SUPERANNUATION FUND SURPLUS:
Another problem for trustees

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Introduction

The modern day employee superannuation trust fund is administered by trustees usually comprising representatives of both the employer and the employees. The fund is constituted by contributions from both.

Sometimes, actuarial calculations reveal that the fund exceeds what is, or will be, required to discharge the obligations to members defined by the trust deed. This may occur for a number of reasons. The liability of the fund might be reduced by, for example, redundancies, or by the performance of the fund exceeding all expectations. This results in an actuarial surplus. The trust deed may provide for the reversion of that surplus to the employer. Frequently, it does not.

The issue arises as to whether, in the latter circumstance, the employer who is often represented on the board of trustees, can with the consent of the trustees amend the trust deed to provide for the payment of the surplus to it.

The question of surplus funds arose only infrequently in 'traditional trusts'. The trust, normally, provided that the life tenants receive the income and the remaindermen the capital.

The rules concerning distribution of any surplus in the superannuation trust fund, and the power of the employer (with the consent of the trustees) to amend the trust deed to distribute any surplus to itself, must be viewed in light of the differences between 'traditional trusts' and superannuation trust funds.

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Traditional Trusts v Superannuation Trusts

Those differences include the following:-[1]

1. The beneficiaries are not volunteers. They provide consideration for the benefits received under the fund by working for remuneration (including a superannuation component) and by themselves contributing to the trust fund. There is, effectively, no settlor, both employer and employee contributing to the fund in discharge of contractual (and statutory) obligations.

2. The underlying contract of employment. Underlying the superannuation scheme is the contractual relationship of employer and employee; in the private trust there is no relationship other than that of donor and donee.

3. The variable size of the trust fund. In the case of a traditional trust, the size of the fund is normally defined from the outset, and apart from investment questions it is not dependent upon the discretion of any third party. In a superannuation scheme, the size of the scheme fund is variable, and will from time to time depend upon estimates made on an actuarial basis.

4. The employers' continuing financial interest. Frequently, employers have a vital financial interest since they have to meet the balance of the cost. Moreover, they may also have access to the actuarial surplus.

5. The power to amend the scheme. Superannuation schemes normally contain a power to amend the Rules. They are usually vested in the employer, but exercisable only with the consent of the trustees, or visa versa.

The potential for conflict between employer and employee is obvious; the situation is complicated by the fact that representatives of the employers are frequently co-trustees, and the other trustees employees. On one view of the facts of a recent English decision, trustees of a scheme who were unwilling to comply with the employer's wishes lost their jobs and,

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1 Lord Browne-Wilkinson , 'Equity and its Relevance to Superannuation Today' delivered at the National Superannuation Conference for Lawyers, Canberra, 27 - 29 February 1992, at 1.5 - 1.10.

thereby, their position as trustees.[2]

It is equally clear that the rules of 'traditional trusts' inadequately deal with the problem.

Some attempts have been made to analyse the difficulties arising from 'non-traditional trusts' on a contractual basis. In *Kerr* v *British Leyland (Staff) Trustees Limited*,[3] Fox LJ, referring to the trusts of a pension scheme, said:-

> Now this is not a case of a trust where the beneficiaries are simply volunteers. The beneficiaries here are not volunteers. Their rights derive from contractual and commercial origins. They have purchased their rights as part of their terms of employment.

In *Palmer* v *Abney Park Cemetery Co Limited*,[4] Judge Blackett-Ord QC., sitting as a Judge of the Chancery Division, said as to the question of whether a resulting trust applied to the surplus of a fund):-

> The nature of the scheme in the present case is not primarily a trust, but primarily a matter of contract. The contributions of members and the contributions of the company were paid irrevocably into the common pool to be applied by the trustees in accordance with the deed and the rules. Under the deed and the rules the company was entitled to no return or benefit other than that of goodwill with its employees, and the members were entitled only to what they contracted for. That they have obtained. And on that ground it seems to me that the balance of the fund can only pass to the Crown as bona vacantia.[5]

If a contract be the essential nature of such a fund, it is arguable that the parties should be free to agree on matters such as the destination of surplus funds. However, it is equally arguable that a purely contractual analysis would leave open the way to defeat the very nature of the arrangement

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2 *Imperial Group Pensions Trust Ltd* v *Imperial Tobacco Ltd* [1991] 1 W.L.R. 589; see Lord Browne-Wilkinson, *supra n 1*, at 1.9.

3 Unreported, 26 March 1986, Court of Appeal, Civil Division.

4 Unreported, 4 July 1985, Chancery Division, High Court of Judicature.

5 See also *Ralna Limited* v *Canada Life Assurance Co* (1985) 51 O.R. (2d) 781 (H.C.); *Rees* v *Dominion Insurance Co. of Australia Limited* (1981) 6 A.C.L.R. 71.

between the parties, which is that contributions will be held as property for the purpose of providing the benefits which the plan lays out.[6] Extreme clauses may be agreed, for example, that put the interests of the employer ahead of those of the employees. Moreover, in practical terms, employees who contribute to superannuation funds frequently are not aware of the terms of the trust or, one may venture to think, its existence.

A more just solution, it is submitted, is reached by tempering the contractual analysis by a regulatory framework of trusts and fiduciary duties. For the purposes of superannuation trust funds, the trustees should (despite the terms of the trust deed) at all times be subjected to these principles.

This safeguard is arguably contained in the Model Trustee Code for Australian States and Territories.[7] By Clause 1.10 (1), it is provided:-

> 1.10 Fiduciary position of trustee
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> (1) Except to the extent expressly authorised by the Trust instrument the trustees shall in all respects act in a fiduciary manner and exclusively in the interests of the beneficiaries.

The extent of the fiduciary duties is relevant to the issue of whether a power of amendment can be used by the employer to generate an entitlement to surplus.

Actuarial Surplus

A surplus is most easily identified in a defined benefit fund upon the termination of the fund. If the assets of the fund are sufficient to meet all the accrued benefits of members and still leave an excess, then the excess may properly be described as a surplus, the distribution of which may be provided for in the trust deed, or if not will usually be returned via a resulting trust to the employer.[8] The employer may have ceased to exist,

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6 Austin, R.P. 'The Role and Responsibilities of Trustees in Pension Plan Trusts: Some Problems of Trust Law', in Youdan, T.G. (ed), *Equity, Fiduciaries and Trusts,* Carswell, 1989, 111 at 114.

7 See Clauses 1.10 (1) and (3).

8 The resulting trust/final surplus authorities are unclear, some indicating that the surplus is held on resulting trust for the employer on the grounds he has provided the balance of costs: *Re Courage Group Pensions Scheme* [1987] 1 W.L.R. 495; *Jones* v *Williams* (unreported) referred to [1990] 1 W.L.R. 1540; others indicating that there

gone into liquidation or just been wound up. This, however, is a final surplus as opposed to an actuarial surplus.

An actuarial surplus exists where the fund is continuing and represents an alleged temporary overfunding or forward funding by the employer. On one view, of course, where a fund is continuing there can be no surplus. The persons entitled to benefits, presently and prospectively, have not received the full amount to which they are or may become entitled, and it cannot strictly be said that there is some part of the fund which is not needed to discharge the obligation to provide those benefits.[9] However, superannuation trusts are often, by their nature, open and fluctuating and created for the benefit of employees identifiable now and in the future only by reason of the class of which they are, or may become, members. Actuarial surplus may exist, and grow, and the courts have adopted the view, rightly or wrongly, that they may also be distributed.[10]

The Power to Amend

The power to amend is normally contained within an amendment clause in the trust deed. Normally, amendment clauses are unrestricted as to subject matter but conditional upon obtaining the trustees' consent and maintaining the value of accrued rights of members at the time of the amendment.[11]

Apart from express limitations it has been held that an amending power can be exercised only for the purpose for which it was conferred, that is, promoting the purposes of the scheme, not altering them. This gives rise inevitably to questions of construction of the amendment clause in the

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may be a resulting trust to the employees and employers rateably to their contributions; others suggest that the surplus should go to the Crown as bona vacantia: *Rees* v *Dominion Insurance Co-op Australia Limited (in liq.)* (1981) 6 A.C.L.R. 71.

9 See *Re Imperial Food Limited's Pension Scheme* [1986] 2 All ER. 802 at 812; see also Lord Browne-Wilkinson, *supra n 1*, at 1.22.

10 *Hockin* v *Bank of British Columbia*, unreported, 25 June 1990, British Columbia Court of Appeal, Carrothers JA; *Lock* v *Westpac Banking Corporation Limited*, unreported, 26 August 1991, Supreme Court of New South Wales, Equity Division, Waddell J.

11 See, for example, *Lock* v *Westpac Banking Corporation Limited*, *supra n 10* and note Reg. 17(1)(d)(i) of the *Occupational Superannuation Standards Regulations*, precluding certain amendments affecting accrued benefits.

context of the deed as a whole.[12]

It should also be noted that it is usually impossible to amend the amending power to remove a restriction as this may constitute fraud on a power.

Importantly, it appears that if the trust deed expressly or implicitly prohibits the employer from participating in a surplus, an amendment will not in the normal course be allowed to enable the employer to take part in any surplus distribution. In *Rees* v *Dominion Insurance Co.*,[13] Waddell J held that, as a matter of construction, the trust deed prohibited both the members and the employer company from participating in the surplus on winding up. Surplus passed to the Crown as bona vacantia. In *Wilson* v *Metro Goldwyn Mayer*,[14] the trust deed provided that, during the lifetime of the trust, surplus moneys could, at the discretion of the company, be applied towards the company's contributions or in the payment of such benefits for members, former members or dependents as the company might, in its discretion, direct. The deed further provided that upon winding up, the trustees were obliged to apply surplus moneys for the purpose of benefits to such members as the company might then direct. Despite the company being excluded from participation in surplus moneys on winding up, the trust deed also conferred upon the company and the trustees a joint power to amend the deed in any respect which would, in the opinion of the company, not prejudice any benefits secured. The company proposed to amend the deed by altering the provision governing entitlement to surplus on winding up, so as to provide that the surplus moneys could be paid to the company. Kearney J held that there was no power to amend the deed in such a way as to prejudice the members' entitlement to surplus on winding up.

Assuming, however, that the trust deed envisages that the employer may participate in surplus assets on winding up, although it does not specifically deal with the distribution of surpluses while members remain in the fund, that is, assuming that an amendment to take the benefit of actuarial surplus

12 *Re UEB Industries Limited Pension Plan*, unreported, 23 March 1990, High Court of New Zealand, Gault J; *Wilson* v *Metro Goldwyn Mayer* (1980) 18 N.S.W.L.R. 730; *Campbell* v *Ferrco Engineering Limited* (1984) 4 C.C.L.I. 268; *Hockin* v *Bank of British Columbia, supra n 10*; *Little and Siefert* v *Kent-McClain of Canada Limited* (1972) 72 D.R.S. 417.

13 *Supra n 8.*

14 *Supra n 12.*

is not contrary to the spirit of the deed, the issues arise as to the duties owed to the members by the trustees, and the employer, in the exercise of the powers of amendment.

Duties owed by the trustees

A general test of a fiduciary relationship which now commands wide acceptance is proposed by Dr. Finn:-[15]

> He (a fiduciary for these purposes) is, simply, someone who undertakes to act for or on behalf of another in some particular matter or matters. That undertaking may be of a general character. It may be specific and limited. It is immaterial whether the undertaking is or is not in the form of a contract. It is immaterial that the undertaking is gratuitous. And the undertaking may be officiously assumed without request.

The trustees of the fund are undoubtedly under a fiduciary obligation to act in the interests of the members. However, if the employer is entitled to surplus on termination, or is entitled to be considered for distribution of the surplus on termination, the employer is already a beneficiary, albeit with a remote and contingent interest.[16]

An amendment in those circumstances dealing with the surplus merely has the effect of accelerating the employer's enjoyment of the surplus.

The trustee must, at all times, act in the interests of all beneficiaries:-

> With respect to the personal welfare of all the beneficiaries the trustees' duty of loyalty requires the beneficiaries to be treated impartially, that is, equally where they have similar rights and fairly when they have dissimilar right.[17]

An analysis of a trustee's actions where the rights of the beneficiaries are dissimilar, as may be the case where there is an actuarial surplus and the employer and members have rights in relation to the surplus, is essentially qualitative. Waddell J, in *Lock* v *Westpac Banking Corporation Limited,*[18]

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15 P.D. Finn, *Fiduciary Obligations*, The Law Book Company Limited, 1977 at 201.
16 R.P. Austin, *supra n 6*, at 119.
17 Ford and Lee, *Principles of the Law of Trusts*, 2nd ed, The Law Book Company Limited at 400.
18 *Supra n 10.*

reasoned:-

> It seems to me that in the present case the Trustees while they had a duty to act in the interests of the Members, were entitled to take into consideration the interests of the Bank in relation to the surplus which had accumulated in the fund in considering whether or not to consent to the proposed amendment to the Deed. If they were satisfied on reasonable grounds that the overall package was a resolution of the interests of the parties in the surplus which was fair both to the Bank and to the Members they were, in my opinion, entitled to consent to an amendment enabling part of the surplus to be returned to the Bank. It is to be noted that the Deed does not attempt to regulate the matters to which the trustees are to give consideration in the exercise of any of their powers. This means that they are left to be the judge of what material is adequate for the decision which they are called upon to make and of what decision should be made on that material. Their decision is valid unless it can be said that, on the material before them, it was not open to them, as reasonable persons, to make it, or, of course, if it was in breach of the rules already mentioned ... All the evidence suggests that they (the Trustees) were prepared to give their consent as part of a package which they considered appropriate in the circumstances.

Such a qualitative assessment of the actions of trustees is not new. However, the potential problems are exacerbated by the nature and structure of modern employee superannuation trusts. The task of the trustees, charged with evaluating the correct course of action to take, weighing up the apparently conflicting interests of employer and employee, is a difficult one. It is complicated by the fact that, perhaps for the first time, the trustees are themselves identifiable with one or other class of beneficiaries. The trustees themselves may stand to gain or to lose. The employer (or, perhaps these days, the employee) may be in a position to influence the other trustees in their favour. Superannuation contributions are becoming an increasingly important component of the average employee's pay entitlement, and will conceivably in the future provide the sole basis for an employee's earnings after retirement. The importance of

these funds, therefore, make it likely that industrial organisations will increasingly become involved in their administration.

All of these matters make it difficult for trustees of superannuation funds to effectively administer them consistently with traditional concepts, and suggest that the employee superannuation trusts will, if left in their current form, be the source of much dispute in the future. The courts are ill equipped at present to deal with the problem, as evidenced by the remarks of Blackett-Ord J in *Doyle* v *Manchester Evening News Limited*:-[19]

> It is accepted that there is intended to be a division of representation between management and managed, so that the trustee as a body hears the views of both sides ... and it is necessary for the trustees to accept that their interests as managers or members, and their duties as trustees, may sometimes conflict, and for them to try consciously to adopt an objective attitude. If they do their best in this direction, that is all the Deed requires.

Lord Browne-Wilkinson was less optimistic:-[20]

> If it is legally possible to alter the rules so as to permit the return of funds to the employer, the trustees are faced with the very great difficulty in deciding whether or not to agree to such change, given the additional benefits being offered to the members of the scheme. It is not a normal function of trustees to bargain on behalf of the beneficiaries. Moreover, as I have explained, they are normally subject to considerable pressure from the employer by reason of their connection as employees. Such a negotiation is in any event a difficult one: a game of poker to see how much benefit can be extracted for the members in return for the benefits to be received by the employer. For myself, I think such a position is an impossible one for trustees.

Duties owed by the employer

The employer's duty to the members is somewhat different from that owed by the trustees. Despite some authorities to the contrary, he is not a

19 Unreported, 19 September 1989, Chancery Division, Blackett-Ord J.
20 Lord Browne-Wilkinson, *supra n 1*, at 1.22.

fiduciary agent.[21] Significantly, in *United States Surgical Corporation* v *Hospitals Products International Pty. Ltd.* (when in Court of Appeal),[22] the Court held that a mere power to affect the interests of another does not give rise to a fiduciary duty. There must be added an essential 'representative' element, which arose when 'a person had undertaken to act in the interests of another and not in his own'.[23] The fact that one party should repose substantial confidence in another in acting on his behalf or in his interests in some effect, though usual or perhaps necessary in a fiduciary relationship would not necessarily give rise to a fiduciary relationship.[24] The employer is, however, under an implied obligation to act in good faith in relation to the exercise of his rights and powers under the superannuation scheme.[25] This obligation has been described to mean:-

> That the employers will not without reasonable and proper cause conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employees.[26]

This assessment of the employer's duty was applied in *Lock* v *Westpac Banking Corporation Limited*[27] where Waddell J said:-

> The power of amendment is subject to an implied condition that it be exercised honestly and in good faith, but is not a fiduciary power ... the decision to make the amendment was no doubt taken as a matter of commercial judgment in the context of the Bank's relationship with its employees who were represented by an industrial union ... the Deed deliberately qualifies the capacity of the Bank to make amendments pursuant to clause 35 by the restrictions imposed therein. Those restrictions recognise that, subject

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21 Cf Warner J in *Mettoy Pensions Trustees Limited* v *Evans* [1991] 2 All ER. 513 at 545 - 547.

22 [1983] 2 N.S.W.L.R. 157 (CA.).

23 At 208

24 *Hospital Products Limited* v *United States Surgical Corporation* (1984) 156 C.L.R. 41 at 141-2, per Dawson J.

25 *Imperial Group Pensions Fund Limited* v *Imperial Tobacco Limited* [1991] 1 W.L.R. 509.

26 See *Woods* v *W M. Car Services (Peterborough) Limited* (1981) I.C.R. 666 at 670; approved by the Court of Appeal in *Lewis* v *Motorworld Garages Limited* (1986) I.C.R. 157.

27 *Supra n 10.*

to the Bank complying with them, it is entitled to act in its own interests.

The obligations of employers in the administration of superannuation funds can, it is submitted, only be appropriately considered as obligations of good faith. Their source is the relationship of employer and employee. There is no need, it is submitted, to consider this obligation as a fiduciary obligation. However, the exercise by the trustees of their fiduciary obligations to their members and employers requires attention.

Conclusion

The current predicament in which trustees are placed in administering superannuation trusts is unsatisfactory. It appears almost inevitable that if the current administrative structures of employee superannuation funds are maintained the administration of such funds will become as much a matter of industrial law as a matter for equity.[28] This is because the practical position of the trustees is such that it is difficult (if not impossible) for them to fulfil the equitable duties placed upon them by the laws relating to traditional trusts.

Currently there is no legislation dealing specifically with superannuation fund surpluses. A statement on 'new prudential arrangements for superannuation' however, issued by the Federal Treasurer on 21 October, 1992 recommends the enactment of a provision requiring the following preconditions to be satisfied before an actuarial surplus can be refunded to an employer:-

(i) The fund has equal employee/employer representation;

(ii) an actuary certifies that the fund will remain in a satisfactory financial position after the refund of surplus;

(iii) members have been given at least three months notice;

(iv) the governing document permits such a refund; and

(v) trustees are satisfied that the return of surplus and any associated changes are a reasonable resolution of the interests of the two groups of parties (being the employer and the members).

These preconditions are now contained in Clause 48 of the

28 *Re Amalgamated Metal Workers' Union; Ex parte Shell Co* (1992) 66 ALJR 613.

Superannuation Industry (Supervision) Bill 1992. This section of the Bill, when passed, will have retrospective effect as and from 21 October 1992, the date of the Treasurer's statement.

In my view the proposed legislative changes, in particular that requiring equal employee/employer representation, are superficial amendments which do not resolve the conflict faced by trustees of superannuation funds. Trustees under the proposed legislation are encouraged to think of themselves not as representative of the beneficiaries as a whole but indirectly as representative of their own interests in being the elected representative of a particular faction, be it employee or employer, to which he or she belongs.

In my submission the unenviable position of the trustees may be alleviated in the following ways:-

1. By provision in the trust deed whereby the amendment of the trust deed is made subject to obtaining the agreement of say, 75% of the beneficiaries. Given the present structure of employee superannuation trust funds, this would at least to some extent relieve the trustees from conflict.

2. The position of the trustees could be filled by persons independent of both employer and employee. This has the immediate appeal of placing the trustees above direct interests on behalf of one group as opposed to the other, but has the disadvantage of placing the funds beyond the direct control of the persons who contribute to it and who, eventually, must benefit from it.

3. At least one of the trustees could be made wholly independent of either group.

4. Members' access to trust information could be increased, thereby precipitating greater regulation and participation in the decision of trustees.

5. Provision should be made in the trust deed that the trustees obtain independent legal advice from that given to either the employer or the employees. Provision could be made for payment of legal fees from the trust fund.

6. Provision could be made, and perhaps should be made by legislative enactment, for the distribution of any actuarial surplus

and/or final surplus. It is probably sound that an actuarial surplus should be able to be distributed, providing that distribution does not prejudice the accrued rights of beneficiaries. It is fair that employers and employees receive surplus rateably to their contributions. It is more difficult to draw the appropriate line, however, when considering the manner of distribution of a surplus generated by the fund over and above the extent of the contributions by employer and employees.

Employee superannuation trust funds pose new and difficult problems for trustees. This is exemplified by the difficulty faced by trustees when assessing whether to consent to the amendment of a trust deed to allow distribution of an actuarial surplus to the employer. The problems are chiefly the result of the common structure of employee superannuation funds. Practical pressures on such trustees make their compliance with, and application of, traditional concepts relating to trustees difficult. Either the structure of the trusts will need to be amended, or new guidelines developed for trustees of superannuation funds. For a number of reasons, without legislative intervention to deal with the peculiarities of these funds it is likely that the administration of employee superannuation funds will soon fall to be determined by consideration of industrial policy which may, or may not, include consideration of the traditional law of trusts.