EVERSHEDS SUTHERLAND

The Local Government Pension Scheme Advisory Board

This note has been prepared solely for The Local Government Pension Scheme Advisory Board (the "SAB"), and unless expressly agreed in writing, we do not accept liability to any other person in respect of the note provided. While we understand that this note may be shared with one or more other parties, our client is the SAB, and all other parties should take their own legal advice on the issues set out in this report. Sharing of this note with any other party or its advisers does not amount to waiver of legal privilege, and any such disclosure is made on the basis that the note and its contents must be kept strictly confidential and must not be used for any purpose other than that for which it is disclosed by our client.

R (ex parte FBU & others) v HMT & Home Office and R (ex parte BMA) v HMT & DHSC[1]

This case involved judicial review challenges brought (respectively) by the FBU and BMA in relation to the decision by the government to include McCloud remediation costs within the scope of the cost control mechanism (**CCM**) (often referred to as the "employer cost cap") applying to all public service pension schemes under the Public Service Pensions Act 2013. All arguments raised were dismissed, fairly robustly, by Choudhury J. We understand that the FBU, at least, has put in an application for leave to appeal on a protective basis, pending taking further legal advice on merits.

The key background facts were as follows:

- Preliminary work on the 2016 valuations (the first set of scheme valuations for the reformed schemes, and therefore the first time that the CCM would be under consideration) revealed by October 2017 that it was likely that the CCM floor would be breached, owing to restricted public sector wage growth, slower than anticipated improvements in longevity, and a higher level of pension commutation than anticipated. CCM floor breaches should lead to improvements in accrual rates and/or reduction to member contributions. These provisional floor breaches were confirmed in respect of most schemes in September 2018.

- On 20 December 2018, the CA decision in the *McCloud / Sargeant* cases was handed down, confirming unlawful age discrimination arising from the transitional protections adopted by public service pension schemes as part of the move to the reformed CARE schemes.

- On 30 January 2019, the government paused the CCM element of the 2016 valuations process, through a set of Directions which effectively permitted the 2016 valuation process to proceed for the purposes of setting future employer contribution rates only. The government's position was that it was not possible to make any sensible assessment at that point in time of the likely remediation costs flowing from *McCloud / Sargeant*, and that the CCM process therefore could not be operated with sufficient certainty.

- On 17 April 2020 [note: the judgment says 2019, but this appears to be a typo], HMT Pensions Board recommended that McCloud remediation costs should be borne by scheme members rather than employers, and that this could and should be reflected by including those costs within the CCM valuation process as a "member cost". (The FBU issued a first set of judicial review proceedings at this point, though these were stayed by consent pending the making of final Directions for the purposes of the 2016 CCM valuation.) On 23 April 2020, HMT agreed with this recommendation and made an "in principle" decision to adopt this approach. It then proceeded in July 2020 to consult on the McCloud remedy process, and at the same time announced the government's intention to restart the 2016 CCM valuation process with McCloud remedy costs expressly included as a member

1 [2023] EWHC 527 (Admin)

cost. Responses to consultation on the McCloud remedy process raised concerns about the decision that such costs should be borne by members.

- In December 2020, HMT agreed that any ceiling breaches arising as part of the 2016 CCM valuations should be waived, but that any floor breaches should be rectified.

- On 7 October 2021, following finalisation earlier in 2021 of the form of the McCloud remedy for most schemes as the provision of a deferred choice underpin, HMT made a fresh set of Directions, amending the original Directions from 2014 which would otherwise have formed the basis for finalisation of the 2016 CCM process, and including McCloud remediation costs as member costs within the scope of the CCM. These amendments meant that there were no longer any floor breaches, and therefore there were no improvements to accrual rates or reductions to member contributions. These 2021 Directions were the subject of the JR challenge.

The principal arguments raised by the FBU and BMA can be grouped into 3 broad categories. All were rejected by the judge:

1) **Construction arguments** regarding the interpretation of the provisions of the PSPA 2013 relating to what "costs" could be included in the CCM.

   a) Here, the judge disagreed that the term "costs" in s.12 should be interpreted in a way which would exclude the McCloud remediation costs: "*As a matter of ordinary language, … the term "cost(s)" is a broad one, apt to encompass any financial resource required to enable the scheme to meet the obligation of paying out pension benefits due to members of that scheme*."

   b) The reference in s.12 to "changes in costs" also did not limit the construction: it was clear from s.12(4)(c) and (5) that costs arising from past service in legacy schemes may be taken into account under the CCM to the extent that they result in a change in the costs of the new scheme.

   c) Policy documents prepared when the move to CARE was first implemented did not provide support for a narrower construction: the statutory words used were unambiguous, and in any event statements of policy intent cannot affect the meaning of legislation as ascertained using the standard tools of statutory interpretation.

2) Challenges to the **decision-making process**:

   a) Both sets of claimants raised arguments based on legitimate expectation, either that costs such as the McCloud remediation costs would not be included in the CCM, or that benefit improvements would follow in the event that the CCM floor was breached. It was argued that that the 2021 Directions breached such expectations. The judge held that such arguments failed at the first hurdle, since there was no "*clear and unambiguous promise devoid of relevant qualification*" that could give rise to a legitimate expectation, given in particular the size of the class of persons to which such promise was argued to be made (the whole of the public sector workforce) and the extent to which the subject matter lay in the macro-political field (given the estimated total cost of £19bn).

   b) The FBU argued that passing on to members the cost of the government's own discriminatory conduct was contrary to the purpose of the CCM, and thereby defeated Parliament's intent in putting the CCM in place. The judge disagreed: "*The fact that those costs are the result of a finding of discrimination against the Government does not of itself render it absurd or unconscionable for them to be taken into account, any more than might be an increase in costs that were the result of irretrievably poor economic policy choices made by Government. Were*

that not the case then any additional cost would be subject to scrutiny as to whether it was an "acceptable" cost, in terms of its moral, political or economic legitimacy, to include. That, it seems to me, is not the purpose of the 2013 Act at all."

c) The FBU also argued that the 2021 Directions had retrospectively extinguished their 2020 judicial review application, and as such was a violation of the right to a fair trial under common law and Art.6 ECHR. The judge disagreed that the 2021 Directions were retrospective in effect: the 2016 CCM valuation process had not been finalised before it was paused in 2019, and as such there was no accrued right to an improvement to benefits under the CCM procedure. In any event, any interference with the FBU's Art.6 rights was justified given the very substantial costs arising from McCloud / Sargeant, and the need to address the question of "*how best that cost should be met having regard to the interests of members balanced against those of taxpayers. That is not simply a question of cost-saving, but a question of the appropriate allocation and distribution of finite resources against the background of increasingly costly pension provision. Such matters constitute a legitimate aim in the context of interferences with ECHR rights and are ones that give rise to a wide margin of appreciation for the State*."

d) The BMA argued that there was a breach of a duty to consult relevant stakeholders as to whether or not to include the McCloud remediation cost in the scope of the CCM. The judge disagreed. There was no common law or statutory duty to consult, and no promise / legitimate expectation of consultation. There was no conspicuous unfairness in not consulting: the decision to include the McCloud costs in the CCM was not taken abruptly or without warning: it was discussed over a number of meetings, and the decision did not remove benefits that members had already accrued or were enjoying. In any event, even if there had been consultation as argued for by the claimants, it would have made no substantial difference to the outcome: "*the Claimants have not suggested (even now) any alternative option (short of the Exchequer simply meeting the cost from public funds) other than the binary one of treating the MRC as a member or an employer cost that could realistically have caused HMT to deviate from its preferred position*."

e) The BMA also argued that there had been a failure by HMT to obtain / take into account relevant information, including alternative options for the treatment of McCloud costs. This was held by the judge to be simply incorrect: HMT considered a variety of other options, including wholesale reform of public sector pensions. No other option, other than putting all the costs onto the taxpayer, was seriously suggested by the claimants, and this was inconsistent with the cost control / cost-sharing objectives adopted following the Hutton Report.

3) Arguments based on the **impact on members**, and in particular possible **discrimination**.

a) The FBU argued that including the McCloud remediation costs within the CCM was indirect discrimination against younger members (who were also more likely to be women / from an ethnic minority). The judge disagreed. It was necessary to be careful not to elide disadvantages caused by other factors and attribute those to the "provision, criterion or practice" (**PCP**) which was alleged to be the cause of the indirect discrimination. The PCP in this case was the inclusion of the McCloud costs in the CCM, and the effect of that PCP was to negate the CCM floor breaches which would otherwise have arisen and which would have led to benefit improvements or contribution reductions. Those floor breaches would have benefited all members, and the negation of those breaches means that all members lose that benefit. There was therefore no disparate impact so as to support a claim of indirect discrimination. The FBU argued that those who are outside the scope of the McCloud remedy suffer a particular disadvantage: however, the judge held that that was a direct consequence of the McCloud

remedy itself, which incorporates a cut-off date of 31 March 2012, rather than being causally linked to the PCP being challenged here. "*Whilst the PCP might have exposed the inherent disparate impact of the McCloud Remedy (which might itself be a PCP), it would not be the cause*." The cut-off date for the McCloud remedy was not the subject of this complaint, and could not be challenged (because it is contained in the PSPJOA 2022).

b) The judge also considered that disparity of treatment resulting from cut-off dates in the context of pension schemes "*provides a weak starting point for a claim of age- related discrimination*". "*It is the drawing of such lines in the context of pension schemes, whether that be because of the introduction of a new scheme or because of a remedy to correct a past wrong, that inevitably gives rise to different benefits as between members of different ages and lengths of service*." The position might be otherwise in a case of direct discrimination, or if the cut-off date chosen was irrational, but neither was the case here.

c) In any event, even if there was a disparate impact, the PCP adopted to pursue a legitimate aim, and was not "solely" about costs: "*Questions about long-term affordability and sustainability of public sector pension schemes and the equitable sharing of the burden as between the members (of whom there are millions) and the taxpayer, go well beyond costs alone … These questions also demonstrate that the aim transcends concerns about pension payments for a particular group: it extends to broader societal concerns about how best to fund public sector pensions in an era of increasing life-expectancy. As such, they will involve decisions in the sphere of social and economic policy that are for government, and in respect of which there will be a broad margin of appreciation. The limited role of the Court in reviewing such decisions is obvious.*"

d) The PCP was likewise a proportionate means of achieving that aim: "*The Defendant's choice when faced with the additional MRC was whether those costs should fall on public sector employers (which would mean either an additional burden on taxpayers or the diversion of finite resources from elsewhere, or both), or whether they should be met by withholding from scheme members the benefits that they might otherwise have enjoyed as a result of the floor breaches and if the MRC were excluded from the CCM. No other options appeared to be available and nor were any suggested by the Claimants*. … *In my judgment, in this context where the employers have a broad margin of appreciation and where the decisions made bear on matters of social and economic policy, the choice made by the Defendants was proportionate. The fact that some members will be affected more adversely than others is a consequence of the design of the McCloud Remedy and does not render that choice disproportionate*."

e) The judge also rejected a claim that the Public Sector Equality Duty had not been complied with. The PSED analysis undertaken prior to the making of the 2021 Directions "*acknowledges and identifies the differential impact, sets out the steps taken to mitigate that impact on younger members, recognises the limitations of those steps, takes account of the GAD advice that alternative mitigation could have an even greater impact on intergenerational fairness, and concludes by stating the Government's belief that the differential impact is, in these circumstances, justified. In my judgment, that is sufficient, in this context to discharge the PSED*." A precise mathematical analysis of the effect of a measure on different groups is not always necessary, nor was there a need here to carry out a scheme-specific analysis for each relevant scheme, given that there had already been some high-level analysis by GAD of some of the main scheme-specific differences. Failure fully to mitigate differential impacts was also not fatal: "*In the context of pension schemes, age-based differential impacts are unlikely ever to be eliminated completely, and thus minimising or reducing that differential to some degree may be the best that can be achieved*." In any event, even if there had been a more detailed and/or scheme-specific PSED analysis, it is highly unlikely that this would have made any difference to the outcome.

Comment – Subsequent to the High Court decision, leave to appeal has now been granted although the case has not yet been listed by the Court of Appeal for a hearing. Whilst a long-stop date of July 2024 has been set, we would expect the appeal hearing will take place in late 2023 or early 2024.

Eversheds Sutherland (International) LLP

July 2023

Privileged and confidential

For more information, please contact:

Gary Delderfield
Partner

D: +44 121 232 1786
M: +44 782 691 8202
garydelderfield@eversheds-sutherland.com

115 Colmore Row
Birmingham
B3 3AL
United Kingdom

eversheds-sutherland.com