employed staff.

ESPS is essentially a two-tier scheme. The superior tier comprises the Scheme Trustee, Electricity Pensions Trustee Ltd (EPTL) and a related Employers' Committee, Electricity Pensions Ltd (EPL) together with Electricity Pensions Services Ltd (EPSL) which provides legal and accounting services for the ESPS Scheme.

Each Group elects one appointed and one elected trustee to serve at the upper level (EPTL). EPTL is responsible for matters central to the Scheme e.g. management of centralised investments, custody of Scheme assets, appointment of ESPS officers, auditors etc. and each Group Committee is responsible for the placing of its own investments i.e. selection of Fund manager, discussion about use of surpluses, adherence to the law, Pensions Act, Revaluations etc. The organisation is cumbersome, difficult for members to understand, and frustrating for member trustees.

The employers' separate body, EPL, decides their joint policies of a scheme wide nature and changes to rules etc.

The Pensions Act makes no provision for the election of pensioner trustees but, in most, if not all Groups, a certain number of the elected trustee posts are designated for pensioner members and these are elected by ballot at 3 yearly intervals together with the employed staff trustees.

A major point of concern here is that employed trustees may be expected to show a degree of loyalty to the company which pays their wages and their independence in pension matters is difficult to maintain.

The independence of the company nominated trustees is extremely doubtful as they are often senior managers or Directors of the companies concerned.

The fact that the ESPS rules give total power over surpluses to employers is a cause of considerable member discontent members feel that the investment of their contributed wages has produced the surpluses. They feel entitled to claim any surpluses; even more so when the employer fails to make its due contributions. The European Court has already decided in another case that pension rights are deferred pay and this reinforces our members' views.

Finally, in respect of all trustee decisions, there is also a feeling that member trustees are being treated as rubber stamps for the employers' decisions - an unhealthy position in this post-Maxwell era

### **Benefit Improvements**

In the 1990's equity markets rose and most pension fund investments prospered - with the exception of annuities which are closely tied to the money purchase schemes.

The 24 employers currently extant in the industry each make their own decisions about the distribution of surpluses. The Scheme rules (Clause 14(5)) clearly state that "the Principal employer....shall make arrangements .. to deal with .. surplus and shall give notice of such arrangements to the Group ...Trustees". Clause 14(2) says that the Group trustees are entitled to give the Principal Employer any recommendations they may wish to make about surplus disposal. Consultation is therefore limited.

Benefit improvement packages have varied widely following the three triennial revaluations since 1990, particularly in 1992.

Even though most members and nearly all the pensioners were obliged to join a single ESPS scheme and paid a uniform rate of contribution, some now enjoy superior benefits to others e.g. widows pensions at 67% as opposed to 55%, actual pensions increased by varying percentages, lump sum payments etc. This has caused mayhem at a number of ESPS AGMs. The Association believes that all benefits should be harmonised to ensure fairness to all who contributed at a uniform rate.

Benefit improvements for employers have been considerable and substantially greater than given to members. Not only have the employers avoided normal contributions, they have financed redundancies and other deficiency payments which had hitherto been company expenses, whilst employed staff members have had to continue paying into the Schemes - albeit in some cases at a reduced rate. Generally, the employers have taken at least 67% of all surpluses since 1992.

### **Pension Scheme Rules**

A cardinal feature of the Scheme's rules is that money cannot be paid by the Fund to the employer.

Until 1990, the ESPS was an "in house" organisation to the industry. The scheme was run by senior managers either appointed from the Electricity Boards or employed by the Electricity Council. All managers and trustees were members of the Scheme and enjoyed identical pension expectations. In effect, these were our own people who members trusted and knew in their everyday workplaces. There was, of course, no private "ownership" factor to consider, only the Government's overall control of the industry. Scheme rules were rarely invoked and the employers were trusted to manage the scheme in the total interests of members.

This situation has now changed fundamentally. The senior managers now appointed to serve as trustees; managers etc. have a fundamental conflict of interest. They have an overriding duty to serve their shareholders and to make punitive changes in a competitive environment. They are less concerned with staff and pensioners - called human resources - and are motivated to withhold contributions to pension funds whenever possible.

Against this background we have a set of Scheme rules which were drawn up in times of great trust and which were never, prior to 1990, used against members interests, but which now are being scrutinised carefully to raise profits for shareholders and other owners.

Several cases can be quoted as examples. The companies have taken legal advice in respect of early retirement costs; their lawyers, on the wording of the Scheme rules have said that the employer can declare a "nil" contribution to the Scheme if the Actuary certifies that the Scheme is already sufficiently funded to "carry" the costs. It is perhaps significant that the Court of Appeal reversed this legal opinion.

These costs, of course, arise directly from the employers wish to reduce staff prior to normal retirement age and, until privatisation employers had always reimbursed the schemes for these expenses. A further contentious matter here is that the employers have denied trustees access to their legal advice, thus frustrating trustee efforts to test the validity of the employers' case.

The aspect of retrospective rule changes has already been mentioned (page 4), together with the deceitful manner in which this additional rule was introduced. A leaflet issued to all staff prior to privatisation in 1989, proves this point. On page 2 the newsheet sets out the principles to be used in the necessary changes. The second principle that "changes to the Regulation .....would be limited to the minimum necessary to comply with other laws and Inland Revenue requirements." was highly misleading since S.I. No318: 1990 introduced the ability to make retrospective rule changes.

In November 1998, the employers, amended the Scheme rules to allow unused surplus to be carried forward as specific reserves; this was mostly for their benefit. In the worse cases, the employers took a contribution holiday and left their employees paying 6% - when previously the Rules ensured contributions at a 2 : 1 ratio of employer/employee contributions. The previous practice had always been to cast all funds back "into the pot" at each triennial valuation. This is a further example, which directly conflicts with the undertaking given in October 1989.

One of the Scheme rules deals with annual increases, which are tied to the end of the previous September figure for RPI. This rule also sets a maximum to annual increases at 5% unless the employer decides otherwise. This is the original pre 1990 rule and it is a fact that the pre 1990 employers always agreed to pay in excess over the 5% when inflation exceeded this figure. Members are seriously concerned that the new owners will interpret this differently in future. In fact, in 1999, the figure was 1.1%; all Groups are currently actuarially financed to the 5% level but the employers are refusing members' representations for a 3% increase in 2000, even though this would not affect the finances of any Group. Such is the trust that members have in the employers' management of their Scheme.

Further examples can be quoted if necessary and some are currently being processed with the Ombudsman.

Our main concern is that the employers can currently amend the rules of ESPS without reference to or consultation with trustees and our members consider this dangerous in this post-Maxwell era. We hope to obtain both legal and political help to alter this situation.

### **Individual Group Scheme Management**

Each Group Scheme has an Administrator whose appointment by the employer has to be notified to the trustees. Member contact is through this individual unless a trustee is personally known to the member concerned. The Administrator is a company employee. The formal Members' complaints procedure is operated by this officer, who provides the initial reply. Only later in the process are complaints considered by the Trustee body.

In most Groups, requests for trustees' names and addresses are refused. In a few the trustees' addresses are published. Similarly, correspondence sent to the Administrator to pass on to trustees is not always delivered to them. The Association finds this situation highly unsatisfactory and open to abuse by the employer.

Although the ESPS rules were amended in 1998 to permit the holding of a formal Annual General Meeting in each Group, employers in some Groups have not favoured this approach and still hold informal annual meetings to avoid the prospect of members demanding formal answers. Annual Meetings have no executive power and even the ESPS Annual General Meeting has no direct influence - even to approve or appoint the Scheme auditors, which remain the province of the employer, dominated EPTL.

The original single Scheme rules - pre-1990 - provided for a Special General Meeting -to be called *only* at the instigation of 100 employed members. This was acceptable when most members were employed but not now, when only 25% are employed it is a most unsatisfactory situation. The 1995 Pensions Act, or its Regulations, should have extended this requirement to all members. If anything goes wrong in the ESPS Group schemes members will have great difficulty in obtaining information and taking any necessary action.

With notable exceptions the Group schemes in the ESI are not providing members with sufficient information. The 1995 Act states that the Annual Report and Accounts must be available to members but does not require that they be sent to all members; in the ESI members only receive them by request. The only individual member circulations are confined to a once or twice a year newsletter following revaluations etc. and these tend to be employer generated with little or no trustee comment. Some AESP members have complained of not receiving notice of the ESPS Annual General Meetings; a task which the ESPS delegate to Group Management.

Obviously, the present position is unsatisfactory and could lead to another "Maxwell" type scandal in the ESI. The Association is looking to the Government and to politicians to take a greater interest in these matters. .We have made submissions to the current Secretary of State for Social Security and have noted his apparent disinterest.

### **Protection of Pension Rights**

The Electricity (Protected Persons England and Wales) Pension Regulations 1990 (S.I. No 346:1990) provided for the protection of pension rights of ESPS members existing at that time. They also laid a duty on employers to protect pension rights in the event of winding up, restructuring, change of ownership or the transfer of employees.

However, the Regulations contained a "Notice of Election", which an employee can sign to relinquish his/her protected status. We are informed that some ESPS members have been required to sign this document as a condition of .their transfer to newly formed companies; also,

some have failed to secure jobs in new companies for refusing to do so whilst others have only been provided with a job on this condition.

In an industry with regular and persistent staff reductions by redundancy members are now fearful for their jobs. Many may be willing to forgo their legal rights for a post in a new organisation. Members retiring are, in some cases being asked to sign away protected ESPS rule entitlements which would provide pensions at 50+ as part of redundancy settlements; all this in return for enhanced lump sums. The Association has actively assisted in some cases where former shop staff have been obliged to terminate Scheme membership in return for posts in newly formed companies..

### **The Role of the Ombudsman**

Members have been encouraged to seek support from Pensions Ombudsman, particularly in our concerns over the use of Actuarial surpluses by the employers for their own purposes and also in their opposition to the employers' unfettered right to effect rule changes. However, when his decision is challenged in the Courts - as in the National Grid case a David and Goliath struggle ensues.

The Ombudsman's role on appeal of his Judgments is limited to assisting the Court. As the Ombudsman has a judicial function when making Determinations, he is restricted from taking an active role on appeal.

The employers have virtually unlimited funds to fight members, some of whom will be pensioners, in the Courts. The original complainants, having used the Pension Ombudsman's procedure because it costs little and effectively provides a "poor man's" Court, face horrendous costs to be represented at an appeal and risk paying the employers' costs if the appeal is successful. It is only comparatively recently that complainants in this position have obtained pre-emptive orders for their costs to be paid by the relevant pension funds. Even that application requires legal representation and carries significant cost risks to the complainants.

The Association considers that, to create a "level playing field", there should be a presumption that the complainants' costs of appeal would be paid by the subject pension fund where:

- (a) the complainant is a respondent to an appeal, and
- (b) where the issues raised apply to a significant portion of the Scheme membership.

### **Conclusion**

This catalogue of irregularities is not exhaustive; they are probably the tip of an iceberg which may, in due course, build into another pensions scam similar to the Maxwell affair.

A cardinal factor in the Association's concerns is that, although each Group Scheme elects some member trustees these, by their very nature are mostly ordinary staff and pensioners, whose ability to supervise and intervene when necessary is limited by their own experience and severely hampered by the employers' stranglehold on the Schemes' administration and rules and their almost ,unqualified control through their superior voting rights.

Occupational pension funds are built on trust and the majority of members rely heavily on that trust. Those who have become more closely involved however, find that trust strained to the limit in the current chaotic struggle between the rightful interests of members and the marauding approach adopted by the employers in pursuit of shareholder or other ownership gain.

For many, their biggest single investment is in the ESPS and this is being weakened by the employer, by the government's tax regimes and by the legal fees incurred in trying to settle through the Courts issues which should be addressed once and for all by Parliament.

We see the solution in a combination of greater control of the Occupational Pensions Regulatory Authority and by political initiative to address the shortcomings of the 1995 Pensions Act. If it is necessary, in future, for employees to invest in occupational or other pension schemes as an alternative to the present national pension scheme, such efforts are being severely undermined by Government and employers' attempts to "raid" such schemes either by use of the Courts or, more directly, by taxation.

## **Summary**

The following matters need urgent attention

- (a) a halt to current employers' attempts to extract or divert pension fund moneys to owners and shareholders;
- (b) the urgent need for members who have contributed to any pension fund to have adequate representation in the management and control of that fund;
- (c) the rules of all contributory pension funds must be agreed jointly between members and employers with necessary arbitration clauses in event of difficulty;
- (d) the ability of either parties to change rules, whether prospectively or retrospectively must also come within (c) above;
- (e) member trustees must be elected to funds in the representative proportion to retired, active, and deferred members and provision should also be made for widows, spouses etc. to be represented;
- (f) all management decisions in contributory schemes should be made jointly; each committee or level of management having an independent chairman; voting rights and consequential liabilities to be shared equally;
- (g) no employer should be permitted to withhold contributions properly due to the fund or to withdraw or divert such funds without trustee agreement;
- (h) employers who retire staff earlier than at normally recognised ages must be required compulsorily to contribute a requisite sum to the fund in compensation for the additional expense incurred by earlier payment of benefit;

- (i) facilities must be provided for all members to be able to call for extraordinary meetings in the event of necessity; all schemes should be required to hold an Annual General Meeting, with individual member invitations;
- (j) the Annual Report and Accounts must be sent to all members and its content must include uninhibited comment by member trustees;
- (k) Regulations should be made to allow members' legal costs to be borne by pension schemes where any Ombudsman or court's decision is being appealed and/or where the subject matter is likely to affect a majority of members;
- (l) taxation of pension scheme investments must cease if more employees are to be encouraged to join private and occupational pension schemes;
- (m) all legal opinions taken by employers and trustees in respect of pension matters must be shared within the trustee group to ensure that all trustees are properly informed of their liabilities and duties;
- (n) pension schemes must provide for minimum annual increases of 3% (the Inland Revenue acceptance level) and must be required to fully index link to the RPI or to wages;
- (o) arrangements must be promulgated for individual members to be able to contact trustees directly if they wish to do so;
- (p) individual trustees should be able to seek independent legal advice whenever necessary to their functions and, collectively, the trustee body must appoint a separate legal adviser, totally independent of the employers;
- (q) Where large Associations such as AESP are formed by members discontented with the management of their Scheme, provision should be made for recognition of such bodies by the employers and in the Ombudsman process;
- (r) where schemes have already been broken up or where this is contemplated by an employer or group of employers all members should be balloted to ensure their agreement to such changes or to the continuation of their present scheme;
- (s) in cases where employee contributions have been universal and of identical proportion, no pension scheme should be permitted to offer differential benefits to employees, pensioners or dependants of the same scheme;
- (t) in all pension schemes the appointment of auditors must be confirmed by members at properly called and constituted Annual General Meetings to prevent employer interference in financial funding; and
- (u) shareholders and other owners must be made fully aware of potential liabilities arising from legal actions taken by company management, particularly where such consequences might adversely affect profitability.