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Case No: HC10C01796

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL
04/04/2014

B e f o r e :

MR JUSTICE WARREN

Between:

(1) IBM UNITED KINGDOM HOLDINGS LIMITED
(2) IBM UNITED KINGDOM LIMITED **Claimants**

- and -

(1) STUART DALGLEISH
(2) LIZANNE HARRISON
(3) IBM UNITED KINGDOM PENSIONS TRUST LIMITED **Defendants**

Andrew Simmonds QC, Paul Newman QC, Henry Legge QC, and Joseph Goldsmith (instructed by Dickinson Dees LLP) for the Claimants
Michael Tennet QC , Nicolas Stallworthy QC, Benjamin Faulkner, and Bobby Friedman (instructed by DLA Piper UK LLP) for the 1st and 2nd Defendants
Andrew Spink QC and Edward Sawyer (instructed by Nabarro LLP) for the 3rd Defendant

Hearing dates: 18th,19th,20th,21st,22nd,25th,26th,27th, and 28th February, 1st,4th,5th,6th,7th,8th,11th 12th,13th,14th,15th,18th,19th,20th,21st, and 27th March, 8th,9th,10th,11th, and 12th, April 2013

HTML VERSION OF JUDGMENT

Mr Justice Warren :

Introduction

1. This is an application for declaratory relief concerning certain proposed changes first announced by the First and Second Claimants in July 2009, and announced in their final form in October 2009, in relation to two final salary pension plans that operated for the benefit of their UK workforce, namely the IBM Pension Plan ("**the Main Plan**") and the IBM IT Solutions Pension Scheme ("**the I Plan**", together "**the Plans**"). These changes were announced following a project known internally as "**Project Waltz**".

2. In these proceedings, the changes are challenged on behalf of the members of the Plans.

3. The First Claimant ("**Holdings**") is the principal employer for the purposes of the Plans (which means that certain important powers and discretions under the relevant rules are vested in it). The Second Claimant ("**IBM UKL**") also participates in the Plans and is the employer of most of the active members. I shall refer to them together as "**IBM UK**" in order to distinguish them from the US parent IBM Corporation. IBM Group's headquarters is in Armonk and is known as "**CHQ**". I use "**IBM**" as a catch-all to include the Group as a whole.

4. The First and Second Defendants, Mr Dalgleish and Ms Harrison, have been selected to be representative beneficiaries ("**RBs**") for the purposes of the Project Waltz Proceedings. They are respectively members of the Main Plan and the I Plan.

5. The Third Defendant ("**the Trustee**") is (and has at all material times been) the sole corporate trustee of the Plans. It takes a neutral role in these proceedings (although it has adduced factual evidence that it considers to be of assistance to the Court).

Trust Deeds and Rules; Notices of Exclusion

6. The Deeds and Rules which currently govern the Plans are described in the following paragraphs.

7. The Main Plan is currently governed by three Deeds dated 24 April 1997 (as amended) comprising:

    i) the 1997 Definitive Trust Deed ("**the Main Plan Definitive Trust Deed**") setting out the general provisions governing the Main Plan as a whole;

    ii) a Deed comprising the 1997 Defined Benefit Section Rules ("**the Main Plan DB Rules**") setting out the Rules for the C, N and DSL Plans and other defined benefit ("**DB**") sections;

    iii) a Deed establishing the 1997 Money Purchase Section Rules ("**the Main Plan DC Rules**") setting out the Rules for the defined contribution ("**DC**") sections.

8. There were many earlier editions of the Main Plan Trust Deed and Rules pre-dating 1997, stretching back to 1957. References in this judgment to the Main Plan Definitive Trust Deed, the Main Plan DB Rules or the Main Plan DC Rules are (unless otherwise stated) references to the then current version of these instruments as they stood at the time of Project Waltz, as reflected in the informal consolidations.

9. The Main Plan has separate DB and DC sections. The DB sections comprise the following structures:

    i) 'N Plan' (closed to new joiners with effect from 5 July 1983 and now having about 270 active members);

    ii) 'C Plan' (closed to new joiners with effect from 5 April 1997 and now having about 2,400 active members);

    iii) 'E Plan' (closed to new joiners with effect from 5 July 1983 and now having a single active member); and

    iv) 'DSL Plan' (in practice closed from its inception, being the product of a scheme merger under which a cohort of members transferred into the Main Plan and now having about 150 members across various sub-categories of membership).

10. The main DC section of the Main Plan is known as "**the M Plan**". There is also a DC section known as "**the Enhanced M Plan**" which was established in 2006 to which various DB members had a one-off option to transfer at that time as I explain below, an option arising in the context of Project Soto.

11. The I Plan is currently governed by a single Definitive Trust Deed and Rules dated 25 July 1994 (as amended) ("**the I Plan Deed and Rules**" or "**the I Plan Rules**" as appropriate). The I Plan Deed and Rules are the instruments which originally created the I Plan; there were no previous editions. References in this judgment to the I Plan Deed and Rules are (unless otherwise stated) references to the then current version of those instruments as they stood at the time of Project Waltz, as reflected in the informal consolidation.

12. The I Plan is a separate trust from the Main Plan. It provides defined pension benefits. I will refer to the I Plan together with the DB sections of the Main Plan as "**the DB Plans**", or the "**UK DB Plans**".

13. Although reference is made in the Main Plan to "sections", it is not in fact a sectionalised plan in the sense of having separate funds appropriated to different sections of the membership and their benefits. There is a single trust and single trust fund albeit that different classes of member have different benefits under the rules of the DB sections and the DC sections.

14. I will come to the package of changes comprising of the Project Waltz changes in due course. One element ("**Element 1**") was the closing (subject to certain exceptions) of both of the DB Plans to future benefit accrual with effect from 6 April 2011. This was purportedly effected by IBM pursuant to the exercise of a power to direct that any specified person or class of persons shall cease to be a member. There is an issue about whether that power was validly introduced into the Main Plan and there is an issue about whether the powers in both the Main Plan (assuming it was properly introduced) and the I Plan were validly exercised. Although neither power contains the word "exclude" or similar words they have been referred to as "**the Exclusion Powers**" and that, or its singular, is the expression I will use. I use that expression generally to refer to the power in the Main Plan whether in the 1990 Trust Deed and Rules or in the Main Plan Trust Deed and Rules (*ie* the 1997 iteration). The wording is the same and it is not suggested that the meaning has changed. These issues have given rise to Issues 1 to 3 in the List of Issues (see paragraphs 46*ff* below).

15. IBM's case (subject to a detailed point to which I will come in due course) is that the Exclusion Powers, as a matter of construction, can be exercised so as to direct that all existing active members shall cease to be members. IBM also contends that, having that construction, the Exclusion Power was validly introduced by way of amendment into the Main Plan. The RBs' case is that the Exclusion Powers cannot, as a matter of

construction, be exercised in that way, so that the purported exclusion of all members from membership of the Main Plan and the I Plan, was invalid. Further, they contend (i) that if the Exclusion Power has the construction for which IBM contends, then it was not validly introduced into the Main Plan in the first place and (ii) that the Exclusion Powers were exercised in the case of both of the DB Plans for an improper purpose.

16. Quite apart from those differences between IBM and the RBs in relation to the Exclusion Powers, the RBs challenge each element of the proposals arising out of Project Waltz (including the exercise of the Exclusion Powers) as a breach of what, by way of short-hand, I refer to as the *Imperial* duty (discussed in detail later in this judgment).

Project Waltz in outline

17. The parties, in their written opening and closing submissions, have all described the essential elements of Project Waltz. They have done so focusing in different ways on different aspects. I have taken account of all of it in setting the background. I have found particularly helpful the written opening submissions on behalf of the Trustee which I consider present an accurate description of the background. What follows, all the way to paragraph 59 below, is taken largely from those submissions. Although I interpose my own comments on a number of occasions, the substantial work is that of the Trustee's team. It seemed to me that I would be re-inventing the wheel in the most unnecessary way if I were to re-write this work in my own words when it is essentially uncontentious. I do not need to identify, as I go along, where I am taking verbatim or almost verbatim what appears in those submissions but I readily acknowledge that a substantial part is not my own work. I am very grateful to the Trustee's team for their thorough, neutral and objective work which I consider to be wholly reliable.

18. Holdings presented the proposed Project Waltz changes to the Trustee in May 2009 and to the IBM UK employees in July 2009. Approximately 5,000 employees were affected by Project Waltz, being, broadly, the then active membership earning DB benefits. The Project Waltz proposals, as presented to the members, were summarised in an email from Mr Brendon Riley ("**Mr Riley**"), the then general manager of IBM UK, to the employees dated 7 July 2009 which stated as follows:

> "After careful consideration by the UKI [that is the UK and the Irish Republic] Leadership team, we are proposing the following:
>
> > a) The Defined Benefit sections of the IBM Main Plan (C, N, and DSL plans), and I Plan, will close to future accrual (i.e. members will cease to build up further benefits on a Defined Benefit basis) with effect from April 2010.
> >
> > b) There will be no further pensionable salary increases for Defined Benefit members while they are active members of the Defined Benefit Plan.
> >
> > c) Employees who are members of the Defined Benefit Plans will have the option of joining the Defined Contribution section of the IBM Main Plan, the M Plan, once their active membership of the Defined Benefit Plan ceases.
> >
> > d) With effect from April 2010, IBM will implement a new early retirement policy which will restrict the circumstances in which it will give its consent to early retirement on the enhanced terms set out in the Main Plan (C, N and DSL plans). This proposal will not affect I Plan members.
> >
> > If these proposed changes in a) to d) above are implemented, IBM proposes to improve the current Defined Contribution Plan (M Plan) for all current members, and for existing Defined Benefit members who transfer into the M Plan…."

19. Project Waltz was finally formulated in 2009. There were five essential elements affecting active DB members:

i) **Element 1**: as described at paragraph 14 above, the closing (subject to certain exceptions) of the DB Plans to future benefit accrual with effect from 6 April 2011;

ii) **Element 2**: the entry by DB members into agreements in October-November 2009 by which any future pay increases would be non-pensionable for DB purposes, pursuant to the principles in *South West Trains v Wightman* [1998] Pens LR 113, Ch D ("**the 2009 Non-Pensionability Agreements**");

iii) **Element 3**: the opening of an "**early retirement window**" in November-December 2009 by which active DB members who were potentially eligible for early retirement could apply to take early retirement with Holdings' consent. This was in accordance with the then existing permissive early retirement policy under which early retirement was almost invariably allowed and which benefited from the application of the then current early retirement discount factors ("**ERDFs**") which were more favourable to the member than would have been, for example, "cost-neutral" ERDFs, prior to the introduction of a new restrictive early retirement policy on 6 April 2010 (see Element 4 below);

iv) **Element 4**: the introduction of a new early retirement policy on 6 April 2010 under which, save for "*exceptional circumstances*", IBM would not consent to an active DB member's early retirement except on terms which were cost-neutral for the Plans;

v) **Element 5**: with effect from 6 April 2011, making M Plan membership available to former active members of the DB Plans so that they would accrue future benefits on a DC basis, and the creation of "**hybrid deferred**" status for their accrued DB benefits which remained in the DB Plans (this status is described in more detail in paragraphs *38ff* below).

20. I now turn to explain each of Elements 1 to 5 in more detail.

Element 1 – cessation of DB accrual from 6 April 2011

21. To accomplish Element 1 of Project Waltz (cessation of accrual in the DB Plans), Holdings served notices ("**the Exclusion Notices**") on the Trustee on 28 May 2010 purportedly excluding active DB members from membership of the Main Plan and the I Plan with effect on and from 6 April 2011. The Notices were expressed to be served pursuant to the Exclusion Powers which were these:

i) Part V clause 4 of the Main Plan Definitive Trust Deed ("**the Main Plan Exclusion Power**") which provided:

> "4. **Exclusion by Principal Employer from Membership**
>
> The Principal Employer may by notice in writing to the Trustee direct that any specified person or class of persons shall not be eligible for membership, or shall cease to be a member or members. Such a notice shall override any provisions of the Plan that are inconsistent with it."

ii) Schedule D Rule 6 of the I Plan Rules ("**the I Plan Exclusion Power**") which similarly provided:

> "Exclusion by Principal Employer from Membership
>
> 6. The Principal Employer may by notice in writing to the Trustee direct that any specified person or class of persons shall not be eligible for membership, or shall cease to be a member or members PROVIDED THAT this will not apply to those Employees admitted to the Plan in accordance with Rule 1(1)(b) of this Schedule such a notice shall override any provisions of the Plan that are inconsistent with it."

22. The Main Plan Exclusion Notice purports to exclude the entire active DB membership from the Main Plan with effect from 6 April 2011. The I Plan Exclusion Notice purports to exclude all of the active members (apart from 455 named I Plan members) from the I Plan with effect from the same date, the 455 members being those who had contractual entitlements to continued DB accrual or whom IBM decided to keep as active members in order to avoid triggering a statutory debt. Due to doubts about whether the terms of the Exclusion Notices comprehensively covered all the active DB members, supplemental Exclusion Notices were served by Holdings on 28 March 2011 with effect from 6 April 2011.

23. Taking the original Main Plan Exclusion Notice dated 28 May 2010 as an example, the Exclusion Notices was as follows:

> "IBM United Kingdom Holdings Limited as Principal Employer for the purposes of the Plan hereby directs that all members currently accruing benefits under the Defined Benefit Rules shall cease to be members of the Plan with effect on and from the 6 April 2011."

24. A similar direction appeared in the I Plan Exclusion Notice of the same date.

25. In the Main Plan Exclusion Notice, there then followed a statement which did not appear in the I Plan Exclusion Notice as follows:

> "For the avoidance of doubt:
>
> (1) …
>
> (2) This does not constitute a direction that the persons so ceasing shall not be eligible to join the M Plan pursuant to paragraph 1 of Schedule B to the Money Purchase Rules."

Element 2 – the 2009 Non-Pensionability Agreements

26. IBM UK employees were informed on 7 July 2009 that there would be no further pensionable salary increases for DB members whilst they were active members of the DB Plans. Holdings sought to accomplish this through the 2009 Non-Pensionability Agreements as follows:

> i) On 22 October 2009, Mr Riley emailed IBM UK employees to inform them that salary increases (known as an "Employee Salary Programme" or "**ESP**") for some employees would be offered in 2009 and 2010.
>
> ii) On 27 October 2009, IBM UK's director of human resources, Mr Jonathan Ferrar, emailed the affected IBM UK employees with an online tool by which employees could agree to the non-pensionability terms by a deadline of 10 November 2009, stating:
>
> > "I am writing to you to explain that any salary increases offered as part of this and any future ESP will not be pensionable as long as you remain a member of a Defined Benefit pension plan, even if such salary increases are backdated. …
> >
> > If you do agree to accept that any further salary increases will be non-pensionable for Defined Benefit plan purposes (by ticking the acceptance box in the tool below), further salary increases will be included in the calculation of pensionable salary for the purposes of an IBM **Defined Contribution** Plan. [my emphasis]
> >
> > If you do not agree to this term (either by ticking the non-acceptance box in the tool below or by not responding in accordance with the deadline set out below) you are advised that you will not be eligible to receive any salary

increases.

Please find the tool below to register your acceptance or not of the terms described above which must be submitted no later than 5pm GMT on Tuesday 10th November."

iii) On 9 November 2009, Mr Ferrar sent a further email to the affected employees which extended the deadline for acceptance to 16 November 2009 and stated ? according to IBM simply by way of clarification ? that employees who did not agree the terms (or failed to respond) would retain the option to change their mind after the deadline.

iv) Of the 3,798 active DB members who were asked to accept the 2009 Non-Pensionability Agreements, 3,066 accepted them, 27 rejected them and 705 did not respond.

Element 3 – the early retirement window

27. IBM UK had a longstanding practice of allowing or encouraging employees to take early retirement before Normal Retirement Date ("**NRD**"), often during their 50s. I will explain later in this judgment the detailed provisions of the Rules of the DB Plans, but, in summary, under the Rules of the C and N Plans, early retirement pensions for active members were reduced by 0.25% for each month between the commencement date of the pension and the member's 60th birthday, *ie* an ERDF of 3% pa taken back from age 60 for retirements from active status before age 60, and no reduction for such retirements from age 60. These were advantageous terms for early retirees which were more expensive (for the Plans) than cost-neutral.

28. Similar provisions applied in respect of some DSL Plan DB members. By contrast, deferred C and N Plan members who drew their pensions before NRD were subject to a larger, cost-neutral, ERDF applicable to all years preceding NRD (and, again, similar provisions applied in respect of some DSL Plan DB members). However, under the Rules of the C and N Plans as they stood at the time Project Waltz was announced in 2009 (and for some DSL Plan DB members), retirement of active members before NRD was subject to Holdings' consent. Such consent had always been forthcoming in practice in the past.

29. As part of Project Waltz, Holdings decided to introduce a new restrictive early retirement policy with effect from 6 April 2010 which would in nearly all cases prevent early retirement on these advantageous terms for active C and N Plan members (and for some DSL Plan DB members).

30. The early retirement window was an opportunity for such members to seek Holdings' consent to retire under the existing permissive and financially attractive policy (from the point of view of the applicable discount factors) before the new policy came into force. The effect of this was that, after the closure of the early retirement window, an active DB member wishing to "retire" early without having been able to obtain Holdings' consent (insofar as consent was needed under the Rules applicable to him) would have to leave service and take early payment of his deferred benefit: this would involve the application of a less generous discount factor than the ERDF that would apply to an early retirement with consent from active membership.

31. The early retirement window was implemented as follows:

i) On 21 October 2009, Mr Ferrar emailed all DB members who would be aged 50 or over by 5 April 2010 inviting them to express interest in taking early retirement before the new policy was introduced on 6 April 2010.

ii) The email set out the following timetable for the early retirement window:

a) 21 October 2009 to 16 November 2009:

Early retirement window for eligible employees to register their intention to retire early

b) Up to 13 November 2009:

> Support for employees (early retirement seminars, one to one consultations, early retirement modeller)

c) 16 November 2009:

> Deadline for employees to register their intention to retire early

d) 4 December 2009:

> Employees to receive IBM's decision on whether to consent to early retirement

e) 11 December 2009:

> Deadline for employees to decide whether to accept or reject the offer.

iii) Of the 2,324 employees eligible to apply for early retirement, 1,162 applied, of whom 861 took early retirement.

32. I note that (subject to giving 12 months' notice of their intention to retire) active I Plan members did not require Holdings' consent for early retirement so, on the face of it, the early retirement aspects of Project Waltz did not affect them in the same way as the members who required consent for early retirement. Similarly, some active DSL Plan DB members did not require Holdings' consent for early retirement. Active I Plan members were also subject to less favourable ERDFs (5% p.a. for each year of early retirement taken back to NRD), so the differential between retiring from active status and retiring from deferred status was less significant for them.

Element 4 – new early retirement policy

33. Holdings' new early retirement policy adopted with effect from 6 April 2010 is recorded in a written policy which includes the following:

> "Where IBM's consent is required to draw a pension prior to Normal Retirement Date, IBM will consider a number of factors in reaching its decision including, but not limited to, the financial impact on IBM and its business needs including the retention of skills.
>
> Where drawing a pension early requires the consent of IBM and the granting of consent would permit retirement on terms that are more favourable than cost neutral (e.g. the Early Retirement Discount Factors ("ERDFs") applicable are more generous than cost neutral), the expectation is that IBM will grant consent to early retirement only in exceptional circumstances. Examples of exceptional circumstances include compassionate and / or medical grounds. IBM may also consent to the payment of pension on favourable terms in certain business initiated situations, such as, but not limited to, restructuring or divestment.
>
> In circumstances where IBM's consent is required to draw a pension early and there is no financial impact (for example, the early retirement of an M Plan member), IBM may nevertheless refuse consent. This could be on the grounds of needing to maintain certain skills.

34. The second paragraph quoted above would have caught C and N Plan early retirements from active status, which under the Rules were on non-cost neutral terms and subject to Holdings' consent (and also some DSL Plan retirements).

35. However, in earlier litigation (see *IBM United Kingdom Pensions Trust Ltd v IBM United Kingdom Holdings Ltd* [2012] PLR 469 - "**the Rectification Action**"), I held that the Rules of the C Plan were to be rectified so as to remove the requirement for Holdings' consent for C Plan early retirements from active status at or after age 60.

The new early retirement policy therefore has no effect on such retirements.

36. The new policy nevertheless catches C Plan early retirements before age 60 and N Plan early retirements.

37. One further complication should be explained: if (under Element 1) the accrual of further benefits by DB members has ceased, it might be thought that they are no longer active members and that the early retirement rules for active DB members (and the favourable ERDFs that apply to such members) are no longer relevant. However, as explained under Element 5 below, as part of Project Waltz, Holdings proposed to allow the excluded DB members to retain the favourable early retirement rules that applied to them as active members in respect of their accrued DB service (but subject to Holdings' ability to withhold consent to early retirement, where applicable). Thus the early retirement rules applicable to active members remain relevant notwithstanding the purported cessation of DB accrual under Element 1.

Element 5 – transfer to M Plan and "hybrid deferred" status

38. As already noted, the DB members were informed on 7 July 2009 that they would have the option of joining the DC section of the Main Plan (*ie* the M Plan) once their active DB membership ceased on 6 April 2011. Holdings proposed to achieve this by excluding members from the DB Plans using the Exclusion Powers and then allowing those who had opted for M Plan membership to join the M Plan section of the Main Plan. IBM considered that there was an argument that it would be possible for the affected members to join the M Plan without Trustee consent and wished to ensure that those members would be able to take advantage of the option if that argument was a good one.

39. Thus for C, N and DSL Plan DB members, they would be excluded from the Main Plan and then be immediately readmitted to the Main Plan but in the DC section. As quoted above, the Main Plan Exclusion Notice dated 28 May 2010 specifically provided that it was without prejudice to the ability of the excluded DB members to join the M Plan. For I Plan members, they would be excluded from the I Plan and then admitted, for the first time, to the Main Plan. The excluded DB members' benefits in respect of future contributions under the M Plan would be governed by slightly different terms from the terms governing ordinary M Plan benefits. Those terms would be known as the "**Hybrid M Plan**".

40. Holdings also proposed to create a new personal pension plan, the IBM UK Personal Pension Plan ("**the IBM UK PPP**"), a contract-based arrangement administered by Standard Life. This would be a DC arrangement outside the Plans, which the excluded DB members would have the option to join on 6 April 2011 as an alternative to the M Plan. They would also have the option of having no IBM pension provision at all for future service.

41. In addition, Holdings proposed to create "**hybrid deferred**" status in both the Main Plan and the I Plan for the excluded DB members' accrued DB benefits. This would involve amending the DB Plans to modify the excluded members' past service DB benefits that had been accrued up to the date of their purported exclusion. Rather than simply becoming ordinary deferred benefits, those benefits would be "hybrid deferred" and would have the following features:

    i) hybrid deferred status would subsist whilst the member remained an IBM employee;

    ii) the hybrid deferred member's accrued DB benefits would retain final salary linkage, but this would be subject to IBM's ability to make the Non-Pensionability Agreements and therefore in practice would be of limited benefit;

    iii) there would be a statutory revaluation underpin for the hybrid deferred member's accrued DB benefits calculated as from 6 April 2011 *ie* these would be subject to a minimum, equivalent to annual revaluation in deferment from the date of the purported closure of the DB Plans as if the hybrid deferred member had left service and become an ordinary deferred member on 5 April 2011, in line with the statutory minimum for ordinary deferred pensions;

iv) hybrid deferred members would retain ill-health early retirement benefits, death in service and (non ill-health) early retirement benefits as if they had remained active members, that is to say:

a) "active" member ill-health early retirement provision, *ie* retaining the option for prospective service to be included in the calculation of pension;

b) "active" member death-in-service provision, *ie* a spouse's pension calculated by reference to prospective pensionable service;

c) as mentioned above, "active" member (non ill-health) early retirement provision, *ie* retention of the favourable ERDFs for early retirement of active members – but insofar as Holdings' consent was required under the Rules for actives, such retirements would be subject to Holdings' restrictive new early retirement policy and would therefore in practice be of limited benefit.

42. Further, the excluded DB members would be entitled to 2 years of enhanced employer contributions to their new DC arrangement for future service (known as "step down" contributions) of 14% of pensionable salary in 2011-12 and 10% in 2012-13.

43. The proposed terms for hybrid deferred status were set out in Holdings' letter to the Trustee dated 23 September 2009. Draft Interim Deeds have been prepared to give effect to hybrid deferred status but nothing has yet been executed.

44. The creation of hybrid deferred status, and (at least arguably: see paragraph 38 above) the readmission of the excluded Main Plan DB members to the M Plan, could not be achieved unilaterally by the Company but would involve the Trustee exercising its powers under the Plans.

The classes of member affected by Project Waltz

45. The classes of member directly affected by the Project Waltz proposals were, broadly speaking, the then active membership of the DB Plans comprising approximately 5,000 employees, that is:

i) 2,682 active DB members of the Main Plan – these were mostly C Plan members, with a smaller number of N Plan members and the smallest group being DSL Plan members (who were affected or potentially affected by all of the five elements of Project Waltz outlined above);

ii) 1,537 active members of the I Plan (who were affected or potentially affected by all elements of Project Waltz except for the early retirement elements – elements 3 and 4 outlined in above);

iii) a further 805 active Enhanced M Plan members with final salary linkage to accrued DB benefits in the Main Plan (this category of member is explained further below) (who were affected or potentially affected by the early retirement elements of Project Waltz – elements 3 and 4 – outlined above).

List of Issues

46. The parties have agreed a list of the issues for decision in the present trial and, depending on the result of this hearing, for decision following a further hearing. I attach as Annex A a list of the issues for decision in the present trial ("**the List of Issues**"). There was a further issue, Issue 4A, but that has now gone. It relates to section 91 Pensions Act 1995. In the light of my decision in *Bradbury v BBC* [2012] EWHC 1369, [2012] PLR 283 ("***Bradbury***") the Issue is not pursued although the point is left open to be taken should the present case ever come before the Court of Appeal. Issues 1 to 3 raise what are essentially legal arguments or, at least, arguments where the facts are not a matter of any real contention. Issues 4 and 4B are concerned with the *Imperial* duty of good faith and the contractual duty of trust and confidence owed by an employer and an employee to each other; they raise many issues of fact on which I have heard a large amount of evidence over a number of weeks, including disputed expert evidence from accountants and actuaries.

The lead-up to these proceedings

47. Following Holdings' presentation of the Project Waltz proposals to the Trustee in May 2009, and after a considerable amount of discussion between them in the ensuing months (in particular, various meetings and correspondence between Holdings and representatives of the Trustee during May-July 2009), the Trustee informed Holdings that there were sufficient doubts about the lawfulness of the Project Waltz proposals that the Court would have to be asked to rule on the issues. The Trustee's concerns arose partly as a result of the previous history of the Plans and in particular the Ocean and Soto projects, matters which I will come to later in this judgment. In a letter dated 18 June 2009, the Trustee informed Holdings of the legal advice it had received (from Leading Counsel) raising its concerns over a number of issues which are now encapsulated in the List of Issues.

48. The Trustee nonetheless continued negotiating with Holdings to see if Holdings would alter the Project Waltz proposals in such a way that would enable the Trustee to conclude, subject to legal advice, that IBM had complied with its *Imperial* and contractual duties. Although the Project Waltz proposals went through various iterations and Holdings made changes (such as the introduction of hybrid deferred status) these changes did not overcome the Trustee's concerns.

49. Consequently, the Trustee informed Holdings' representatives at the Trustee meeting on 22 October 2009, and subsequently confirmed in writing, that it would not be prepared to proceed without an application to Court to affirm the lawfulness of the Project Waltz changes.

Emergence of the 1983 C Plan issue

50. By this stage, matters were developing on the ground. As of October or November 2009, Holdings was seeking to initiate the early retirement window (Element 3) as well as inviting members to enter into the 2009 Non-Pensionability Agreements (Element 2). In addition, an issue of rectification of the C Plan arose. This was the subject matter of the Rectification Action (see paragraph 35 above), in which I gave judgment last year. In that case, it was asserted that members who joined the C Plan when it was created in 1983 had done so on the basis of announcements promising them a right of "flexible retirement", *ie* a right to retire from active status at any age from 60 to 63 at the member's election on an unreduced pension.

51. Individual employees raised this point with Holdings from July 2009 onwards when Project Waltz was announced. The issue took on prominence on 5 October 2009 when an in-house solicitor employed by IBM UK, Mr Tony Ford, emailed senior executives of Holdings (copying in Mr Newman of the Trustee) setting out a detailed account of the 1983 announcements, offering copies, and calling for the C Plan Rules to be rectified.

52. On 9 November 2009, DLA Piper UK LLP ("**DLA**"), by this stage acting for a group of members, wrote to Holdings (with a copy to the Trustee) referring to an Opinion from Leading Counsel in support of the existence of a rectification claim. DLA also referred to evidence from some of the key witnesses in the Rectification Action (who eventually gave witness statements in support of the rectification claim relied on at the May 2012 trial).

53. The emergence of the rectification issue was a further cause for concern on the part of the Trustee, in particular because it was directly relevant to the early retirement window, for which Holdings had set the rapidly-approaching deadline of 4 December 2009 for members to decide whether to take early retirement.

54. By a letter dated 13 November 2009, the Trustee's solicitors formally raised the rectification issue with Holdings' solicitors and asked for an extension of the early retirement window. Holdings rejected this request and, relying on the evidence of Mr Sam Ellis (who gave evidence in the Rectification Action in May 2012), its solicitors wrote to DLA on 4 December 2009 contending that there were no grounds for rectification and that there was no legal right for C Plan members to retire from age 60 on an unreduced pension. Holdings did, however, make a qualified concession on or about 4 December 2009 in relation to certain C Plan members, namely that employees who joined the C Plan at its inception on 6 July 1983 would, once they reached age 60, be given consent to retire

early with an unreduced pension, other than in the most exceptional, business critical, circumstances (this concession was slightly widened in early 2010 to those who joined the C Plan up to 30 November 1983 when the November 1983 update to the Employee Handbook was published).

55. Eventually proceedings were commenced by IBM on 28 May 2010. I do not need to go into an explanation of why it was IBM, rather than the Trustee, which did so. There are perfectly good reasons for this and no criticism is made by anyone about it. Nor do I need to go into the history of the exchange of evidence including the difficulty faced by the Trustee in remaining, on the one hand, entirely neutral as between IBM and the RBs and, on the other hand, explaining to the Court how it is said that IBM was in breach of its *Imperial* duty. All this is water under the bridge since the Trustee's witnesses were cross-examined by Mr Tennet and Mr Stallworthy (for the RBs) and by Mr Simmonds (for IBM) so that, neutral or not, their evidence was exhaustively considered.

56. Another aspect of the procedural background which I should mention is that IBM applied to expedite the trial but that application was rejected at a hearing on 25 October 2010. Following that, the Trustee requested Holdings to postpone the implementation date. Ignoring the warning of Irving Berlin that there may be trouble ahead, Holdings decided to dance. It declined the Trustee's request; and, in the face of what it perceived as a threat by IBM putting at risk the availability of hybrid deferred status or M Plan membership for former DB employees, the Trustee, under protest, agreed to implement Project Waltz on an interim basis. This was on the footing that the steps taken would be unravelled if the Court ruled that the project was unlawful. And so the Waltz had begun.

57. As I have already mentioned, the interim proposals have not been formally implemented by an Interim Deed. In practice, Holdings gave DB employees the option, as from 6 April 2011 (with hybrid deferred status for their accrued DB benefits):

    i) to join the M Plan for future service;

    ii) to join the new IBM UK PPP; or

    iii) to have no IBM pension provision for future service at all.

    It was made clear to members that they would nevertheless have the right to continued DB accrual if that is what the Court rules in the present proceedings they are entitled to.

58. The current position, assuming the validity of the Project Waltz changes is as follows:

    i) DB accrual has ceased in the DB Plans as from 6 April 2011 (except for the 455 I Plan members who were exempted from Project Waltz) as a result of the Exclusion Notices served on 28 May 2010;

    ii) of the 455 exempt I Plan members, 320 remain as active members of the I Plan;

    iii) there are 3,390 former active members (purportedly) excluded from the DB Plans who are still IBM employees and who have transferred to the M Plan or the IBM UK PPP or not joined an IBM pension arrangement;

    iv) of these, around 2,500 excluded DB members joined the M Plan;

    v) 3,066 DB members signed the 2009 Non-Pensionable Agreements;

    vi) 861 DB members retired pursuant to the early retirement window;

    vii) Holdings is operating its restrictive new early retirement policy and thus refusing to consent to the early retirement of members with accrued DB benefits on non-cost neutral terms, save that:

a) as explained above, since December 2009 it has given a concession to C Plan members who joined the C Plan in 1983;

b) active C Plan members were held to be entitled to retire from age 60 on an unreduced pension by my decision in the Rectification Action.

59. If, in contrast, the Project Waltz changes are invalid and unlawful, the true position may be that all DB members have continued to be members of their DB Plans and have accrued DB benefits linked to final salary.

Overview of the Plans

60. It is useful to have an overview of the governance, structure, terms and administration of the Plans, this being the context in which the disputed issues arise. This section of my judgment is again based largely on the written opening on behalf of the Trustee for which I am again very grateful. This description is not contentious (unless otherwise indicated).

The Trustee

61. The Trustee is the sole trustee of both the Main Plan and the I Plan, although as already noted they are separate trusts. During the period relevant to the proceedings and up to 2012, the Trustee had a board of 12 directors, of whom 4 were member nominated, the rest being nominated by Holdings.

62. The board of the Trustee delegated all functions to a committee of the full board known as the Trustee Management Committee. Meetings of this committee are referred to in the contemporaneous documents and evidence as Trustee Management Meetings or "**TMMs**". The board of the Trustee also established a sub-committee known as the Investment Committee which was authorised to decide and implement the Trustee's investment strategy. Until about July 2004, the Investment Committee decided on the overall asset allocation for the Plans, but from that time the basic allocation decision as to the split between reward-seeking assets (equities/property/alternatives) and bonds was decided by the TMM, with the Investment Committee implementing the detailed investment strategy in accordance with the parameters set by the TMM.

63. The Main Plan and the I Plan each had their own TMM and Investment Committee, and separate minutes were kept for each. However, in practice the TMMs had the same membership and met on the same occasions and their meetings were held concurrently, and likewise for the Investment Committee. As can be seen from an examination of the actual minutes, those relating to the Main Plan and those relating to the I Plan mirror each other to a large extent, since the Trustee's decisions applied equally to both Plans, although, naturally, Plan-specific discussions appear only in the minutes applicable to that Plan.

64. A number of the Trustee directors were IBM executives who from time to time represented IBM's interests in pensions matters. To accommodate this, these executives were designated as "**conflicted Trustee directors**" (if and when the issue being considered required it) and they were (on those occasions) treated as representatives of Holdings, whereas (in relation to such issues) the other directors were designated as "**non-conflicted Trustee directors**" who were able (on those occasions) to represent the Trustee in its discussions with Holdings. As is clear from the evidence, on various occasions, discussions between Holdings and the Trustee actually took place within the TMMs, with the conflicted directors representing Holdings and the non-conflicted Trustee directors representing the Trustee.

65. It is to be noted, however, that not all IBM executives on the Trustee board were treated as conflicted directors. Thus a number of non-conflicted Trustee directors were in fact IBM executives.

66. During the period of principal relevance to these proceedings (2004-09, when the Ocean, Soto and Project Waltz changes were announced):

i) Mr James Lamb ("**Mr Lamb**") was the chairman of the Trustee board and the TMM and a member of the Investment Committee. He had previously been the chief financial officer ("**CFO**")

of IBM UK from 1994-2002, a Trustee director from 1994-2012, chairman of the Investment Committee from 1997-2002, and chairman of the Trustee board and TMM from 2002-2012). He gave evidence on behalf of the Trustee;

ii) Mr Stephen Wilson ("**Mr Wilson**") (not to be confused with Mr Gavin Wilson or Mr E Bradley Wilson, one of the expert witnesses who also feature) was a member of the Trustee board and TMM and the chairman of the Investment Committee (until April 2009). He was CFO of IBM UK from 2002-2009, a Trustee director from 2002-2009 and chairman of the Investment Committee from 2002-2009. He gave evidence on behalf of the RBs;

iii) there were two independent professional trustees on the Trustee board and TMM and Investment Committee, namely Mr Robert Bridges and Mr David Gamble. Mr Bridges was a member of the Trustee board and TMM and Investment Committee from 2004-2012 and was Mr Lamb's successor as chairman of the Trustee board and TMM between April and October 2012. He gave evidence on behalf of the Trustee.

iv) IBM UK's director of human resources was a member of the Trustee board and TMM, namely Mr David Heath ("**Mr Heath**") (to 2007) and then Mr Jonathan Ferrar ("**Mr Ferrar**") (from 2007). Both of them gave evidence on behalf of IBM;

v) various senior IBM executives from the international IBM group were from time to time members of the Trustee board and TMM and Investment Committee, including senior representatives of IBM Corporation such as Mr Jesse Greene ("**Mr Greene**") (IBM Corporation's Treasurer and Chief Financial Risk Officer, and a member of the Trustee board and TMM and Investment Committee from 2002-2011).

Pensions Trust

67. The day-to-day administration of the Plans was carried out by Holdings' in-house pensions administration organisation, known as Pensions Trust, staffed by Holdings' employees and led by the Pensions Trust Manager. From 1999-2011, the Pensions Trust Manager was Mr David Newman ("**Mr Newman**") who gave evidence on behalf of the Trustee. During this period, Mr Newman was also company secretary of the Trustee and the secretary of the TMM and Investment Committee. As Pensions Trust Manager, Mr Newman had delegated authority, within certain parameters, to manage the financial business of the Plans and oversee the investment of the Plans' assets.

68. Pensions Trust had various operating departments headed by other managers (*eg* Ms Suzanne Ross, the Pensions Investment Manager), but ultimate responsibility for all aspects of Pensions Trust's activities remained with the Trustee.

Actuarial and investment advisers for the Plans

69. The same actuary was appointed for both the Main Plan and the I Plan. During the 2000s, the appointed actuary was Mr Stephen Gooch of Aon (until 13 December 2002), Mr David Eteen of Aon (14 December 2002 to 7 December 2003), Mr Greg Alexander of Watson Wyatt (8 December 2003 to 11 May 2009) and Mr Graham McLean of Watson Wyatt (renamed Towers Watson in 2010) (11 May 2009 to present).

70. The principal investment advisers were Aon and (from December 2003) Watson Wyatt (later Towers Watson). It is to be noted that from time to time Holdings also retained the services of Watson Wyatt, but such services were provided by different teams and offices within Watson Wyatt and were separate from the advice given to the Trustee.

Overview of the Main Plan

71. I have already introduced the Main Plan and I now give some more detail. The Main Plan was established by an

Interim Trust Deed dated 3 April 1957 and took effect from 1 January 1957; its original Definitive Trust Deed was dated 19 May 1959, and was replaced by subsequent definitive editions in 1977 and then on a number of occasions in the 1980s and 1990s.

72. One of those definitive editions was the deed and rules dated 14 December 1983 ("**the 1983 Trust Deed and Rules**") which introduced the C Plan, a contributory DB arrangement, on 6 July 1983 and closed the N Plan to new members after 5 July 1983. The 1983 Trust Deed and Rules were in turn replaced by a new form of Definitive Deed and Rules dated 1 October 1990 ("**the 1990 Trust Deed and Rules**"). The 1990 Trust Deed and Rules introduced the Main Plan Exclusion Power which gives rise to Issue 1 on the List of Issues. The 1990 Trust Deed and Rules were in turn replaced by new definitive editions in 1991, 1992, 1993 and 1995 which made various updating changes. These new editions were for the most part essentially similar to the 1990 version.

73. The next major round of changes was in 1997 when the previous trust documents were replaced and split into the three current Deeds referred to in paragraphs 6*ff* above.

74. A number of additional Deeds making discrete amendments have been executed from time to time. Amongst these amendments, two changes of note have been made since the current versions of the Deeds and Rules were introduced in April 1997:

    i) By a Deed of Merger dated 3 December 1997, the Data Sciences Pension Scheme was merged with the Main Plan with effect from 15 December 1997, following the acquisition of Data Sciences Ltd by IBM. One section thereby created was the DSL Plan (mentioned at paragraph 9 iv) above) whose membership consists of a relatively small group whose benefits are governed by a set of rules incorporated by reference into the Main Plan known as the "**Relevant Benefit Provisions**". There were several categories of DSL Plan membership each with different benefits but it is not necessary to go into the detail.

    ii) More importantly, as part of the Soto changes in 2006, the Enhanced M Plan was created by a Deed dated 30 March 2006. This was the new DC section of the M Plan which I have already mentioned. Eligible active members of the DB Plans were given a one-off opportunity to join the Enhanced M Plan with effect from 6 July 2006, and thereby became "**Enhanced M Plan Members**" earning enhanced DC benefits for future service within the M Plan. Their accrued past service DB benefits were left in their DB Plans, in respect of which the transferring members were known as "**Enhanced Deferred Members**". The Enhanced Deferred Members retained certain advantageous rights which they had enjoyed as active DB members in relation to early retirement, death-in-service and ill-health early retirement. Since the initial transfer of DB members into the Enhanced M Plan on 6 July 2006, it has been closed to new members.

Overview of the I Plan

75. The I Plan was created by Holdings in 1994 to be used as the DB pension scheme for DB members who transferred to IBM employment following outsourcing by the public sector or certain corporate acquisitions. The I Plan was established with effect from 28 July 1994 by a Definitive Deed and Rules dated 25 July 1994 made between Holdings as Principal Employer and the Trustee.

76. Unlike the Main Plan, the I Plan does not have different sections. However, like the Main Plan members, as part of the Soto changes in 2006, active I Plan members were given the option to transfer to the new Enhanced M Plan section of the Main Plan on 6 July 2006. The transferring members similarly became "**Enhanced Deferred Members**" of the I Plan in respect of their accrued DB benefits which were left in the I Plan, pursuant to a Deed dated 30 March 2006.

Common features of the Main Plan and the I Plan

77. All of the Main Plan Deeds since 1990 have adopted the style of the 1990 Deed with essentially similar

provisions and language. Likewise, the I Plan Deed and Rules were based on the Main Plan Deeds and contain similar provisions and language to the Main Plan, although with a different benefit structure. In fact, the I Plan Deed and Rules (prepared in 1994) were closely modelled on the then current Main Plan Definitive Trust Deed and Rules (the 1993 version) and adopted an identical drafting structure. Thus many of the standard provisions of both the Main Plan and the I Plan are the same. In particular, in both the Main Plan and the I Plan, "**Member**" is defined as meaning, broadly, active members, that is to say current employees, and deferred members are described in both Plans as "**Deferred Retirees**". "Deferred Retirees" are not to be confused with another class, namely "**Postponed Retirees**", who are former members who remain in service after their NRD with Holdings' express consent.

The Plans' amendment powers

78. Both Plans contain powers of amendment which are subject to restrictions. The terms of the amendment powers are relevant to Issues 1 to 3 of the List of Issues. The Main Plan amendment power is now found at Clause 1 of Part II of the Main Plan Definitive Trust Deed and the I Plan amendment power is at Schedule B rule 1 of the I Plan Rules. The validity or otherwise of the Exclusion Power in the Main Plan (which is the subject matter of Issues 1 to 3) turns on the power of amendment at Clause 4 of the 1983 Trust Deed and Rules which was in the following terms:

> "After consulting the Trustee may at any time and from time to time with the consent of the Principal Employer alter or modify all or any of the trusts powers or provisions of this Deed or of the Rules and any such alteration or modification shall have retrospective effect..... Provided always as follows:-
>
> (a) nothing herein or in the Rules contained shall authorise nor shall this Deed or the Rules be altered or modified so as to authorise the transfer or payment of any part of the Fund in any circumstances to the beneficial ownership of any Participating Employer
>
> (b) no such alteration or modification shall be made as shall operate to effect a change of the main purpose of the Scheme as set out in the Interim Trust Deed
>
> (c) no such alteration or modification shall be made which in the opinion of the Actuary shall operate substantially to prejudice the pension payable to any Member or other person who is at the effective date of such alteration or modification entitled to a pension under the Scheme or the pension contingently payable to any person on the death in the lifetime of such person of a Member who at the effective date of such alteration or modification is entitled to a pension under the Scheme
>
> (d) no such alteration or modification shall be made which in the opinion of the Actuary shall operate substantially to prejudice the interests under the Scheme of any Member not being at the effective date of such alterations or modification entitled to a pension under the Scheme in respect of contributions received by the Trustee prior to 1st January 1973 except with the consent of the majority of the members certified by the Actuary to be affected by such alteration or modification
>
> (e) no such alteration or modification shall be made which in the opinion of the Actuary shall operate to reduce the aggregate value of the retirement benefits payable under the Scheme to any Member not being at the effective date of such alteration or modification entitled to a pension under the Scheme in respect of contributions already received by the Trustee except with the consent of any Member affected by such alteration or modification
>
> (f) … …."

79. The I Plan amendment power, at Schedule B rule 1 of the I Plan Rules, is in the following terms:

> "Power of Amendment

1. The Principal Employer acting in a fiduciary manner may at any time add to, alter or modify any or all of the provisions of the Plan, subject to the consent of the Trustee. Any such amendment shall be brought into effect by the execution by the Trustee and the Principal Employer of a Deed, which may make the alteration effective from a date earlier than the date of the amending Deed itself PROVIDED THAT no such retrospective amendment may be made which would result in the reduction of any rights of a Member, Deferred Retiree, Postponed Retiree or Retiree or an Eligible Child Dependant or Spouse of any of them, unless such retrospective amendment is required as a result of statutory modification or any other overriding requirement."

Overview of the funding of the Plans

80. The legal background to the discussions between the Trustee and Holdings in relation to scheme funding included the balance of power as to the setting of employer contributions. This is described in the Trustee's written opening submissions and was, in summary, as follows:

i) Prior to the triennial Actuarial Valuation Report ("**AVR**") as at 31 December 2006, subject to compliance with the minimum funding requirement ("**MFR")** regime under the Pensions Act 1995, the contribution setting power was as set out in the Deeds and Rules of the Plans:

a) for the DB sections of the Main Plan, the power to set the level of employer contributions (over and above those required by the statutory schedule of contributions) was vested in the Company "having considered the advice of the Actuary";

b) for the I Plan, the power to set the level of employer contributions was vested jointly in Holdings and the Trustee "having considered the advice of the Actuary";

ii) From the 31 December 2006 AVR onwards, Part 3 Pensions Act 2004 applied, with the effect, stated shortly, that the Trustee and Holdings had to reach agreement on the Statement of Funding Principles, the statutory schedule of contributions and the recovery plan (with the Pensions Regulator deciding in default of agreement). This represented a change in the balance of power for the Main Plan but not for the I Plan.

iii) To complete the picture, it is to be noted that under the provisions of each Plan, Holdings and the Trustee each had a power to wind up the Plan. In the case of the Main Plan, this was so since the 1990 amendments and in the case of the I Plan from its inception.

The Trustee's investment strategy

81. Mr Spink has included in his opening written submissions a review of Mr Lamb's evidence concerning investment strategy. In relation to the matters set out below, I accept Mr Lamb's evidence.

82. As of the early 2000s, the Trustee was still following an investment strategy strongly focused on equities. As of 2003, the Main Plan DB sections were invested approximately 80:20 in equities/property versus bonds, whilst the I Plan was invested 100% in equities/property.

83. After the dot.com bubble had burst, markets fell and became volatile, and the DB Plans moved into deficit in 2002 and 2003. Prior to this occurring, discussions between the Trustee and the Plans' actuary (at that time Mr Gooch of Aon) about the possible need to start changing the existing asset allocation of the Main Plan had already taken place. This resulted in a decision being taken by the Trustee in May 2002 that the investment strategy needed to be changed to recognise the increasing maturity of the Main Plan. It was agreed to start the process with a 5% move from equities into Index Linked bonds (to be effected by a 1% switch per quarter for five quarters).

84. Thereafter, discussions during 2002 and 2003 about asset allocation took place against the background of the

deficit referred to above, which prompted a more fundamental review of the equity/bond mix, a temporary suspension of the gradual move from equities into bonds decided upon in May 2002 and then discussion as to whether to recommence that transfer.

85. During 2003, in view of the emerging deficit, the Trustee sought and obtained reassurance about the Company's intention to support the Plans. Watson Wyatt became the new actuarial/investment advisers in December 2003. The newly appointed actuary for the Plans, Mr Alexander, adopted a new, more conservative approach than his predecessor for the AVR as at 31 December 2003, with a focus on (amongst other things) employer covenant and "risk budgeting" (Mr Alexander's consideration of the latter led to a conclusion that 97% of the Main Plan's investment risk was attributable to its equity holdings and a recommendation to the Trustee that it think seriously about a move into alternative asset classes).

86. The draft AVR as at 31 December 2003, in which the assumed future investment returns included a "margin for prudence", showed a very large deficit of £1.2bn.

87. This led to extended discussions, the eventual outcome of which was that the provision of a funding guarantee dated 9 December 2004 ("**the Funding Agreement**") (see paragraph 111 below) in exchange for which (*inter alia*) the Trustee accepted the "best estimate" basis for the 31 December 2003 AVR, leading to a lower deficit.

88. At the same time as these discussions were going on, the Trustee was reconsidering asset allocation, which at this stage was 75:25 equities/property versus bonds in the Main Plan. From around July 2004, the responsibility for making the fundamental decision as to the equities/bond split was transferred from the Investment Committee to the TMM. In Watson Wyatt's view, the Main Plan's allocation to equities was at the high end of the range typically seen, and the general gist of their advice was that the Trustee should be shifting the asset allocation to bonds.

89. It was at this time that Holdings proposed the Ocean changes to the DB Plans to increase employee contribution rates (or reduce accrual rates). The result of these various developments was that in October-December 2004, the Trustee agreed a linked package of measures with Holdings which included:

    i) support for the Ocean changes;

    ii) the use of the "best estimate" basis for the 31 December 2003 AVR, leading to a lower deficit in the Main Plan (£900m) and lower company contributions (£181m p.a.);

    iii) the Funding Agreement;

    iv) the maintenance of the higher risk investment strategy for the Main Plan, with a gradual switch to bonds limited to 10% over 3 years from late 2004 (*ie* to bring the proportion of bonds up from 25% to 35% by the end of 2007);

    v) the investment of part of the company contributions in an IBM pooled bond fund run by Retirement Funds Europe.

90. I consider in detail below the basis on which the Trustee thought it was entering into this bargain.

91. The Trustee was aware of the risks involved in the investment strategy but was prepared to take these risks on the basis that, because of the Funding Agreement, it would be able to rely on the support of IBM World Trade Corporation ("**IBM WTC**") (a subsidiary of IBM Corporation) if investment returns were poor.

92. In November 2005 to January 2006, Holdings proposed and discussed the Soto changes with the Trustee for consideration.

93. The Trustee reconsidered its investment strategy around the time of the Soto changes, and was advised that if DB accrual ceased it would be likely that some reduction in the allocation to equities would be indicated and

possibly a very material reduction. But in the event, given that the Trustee was reassured that Holdings would support the Plans in the long term, it decided to adhere to the higher risk strategy (involving a modestly-paced movement towards an allocation of 35% bonds by December 2007) agreed by the it in December 2004.

94. As a result of the large cash contribution made to the DB Plans by Holdings as part of the Soto changes, the DB Plans had moved into surplus by October 2006. The finalised AVR as at 31 December 2006 (completed in 2007, on the "best estimate" basis) showed that both Plans were in surplus.

95. During 2007, in connection with the preparation of the 31 December 2006 AVR, the Trustee initiated discussions about obtaining a 3 year extension of the Funding Agreement to replace the 3 years that had already expired. IBM agreed to this; it was also agreed that IBM Corporation would replace IBM WTC as the guarantor of the Company's funding obligations, and that for a 3 year period the Trustee would limit further increases in the bond allocation of the Main Plan to 3% p.a. (and to 20% over the 3 year period for the I Plan). The Trustee indicated to Holdings that the extension of the guarantee would put the Trustee in a better position to consider IBM's requests for the Trustee to invest in reward-seeking assets.

96. By this stage (late 2007), the Main Plan had an asset allocation of 35% bonds (as had been agreed in late 2004). Thus the effect of agreeing to limit the move to bonds to a gradual shift of 3% p.a. for 3 years meant that the Main Plan allocation to bonds was targeted to be 44% by late 2010.

97. The Trustee thought that it had agreed to these restrictions to the asset allocation on the basis that it was implementing a long-term investment policy, rather than one in which short-term asset falls might encourage Holdings to close the DB Plans. The Trustee and Holdings were well aware of the risks involved in the investment strategy (including their susceptibility to financial "shocks" due to equity market falls). I will be considering these matters in detail later when I will make relevant findings.

98. One feature of the Trustee's investment strategy was to target "self-sufficiency" (*ie* solvency on a discontinuance basis) at the end of the period of the Funding Agreement as a result of the gradual increase in the allocation to bonds over the period. The background against which the Funding Agreement was extended in 2007 was that the Trustee was proposing to target a discontinuance funding level of 105% by the end of the guarantee period. Mr Alasdair MacDonald said that an allocation of 55% bonds would be appropriate to achieve this.

99. Also in 2007, the Trustee introduced a "liability driven investment" programme, *ie* a programme of investing in swaps to reduce the interest and inflation risks resulting from the duration mismatch of the bond portfolio.

100. During the 2007-08 period, the Trustee sought and received further assurances from Holdings that there were no discussions about or plans on foot to change the Plans (albeit there were no absolute guarantees).

101. By autumn 2008, with the Lehman collapse, markets were in a period of extreme volatility and there were large falls in the value of the Plans' assets. The fall in equity values had the unintended consequence that (due to the shrinking value of the Plans' equity portfolios) the intended target of 44% bonds in the Main Plan was reached by autumn 2008.

102. The Plans' actuary, Mr Alexander, advised that the Plans had moved back into deficit, and there was discussion of bringing forward the next AVR (scheduled to be performed as at 31 December 2009) to 31 December 2008.

103. By the end of 2008, the asset allocation for the Main Plan was 52:48 equities/property versus bonds, and the I Plan was 92:8 equities/property versus bonds.

104. In terms of investment strategy and scheme funding, the announcement of Project Waltz in May 2009 caused the Trustee (in accordance with its professional advice):

    i) to seek to bring forward the next valuation and perform an out-of-cycle AVR as at 31 December 2008;

    ii) to form the provisional view (subject to consultation) that the asset allocation of the DB Plans should be

substantially de-risked. This was because there appeared to the Trustee to be only limited benefit in taking investment risk: previously the Trustee had been willing to pursue the higher risk strategy to help keep the DB Plans affordable to the employer and open to accrual, but this reason had fallen away. Watson Wyatt's previous advice (see above) had been that a cessation of accrual might lead to a very material de-risking, and they gave similar advice following the announcement of Project Waltz.

105. Following the announcement of Project Waltz, there was extensive discussion between Holdings and the Trustee about investment strategy, in which the consistent position of the non-conflicted Trustee directors was that the Plans should be significantly de-risked, whereas Holdings' position was that the existing asset allocation should not be changed.

106. This disagreement about investment strategy can be seen in the discussions between Holdings and the Trustee about the AVR following the announcement of Project Waltz. In fact, the out-of-cycle AVR as at 31 December 2008 had to be abandoned as the Trustee was unable to agree the assumptions with Holdings in time. During the subsequent discussions about the AVR as at 31 December 2009, Holdings argued against de-risking in the short-term, whereas the Trustee proposed a substantial de-risking.

107. Ultimately, the negotiations between Holdings and the Trustee went up to the statutory deadline. The final agreement was, broadly, to de-risk on a straight line basis to target a portfolio equivalent to 20:80 equities/property versus bonds by 31 December 2016 in both Plans.

108. There is one other point to note. Although the Trustee was generally aware of NPPC, the Trustee's focus was on cash contributions and scheme funding, rather than on Net Period Pension Cost (an accounting concept under US GAAP: see paragraph 496 below).

Changes to the benefit structure of the DB Plans from 2004: Ocean and Soto

109. In order to put the Project Waltz changes in their context, it is necessary to consider earlier changes to the DB Plans from 2004, in particular two sets of changes known respectively as Project Ocean (in 2004-2005) and Project Soto (in 2005-2006). I start with the actual changes to the relevant Trust Deeds and Rules turning to consider later the reasons for the changes and how they were presented by IBM and implemented.

The Ocean changes

110. The Ocean changes were proposed by Holdings to the Trustee in October 2004, they were approved by the Trustee in October-December 2004 and they were given effect as from 6 April 2005 (or 6 July 2005 for DSL Plan members) by Deeds dated 9 December 2004 and 10 January 2005. The Ocean changes are set out in the table at Annex B to this judgment. It can be seen that Ocean involved, principally, changes to the employee contribution rates.

Ocean: the Funding Agreement dated 9 December 2004

111. As part of the Ocean changes, IBM agreed to provide the Trustee with a parent company guarantee in respect of the funding obligations of Holdings (the Funding Agreement). I will come to how this came about in due course. The guarantee was provided by IBM WTC, in a Deed made between Holdings, IBM WTC and the Trustee dated 9 December 2004. Under the Funding Agreement, which was governed by English law, IBM WTC guaranteed certain of Holdings' funding obligations in respect of the cost of ongoing accrual, deficit repair contributions and the statutory employer debt in respect of the Main Plan and the I Plan up to March 2014. The Funding Agreement was a complicated arrangement, whose key features were, as follows:

> i) The Funding Agreement recorded that, in return for the commitments of IBM WT and Holdings under the Agreement, the Trustee had agreed to use the "best estimate" basis for the AVR as at 31 December 2003 as opposed to the "conservative basis": see see recitals (D) and (E).
>
> ii) The duration of the Funding Agreement was to be until 31 March 2014 and it applied in respect

of the triennial AVRs as at 31 December 2003, 2006 and 2009.

iii) Holdings agreed to make payments to the Plans including among other matters the cost of ongoing accrual, the statutory Schedule of Contributions and certain "Minimum Payments".

iv) IBM WTC agreed to guarantee such payments together with (subject to some exceptions) any statutory debt under section 75 Pensions Act 1995.

v) The Minimum Payments were essentially a mechanism whereby additional deficit repair contributions could become payable from the 2006 AVR onwards. At each triennial AVR from 2006 to 2012, the funding level of the Plans would be compared to a targeted minimum level (calculated on the assumption that experience, including investment returns, was in line with the best estimate assumed at the previous AVR), and if there was a shortfall against the targeted level, Minimum Payments would become payable over the life of the guarantee (to March 2014) to amortise the shortfall.

vi) But such Minimum Payments were subject to a cap: the cap was equal to the difference between (1) the employer contributions that would have been payable had the "consrvative basis" been adopted at the previous AVR and (2) the employer contributions in fact payable.

vii) The Funding Agreement would terminate before 31 March 2014 in respect of a Plan if:

a) the Plan was fully funded on a best estimate and Closed Fund Discontinuance basis; or

b) Holdings and participating employers together had sufficient resources to meet any funding shortfalls; or

c) one of the specified triennial AVRs was carried out on a basis inconsistent with the best estimate basis (unless required by statutory, regulatory or professional requirements or for reasons controlled by the employer).

The Soto changes

112. The Soto changes were proposed by Holdings to the Trustee during late 2005 and early 2006. They were approved by the Trustee on 19 January 2006 and they were given effect as from 6 July 2006 by Deeds dated 30 June 2006.

113. The principal feature of the Soto changes was that DB members (in both the Main Plan and the I Plan) were given an option exercisable by 30 June 2006:

i) either to remain within their DB section and continue accruing DB benefits, but subject to a partial non-pensionability agreement pursuant to which future salary increases would consist of a pensionable base salary increase plus a 50% non-pensionable supplement (in effect only 2/3rds of future salary increases would be pensionable); or

ii) (if they were eligible) to transfer to the new Enhanced M Plan (part of the M Plan section of the Main Plan) with effect from 6 July 2006, to earn enhanced DC benefits for future service but retaining full final salary linkage (*ie* not subject to the partial non-pensionability agreement) for accrued past service DB benefits.

114. Another feature was that IBM would inject a cash lump sum into the Main Plan and the I Plan by 31 March 2006 in order to extinguish the funding deficit and to fund the 2006 service costs. In the event, the figures were £544m for the Main Plan and £10.25m for the I Plan.

115. The affected DB members (about 6,000 in number) were invited to make the election by 30 June 2006 using an

online tool which gave them the option to remain in their DB Plan subject to the non-pensionability agreement or to transfer to the Enhanced M Plan. The tool explained that a member who failed to respond would be left in his DB Plan but, in respect of any future salary increases, would not be offered the non-pensionable 50% salary supplement. Of the affected DB members, 78% elected to remain in their DB section, 20% elected to transfer to the Enhanced M Plan and 2% did not respond.

116. The Soto changes are set out in more detail in Annex C to this judgment.

The Enhanced M Plan

117. The members of the DB Plans who transferred to the Enhanced M Plan on 6 July 2006 became:

i) "Enhanced M Plan Members" of the M Plan in respect of their DC benefits earned from 6 July 2006; and

ii) "Enhanced Deferred Members" of the relevant DB sections of the Main Plan or of the I Plan in respect of their accrued DB benefits earned up to 5 July 2006.

118. The terms governing Enhanced M Plan Membership and Enhanced Deferred Membership were inserted into the Rules of the Main Plan and the I Plan by the Deeds of amendment dated 30 March 2006.

119. The principal rights of Enhanced M Plan Members under the Main Plan DC Rules are, in summary, as follows:

i) Enhanced M Plan Members pay employee contributions at the ordinary M Plan contribution rate of 3% of pensionable salary.

ii) Employer contributions are payable in respect of Enhanced M Plan Members at enhanced, age-related, rates of up to 20% of pensionable salary (compared to 8% for ordinary M Plan members).

iii) Otherwise, generally speaking, they are treated in the same way as ordinary M Plan members and are subject to the ordinary M Plan rules (with some modification of the rules for death-in-service and ill-health early retirement benefits).

120. The principal rights of Enhanced M Plan Members as Enhanced Deferred Members of the DB sections of the Main Plan and of the I Plan are, in summary, as follows:

i) Enhanced Deferred Members retain full final salary linkage for their accrued DB benefits, because their Final Pensionable Earnings for DB purposes are calculated by reference to their Pensionable Earnings upon termination of Pensionable Service whether on retirement or otherwise.

ii) Enhanced Deferred Members are "members" of the DB Plans and thus are treated under the Rules as a form of active "Member" and not as true deferred members albeit that they no longer accrue further years of Pensionable Service in the DB Plans. Thus, in respect of Enhanced Deferred Members' accrued DB benefits:

a) as "Members" of the DB Plans, they retire under the rules of the DB Plans for the normal or early retirement of actives, and accordingly:

i) they are entitled to the favourable ERDFs applicable on the early retirement of active DB members;

ii) in relation to the right of active C Plan members to take early retirement from age 60 on an unreduced pension, it is common ground that Enhanced Deferred Members with accrued C Plan benefits would retain that right;

b) similarly, as "Members" of the DB Plans, Enhanced Deferred Members enjoy death-in-service

and ill-health early retirement benefits applicable to active DB members (which in summary allow for the calculation of pension based on prospective pensionable service up to NRD).

121. The creation of Enhanced Deferred status applied equally to the accrued DB benefits of DSL DB Plan members who elected to transfer to the Enhanced M Plan.

122. One complication to note is that, because Enhanced Deferred Members are still "Members" of the DB Plans, they had to be carved out of the Exclusion Notices, so that they were not excluded from the DB Plans along with the other active DB members. Thus the Exclusion Notices contain provisos exempting Enhanced Deferred Members from their scope.

Amendments to the Funding Agreement in 2006-2007

123. As part of the Soto changes, it was agreed that Holdings would make additional contributions to eliminate the deficit in the Plans. These contributions could have terminated the Funding Agreement (because of a clause terminating it if the Plans became fully funded), so it was agreed to amend the Funding Agreement to remove this difficulty. Accordingly, by a Deed of Amendment between Holdings, IBM WTC and the Trustee dated 30 March 2006, the Funding Agreement was modified on the following terms:

i) It was agreed that, in consideration of the Trustee agreeing to the Soto changes, Holdings would make contributions to the Plans equal to their funding deficit as at 31 December 2005 calculated on the best estimate basis.

ii) The funding-related termination trigger was deleted from the Funding Agreement.

124. The Funding Agreement was amended again in 2007 as part of the discussions surrounding the triennial AVR as at 31 December 2006. It was agreed that the Funding Agreement (which was due to expire in March 2014) should be extended by 3 years and that IBM Corporation should replace IBM WTC as the guarantor.

125. Accordingly, by a Deed of Amendment and Novation between IBM WTC, IBM Corporation, Holdings and the Trustee dated 15 November 2007, the Funding Agreement was modified on the following terms:

i) IBM WTC's obligations as guarantor were novated to IBM Corporation.

ii) The duration of the Funding Agreement was extended to 31 March 2017.

iii) The terms of the Funding Agreement were made applicable to the triennial AVR as at 31 December 2015 (in addition to the AVRs up to 31 December 2012 which were already covered by the Funding Agreement). The effect of this was that the Funding Agreement would terminate if any of the specified triennial valuations up to 31 December 2015 was carried out on a basis inconsistent with the best estimate basis.

iv) The mechanism for calculating the Minimum Payments based on minimum targeted funding levels was extended to the AVRs up to 31 December 2015.

126. It is against the background of the Ocean and Soto changes that Project Waltz falls to be considered. The dry explanation which I have given of the result of Ocean and Soto hides an important (and very large and complicated) part of the story when it comes to assessing the impact of the *Imperial* duty in relation to Project Waltz. This will be seen when I turn to consider Issues 4 and 4B.

The Project Waltz changes

127. I have dealt with these in outline already: see paragraphs 17*ff* above. The Trustee's written opening submissions contain a table of drafting amendments and the mechanics for implementing Project Waltz. I do not think I need to set them out.

128. I would nonetheless note one feature which is that "hybrid deferred" membership is conceptually the same as Enhanced Deferred membership created in 2006, so that the ex-DB members affected by Project Waltz will still be a type of "member" of the DB Plans in respect of their accrued DB benefits and governed by the same rules as those applicable to active members. Hybrid deferred membership is, however, less valuable than Enhanced Deferred Membership because the final salary link is broken as a result of the 2009 Non-Pensionability Agreements (assuming they are valid and effective) which were not required to be entered into by Enhanced Deferred Members; and because hybrid deferred members do not enjoy the benefit of enhanced employer contribution rates.

129. With that background, I turn to Issues 1 to 3.

Issue 1 - whether the Main Plan Exclusion Power was validly introduced into the Main Plan

130. Resolution of Issue 1 requires consideration of (1) the powers to terminate accrual of benefits under the 1983 Trust Deed and Rules (2) the scope of the amendment power in the 1983 Trust Deed and Rules ("**the 1983 Amendment Power**") and (3) the true construction of the Exclusion Power in the Main Plan. Each of those items informs the others. Thus, if the pre-existing powers of termination were very wide, the restrictions on the 1983 Amendment Power would be less likely to be infringed than if the pre-existing powers were very narrow; and items (1) and (2) are likely to have an impact on item (3) since, if possible, the Exclusion Power should be given a construction which reflects a valid, rather than an invalid, exercise of the 1983 Amendment Power.

Powers to terminate accrual of benefits under the 1983 Trust Deed and Rules

131. So far as item (1) is concerned, the powers to terminate accrual of benefits can be understood by reference to Rule 2, in Part I of the 1983 Rules (containing definitions including "Member", "Eligible Employee" and "Pensionable Service"), Rule 3(A) in Part II (the principal eligibility provision) and Rule 3(D) (relating to cessation of membership). Those provisions are as follows:

i) by Rule 2 "Eligible Employee" was defined as:

> "a person in Service whose name is recorded in the register specified in the qualifications for members in Sub-rule 3(A) (Joining the Scheme). A person shall cease to be an Eligible Employee on his name ceasing to be so recorded except that a person who is a Member and whose name is transferred to a Participating Employer's register of Part-time employees shall remain an Eligible Employee for so long as he remains in Service as a part time employee and is not transferred to non-pensionable employment.
>
> The decision of the Principal Employer as to whether a person is in Service and whether his name shall be recorded or cease to be recorded in any such register shall be conclusive";

"Member" was essentially defined as an Eligible Employee who was a member under the previous Rules or who had joined the Scheme under Rule 3 but

> "subject always to Sub-rule 3(D) (ceasing to be a Member");

"Pensionable Service" was defined, so far as relevant, as:

> "in relation to a Member, the number of complete years and Pay Months of Group Service [Service with a Group Company] in the period … until whichever is the first to occur of (1) the date of ceasing to be an Eligible Employee …" ;

and "Service" was defined as

> "continuous service with one or more Participating Employers (or the predecessor in

business of any such Participating Employer) except that

(a) service which is interrupted only by National Service shall be deemed to be continuous service,

(b) in the case of a Participating Employer included in the Scheme after the Appointed Day any period of Service with such Participating Employer before inclusion in the Scheme shall, except as provided in the Rules, count as Service if and to such extent and for such purposes as the Principal Employer shall determine but subject thereto any such period shall be excluded, and

(c) the Principal Employer shall finally determine, in relation to any Eligible Employee, the date of commencement of Service and the number of years to be counted as Service."

ii) Rule 3(A) provided:

"An Eligible Employee shall be eligible for admission to membership of the Scheme if in the opinion of the Trustee he fulfils the following qualifications:-

(1) his name is recorded in a Participating Employer's register of permanent employees, and …[he satisfied the other criteria set out at (2)-(5)]

Any such Eligible Employee who (unless the Trustee otherwise determines) fulfils the above qualifications shall be admitted to membership of the Scheme on the first day on which he is eligible in accordance with this Sub-rule"

The Principal Employer may determine in any particular case that any one or more of the qualifications set out above shall be waived."

iii) Rule 3(D) provided:

"A person shall cease to be a Member on ceasing to be an Eligible Employee (but not otherwise) although referred to as a Member in relation to any benefit to which he may become entitled or prospectively entitled under the Scheme".

132. The result of these definitions is, at least for present purposes, clear. Under Rule 3(A)(1), it was envisaged that each Participating Employer would keep a register of permanent employees. Such employees would be Eligible Employees if they fulfilled the other conditions in Rule 3(A). A person would cease to be a Member on ceasing to be an Eligible Employee (*eg* because he or she has attained age 63 and thus ceases to fulfil the requirement of Rule 3(A)(2) ("he has not attained the age of 63 years")).

133. The definitions of "Eligible Employee" and "Service" contained within them powers for the Principal Employer to determine certain matters. Under the definition of "Eligible Employer" it was given the function of deciding whether a person was in Service and whether his name should be recorded in the register. Under the definition of "Service", it was given the function of determining the date of commencement of Service and the number of years to be counted as Service.

134. In my judgement, these functions were vested in the Principal Employer in order to deal with cases where there might otherwise be doubt about whether a person is (i) in Service or (ii) a permanent employee or doubt about the date of commencement of the last period of continuous Service or the number of years of Service with, for instance, to be brought into account under paragraph (b) of the exceptions listed in the definition of "Service". These functions did not allow the Principal Employer to determine that a person who was in fact a "permanent employee" on any sensible meaning of those words to determine that, for the purposes of the Scheme, that person was not to be treated as a permanent employee. Nor did it allow it to determine that the service of such a

permanent employer during a specified period or, perhaps, at all is not to be treated as within the definition of "Service".

135. Further, it is in my judgement implicit in the definitions of "Service" and "Eligible Employee" that the name of a person who was in Service and who was in fact a permanent employee would appear in the Participating Employer's register of permanent employees. The Principal Employer could not, in my judgement, exclude from membership of the Scheme (or exclude an entitlement to become a member) a person who was in fact a permanent employee in Service by the simple expedient of declining to place his name on the register. If the Principal Employer was able to exclude a person from membership of the Scheme by, in effect, making a decision to that effect, I would expect to see such a power clearly expressed which it was not. Thus, if Rule 3(A)(1) had referred to a "a register of such of its participating employees as it determines to admit to the Scheme", the position would be clear. But the Rule did not make that provision or anything like it. Instead, it referred to a list of persons capable of identification by reference to a given criterion, namely status as a permanent employee. In cases of doubt about whether an individual was a permanent employee, the Principal Employer was given the function of resolving the doubt; but where there was no doubt, it had no function to perform. It would, in any case, be a remarkable situation if the Principal Employer had been able to dictate the names which appear on the register of permanent employees of each Participating Employer: that register and the names to be placed on it was surely a matter for the Participating Employer concerned, subject to resolution, by the Principal Employer, in cases of doubt.

136. I reach the conclusion which I have without reference to other provisions of the Scheme. Reference to those provisions only goes to reinforce the conclusion. In particular, the Scheme contained entirely separate provisions allowing a Participating Employer to terminate accrual (either for all of its employees or for a specified category or categories) of employees, such provisions appearing in Part VII of the Rules relating to "Suspension or Termination of the Scheme". The relevant Rules are Rules 56 and 57. Rule 56 (so far as material) provided:

> "56. A Participating Employer's contributions
>
> > (a) may be terminated at any time by notice in writing to the Trustee and may be similarly terminated only in respect of persons in a specified category or specified categories …..
> >
> > In the event of the contributions of a Participating Employer being terminated under this Rule Paid-Up Policies shall (subject as hereinafter provided and to the provision of sub-paragraphs (c) and (d) of Rule 57 (Termination of contributions by all Participating Employers) and Rule 58 (Alternative powers on termination of contributions)) be provided in accordance with Rule 57 …"

137. On its own, Rule 56 was a partial termination provision, leading to a partial winding up in accordance with Rule 57 by the purchase of annuities, subject to the unilateral discretions on the part of the Trustee to provide for affected members' benefits by transfers (Rule 58(A)) or to continue the Main Plan as a closed fund (Rule 58(B)).

138. However, Rule 57 (so far as material) provided:

> "In the event of the contributions of all the Participating Employers being terminated under Rule 56 the Scheme shall, subject to sub-paragraph (B) of Rule 58 (Continuation of the Scheme as a closed scheme), determine …"

139. Subject to continuation of the Scheme as a closed scheme, Rule 57 provided, on the termination of the entire Scheme, not only for members to be bought annuities in respect of their accrued benefits under the Scheme (see Rules 57(d)(1)-(5)) but also for any surplus to be applied in augmentation of members' benefits: see sub-Rule 57(d)(6), as follows:

> "Subject as aforesaid, the Trustee shall apply any balance of the Fund thereafter remaining to augment all or any of the benefits provided under this Rule or to provide Paid-up Policies in respect

of any person who, had the Scheme been maintained, would have been entitled or prospectively entitled to a benefit or benefits thereunder, not being a benefit or benefits provided under this Rule."

140. Given that the power under Rule 56 is a unilateral power exercisable by each Participating Employer in respect of its own employees and given that Rule 57 (subject to the Trustee's discretions under Rule 58) makes detailed provision for how the Scheme is to be dealt with (by way of partial or total termination), it would be an odd result if a Participating Employer was entitled, in addition, to remove from the list of permanent employees the names of a whole category of employee or indeed of its entire workforce thus bringing about a cessation of accrual but making absolutely no provision at all about how the Scheme was to be administered in circumstances equivalent to partial or total termination under Rules 56 to 58.

141. I do not understand Mr Simmonds to argue for a different result. Whilst drawing attention to the apparently conclusive nature of the decision of the Principal Employer concerning the names to be recorded in the register, and suggesting that there are superficial similarities between those provisions and the Exclusion Power, he acknowledges IBM's acceptance that the scope of the Exclusion Power exceeds that of the eligibility provisions in the 1983 Trust Deed and Rules.

142. I have, nonetheless, gone into the point myself and reached a conclusion in relation to it because it is, I consider, relevant to understand precisely how the provisions of the 1983 Trust Deed and Rules differ in their substantive effect from the Exclusion Power and why Mr Simmonds is right not to advance the argument which he has referred to.

The 1983 Amendment Power and the fetters on its exercise

143. I turn now to the scope of the 1983 Amendment Power and the restrictions placed on it. The RBs' position is that the Exclusion Power can be valid only if, on its true construction, it has a scope and/or purpose that is consistent with the 1983 Trust Deed and Rules and the fetters on the 1983 Amendment Power. IBM's position is that the Exclusion Power, construed as IBM would construe it, is consistent in that way, so that the introduction of the Exclusion Power was valid. However, if IBM is wrong in this respect – that is to say, if, *prima facie*, the Exclusion Power could be exercised in a manner that would infringe one or more of the fetters on the 1983 Amendment Power – then IBM submits that the Exclusion Power is nevertheless not void *in toto* but rather should be construed as subject to an overriding limitation to protect the relevant beneficiaries from the two adverse effects of the amendment which the RBs rely on. I will, in due course, consider Mr Simmonds' detailed argument on that point. As to construction, it is important not to lose sight of the impact which the scope of the 1983 Amendment Power and the fetters on it might have on the proper construction of the Exclusion Power.

144. The 1983 Amendment Power, which is to be found at Clause 4 of the 1983 Trust Deed and Rules, is set out at paragraph 78 above.

145. It is common ground that provisos (a) and (b) to the 1983 Amendment Power were not engaged by the introduction of the Exclusion Power. Proviso (f), which concerns the effect of amendments pending the formal documentation of the same, is similarly not in issue. Furthermore, it is no part of the RBs' case that the introduction of the Exclusion Power was defective for want of compliance with the formalities required by the 1983 Amendment Power.

146. It was pursuant to this power of amendment that the Exclusion Power in the Main Plan was introduced, it first appearing, as I have mentioned, in the 1990 Trust Deed and Rules. The 1990 Trust Deed and Rules made no provision for the consequences of an exercise of the Exclusion Power (such as the triggering of a partial or total winding-up); accordingly, the Main Plan would simply continue to run according to its terms. The Exclusion Power would, on IBM's approach, have represented a significant change from the pre-existing provisions since Holdings would be able to terminate future accrual and break the final salary link in respect of pensions earned by service to date; and it would be able to do so without triggering a winding-up. Previously, termination of contributions would have involved a total or partial winding up, on which event the Members concerned would have been entitled to augmentation of benefits out of surplus (if there was any) after the making of provision for benefits. Such provision would have been effected by the purchase of annuities in accordance with the winding-

up provisions under the 1983 Trust Deed and Rules subject always to the operation, at the Trustee's discretion, of the alternative provisions of Rule 58.

147. In my judgement in the Rectification Action, I discussed the circumstances in which the 1990 Trust Deed and Rules were drafted and executed: see in particular at [420]*ff*. Mr Stallworthy relies on my finding, at [423], that the instructions given to Nabarro (who carried out the drafting) were:

> "to consolidate the existing Rules of the Main Plan into 'a new, modern, single document, using plain English where possible'"

148. He also relies on [428], where I was dealing with a report prepared by Mr Quarrell (of Nabarro) for the Trustee, during the course of which I stated:

> "Mr Quarrell thought that the new version of the Trust Deed and Rules was replicating the 1983 Trust Deed and Rules save in respect of amendments his firm had been instructed to reflect in the drafting (which did not include any change to early retirement conditions)."

149. I said that in relation to "early retirement" and "flexible retirement" but it applies equally to any change to the substance of the termination provisions and the balance of power between IBM on the one hand and the Trustee on the other.

150. In these circumstances, Mr Stallworthy submits that "one would not expect to find (unannounced) a significant new power introduced amongst the eligibility provisions of the 1990 Trust Deed & Rules". That point demonstrates the close connection between Issue 1 and Issue 2. One can only decide whether the Exclusion Clause was validly introduced if one knows what it means: but one can only decide what it means once one knows the scope of the fetters on the 1983 Power of Amendment because one should, if possible, construe the Exclusion Power in a way which is consistent with those fetters. Nonetheless, I propose to address Issue 1 and Issue 2 separately, as did both Mr Stallworthy and Mr Simmonds.

151. It is, however, important to note that I said what I did in the Rectification Action in the context of a rectification claim. It was a material factor in ascertaining the intention of the members of the board of the Trustee in their consideration of what became the 1990 Trust Deed and Rules. I very much doubt that evidence of Nabarro's instructions (or of the fact that the 1990 Trust Deed and Rules was intended to be a consolidation in plain English, with substantive amendments being made only in relation to matters on which Nabarro had instructions) is admissible on the question of construction of the 1990 Trust Deed and Rules; and this is so in spite of the current approach to construction under which context appears to be an almost overarching consideration: see in particular the speech of Lord Clarke in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50.

152. I note for completeness at this stage that Mr Stallworthy submits, correctly in my view, that the directors of the Trustee never asked for any new power to close the Main Plan to accrual to be introduced into the 1990 Trust Deed and Rules; and there was no suggestion from any of the Trustee's advisers (*eg* Nabarro and the Actuary) that any such new power was being introduced. They had no notion that they might be altering materially the balance of powers within the Main Plan by introducing a new power to close the plan to accrual, and thereby break final salary linkage, without triggering a winding up. This is evident from the contemporaneous documents relating to the production of the 1990 Trust Deed and Rules including, in particular, Mr Quarrell's report which I have referred to above. There is no subsequent material which suggests that any of the directors ever thought that that was what had happened.

153. Mr Stallworthy goes on to submit that if IBM's case is correct, then the Trustee was acting under a fundamental mistake as to the legal effect of the 1990 Trust Deed and Rules, because the Trustee did not appreciate that such a significant new power was being introduced. However, he accepted that, on the state of the law current at the date of the hearing before me, as stated in *Pitt v Holt* and *Futter v Futter* [2011] EWCA Civ 197, the Trustee's decision to introduce the Exclusion Power by amendment would not be void or voidable under the principles previously often referred to as "the Rule in *Hastings-Bass*". Mr Stallworthy reserved his position in the light of anything which the Supreme Court might decide or have to say on the appeals then before it in those cases. The

Supreme Court has now given its decision: see [2013] UKSC 26. Mr Stallworthy has not sought to make any further submissions. The *Hasting-Bass* point cannot now avail him.

154. The issue of whether the introduction of the Exclusion Power is vitiated to any extent by mistake was not argued, possibly because the distinction drawn by Millett J in *Gibbon v Mitchell* [1990] 1 WLR 1304 between effect and consequences was seen as an insuperable obstacle. The law has now been clarified – and to some extent it has moved on – in the light of the decision of the Supreme Court. Again Mr Stallworthy had reserved the RBs' position in the light of anything which the Supreme Court might say but he has not sought to add to his submissions. I therefore say no more about this issue.

The Actuary's opinion

155. Each of the provisos (c) to (e) to the 1983 Amendment Power commences with the words "no such alteration or modification shall be made which in the opinion of the Actuary shall operate …..". There appeared from their skeleton arguments and their written closing submission, to be a gulf between Mr Stallworthy and Mr Simmonds on the impact of that requirement in relation to the introduction of the Exclusion Power in the light of the absence of any opinion at all from the Actuary. Mr Stallworthy accepted that the default position is that an amendment is valid unless the Actuary expresses a negative opinion. But he submitted that, on the facts of the present case, the fact that the Actuary had been consulted and had not expressed a negative opinion meant that the Actuary had been satisfied that the fetters on the 1983 Amendment Power had not been broken. The Actuary had been wrong as a matter of law to reach that conclusion; his conclusion was in effect an expert determination which could be challenged in accordance with the established principles.

156. Mr Simmonds had originally taken the line that the absence of negative opinion meant that the amendment was valid. Having read and heard Mr Stallworthy's closing submissions, he did not pursue any of the arguments which he had canvassed about the effect of the absence of a negative actuarial opinion.

The RBs' case

157. Mr Stallworthy identifies two elements of the Exclusion Power which he submits breach the fetters found in the provisos:

> i) The first is the loss of opportunity to benefit from augmentation out of surplus on the (partial or total) winding-up of the Main Plan. This element relates to all three provisos.
>
> ii) The second is the break in the final-salary link between accrued service and future salary increases. This element relates to provisos (d) and (e), but not to proviso (c).

158. The abandonment by IBM of the arguments based on the absence of a negative opinion from the Actuary greatly reduces the area of contention based on the break in the final salary link. The difference now is this. The RBs contend that the exercise of the Exclusion Power in a way which broke that link is wholly invalid. IBM's contention is that the amendment was valid *pro tanto* and should be given effect to in relation to service after the date of the amendment whilst preserving the final salary link in relation to service prior to the amendment. But the acceptance of that result by IBM relates only to the exercise of the Exclusion Power itself and will, in practice, have little impact because, on IBM's case, the 2009 Non-Pensionability Agreements will have restricted the part of pay which is pensionable to a figure less than the definition of Final Pensionable Earnings would suggest. The loss of opportunity to benefit from augmentation remains, however, an area of contention.

159. Mr Stallworthy begins with proviso (e) which is the most important proviso for present purposes. This protected non-pensioner Members (*ie* active or deferred members) as regards "the aggregate value of the retirement benefits payable under the Scheme …in respect of contributions already received by the Trustee". In contrast with provisos (c) and (d), there was no test of substantiality – any reduction in the aggregate value of the retirement benefits payable in respect of contributions already received by the Trustee would engage proviso (e).

160. Mr Stallworthy's argument is as follows:

i) His starting point is that the aggregate value referred to in proviso (e) would for active members have included the value of the final salary linkage applicable to the retirement benefits accrued by past Pensionable Service. I do not need to address his submissions in support of that point since it is common ground: Mr Simmonds concedes, as I have said, that the retirement benefits referred to in proviso (e) to the 1983 Amendment Power do embrace a link between accrued service and future salary increases. The same is true of proviso (d) but, in IBM's submission, that proviso is subsumed by proviso (e) and, accordingly, there is no need to deal with it separately. I add that it is also common ground that the final salary link is irrelevant in the case of proviso (c).

ii) The reference to "aggregate value" is significant. The draftsman appears to have used the word "value" to connote sums which cannot be mechanistically determined but require valuation (usually by an actuary). From that, it follows that the Actuary would have to form an opinion as to whether the amendment had an adverse effect on the value of the benefit taking account of potential salary increases making appropriate assumptions in order to derive a predicted Final Pensionable Salary. This in turn suggests that proviso (e) is not concerned narrowly with the "amount" of presently accrued pension (calculated by reference to current Pensionable Service and Salary as at the date of amendment). As will be seen I do not agree with the suggestion.

iii) The temporal element of the fetter is the reference to the aggregate value of the retirement benefits payable "in respect of contributions already received by the Trustee". The fetter is not expressed by reference to benefits earned by Pensionable Service prior to the date of amendment. Nor is there any indication that the aggregate is to be determined on the basis of a deemed fiction that the Member left Pensionable Service immediately prior to the amendment (which is the assumption under section 124(2) Pensions Act 1995 when assessing the level of statutory protection against adverse amendments).

iv) And so the introduction of the Exclusion Power (which permits Holdings unilaterally to terminate contributions without triggering a winding up) not only breaks the final salary linkage but also denies non-pensioner Members the value of augmentation out of surplus which in turn breaches the fetter imposed by proviso (e).

161. In support of his submissions, Mr Stallworthy has referred to a number of cases in this jurisdiction and other common law jurisdictions, where the courts have had to grapple with the effects of various fetters on powers of amendment. He prepared a short analysis of the cases relied on. I have taken that analysis into account in reaching my conclusions.

162. Mr Stallworthy's argument is that, assuming the Exclusion Power to have the scope for which IBM contends, the Actuary should (and if he had appreciated that scope, would) have formed and expressed the opinion that provisos (e) and (d), and perhaps even proviso (c), were infringed. He says "would" because such an opinion was given in relation to the amendments under Project Soto implementing partial non-pensionability of further pay rises. Those amendments were only rendered valid by the consent of the affected members. Those are bold submissions in the light of the absence of any expert evidence directed at the question whether the fetters were infringed, not by the Soto changes but by the making of the 1990 Trust Deed and Rules.

163. The point is also made that these conclusions are not affected by the fact that the amendment introduced a power for future use, rather than immediately itself terminating accrual. Mr Stallworthy relies on *Re Courage Group's Pension Schemes* [1987] 1 WLR 495 at 513C-F which demonstrates that Millett J was indeed concerned about the future exercise of the powers inserted by amendment; and in *Bradbury v BBC* [2012] EWHC 1369, [2012] PLR 283 at [67] I reached a similar conclusion (albeit *obiter*) in relation to the particular power concerned in that case. As Mr Stallworthy observes, an amending party cannot achieve in two steps what he cannot achieve in one (*eg* by purporting to delete a fetter to an amendment power and subsequently making a second amendment which would have been precluded by that fetter): see *Air Jamaica v Charlton* [1999] 1 WLR 1399 at 1411G and *HR Trustees Ltd v German & IMG* [2009] EWHC 2785, [2010] PLR 23 at [115]-[125], especially [123].

164. In relation to proviso (d), Mr Stallworthy submits that this clearly protects contingent benefits, including discretionary benefits, referring as it does not simply to "benefits" but to "interests under the Scheme". He is clearly correct in saying what he does in relation to contingent benefits. Whether he is right that it includes discretionary benefits (such as augmentation in a winding-up) is something I will come to.

165. He finds support in the decision of the Court of Appeal in New Zealand in *UEB Industries Ltd v W S Brabant* [1992] 1 NZLR 294, [1991] PLR 109 where the amendment power in clause 10 precluded any amendment which would "reduce or adversely affect that Member's interest in the Fund at the date of alteration". The issue was whether it was possible to amend the winding up clause to provide for any surplus to be paid to the employers rather than applied to augment benefits. The Court unanimously held that this fetter precluded an amendment, because the possibility of augmentation constituted part of a "Member's interest in the Fund at the date of alteration". A pithy passage from the judgment of Cooke P at [34] is worth quoting, It reads as follows:

> "34. In considering the meaning of "interest" in the context of a protection clause in a superannuation scheme, I do not derive major help from cases on revenue statutes, such as *Commissioners of Stamp Duty (Queensland) v Livingston* [1965] AC 694 and *Gartside v Inland Revenue Commissioners* [1968] AC 553 553, from which both sides claimed support here. In a superannuation scheme, a clause designed to prevent adverse effect on a member's 'interest' without consent should be construed, in my opinion, in the light of the principle and evidence purpose that, without the consent of the member, benefits which may flow from his or her past membership and contributions should not be altered to his or her disadvantage…."

166. Accordingly Mr Stallworthy submits that any introduction of a new power by which Holdings could unilaterally close the Main Plan to all accrual, breaking the final salary link, should (and would) have been invalidated by an opinion from the Actuary under proviso (d).

167. In relation to proviso (c), Mr Stallworthy submits that the Actuary might even have been of the opinion that the introduction of the Exclusion Power engaged, and should be invalidated by, proviso (c), on the basis that such a power unilaterally to close the Main Plan to all accrual without triggering a winding up operated "substantially to prejudice the pension payable" to pensioners and the contingent beneficiaries of Member pensioners because it permitted Holdings to avoid augmentations from surplus on winding up.

IBM's case

168. Mr Simmonds breaks the issue of the validity of the Exclusion Power down into three questions.

> i) The first is: What interests are protected by the fetters on the clause 4 power?
>
> ii) The second is: Does the Exclusion Power *prima facie* prejudice the rights that are protected by the fetters in Clause 4?
>
> iii) The third is: If the Exclusion Power would, *prima facie*, prejudice those protected rights, what as a matter of law is the impact of the clause 4 fetters on the Exclusion Power in terms of the validity of the rule: is the Exclusion Power wholly invalid (as the RBs contend) or can it be saved, in part, as IBM contend?

169. These seem to me to be the right questions to ask although, in answering the third question, consideration needs to be given to the role of the Actuary and the matters of which he needs to be satisfied. Mr Simmonds sees the issue between him and Mr Stallworthy as resulting simply from a different approach to the way in which an amendment which admittedly breaches the fetters should be treated – whether it is wholly invalid or only *pro tanto* invalid. But that does not do justice to Mr Stallworthy's appeal to the role of the Actuary: on the basis that there is a *prima facie* breach of the fetters, the Actuary could not have done anything other than provide a negative opinion, in which case the argument is that the purported exercise of the Amending Power must be wholly void.

The first question

170. In relation to his first question, Mr Simmonds' focus is on the point concerning access to surplus. He accepts that the final salary linkage is something that would cease to apply on an exercise of the Exclusion Power as a matter of construction of the Main Plan and the I Plan documentation (although it should be remembered that the final salary linkage point is not relevant to persons who are already pensioners or deferred pensioners at the time of the exercise of the Exclusion Power). He accepts that the prospective right to a pension based on final salary is part of the interest of a Member. It follows that the elimination of this interest would prejudice the interests of a person who is an active member at the time of the exercise of the Exclusion Clause and would thus be a breach of proviso (d) to the extent that it is "in respect of contributions received by the Trustee prior to 1 January 1973". He does not now seek to argue that the exercise of the Exclusion Power would not reduce the aggregate value of the retirement benefits payable under the Scheme to a person who is an active member at the time of the exercise of the Exclusion Power. It follows that the elimination of the final salary link would be a breach of proviso (e) to the extent that the aggregate value is "in respect of contributions received by the Trustee".

171. So far as concerns augmentation of benefits Mr Simmonds acknowledges that, under the 1983 Trust Deed and Rules there was no free-standing power to terminate contributions in respect of a Member; termination of contributions would lead to a partial winding-up (albeit subject to the power (whatever it actually means) for the Trustee under Rule 58(B) to continue the Main Plan as a closed fund) and that, on winding-up, there was a requirement to use surplus to augment benefits. But he does not accept that this entitlement is within the scope of the protection afforded by the provisos to Clause 4; nor does he accept, even if that is wrong as a matter of construction, that the introduction of the Exclusion Clause did infringe any of those provisos.

172. Mr Simmonds says that proviso (c) is concerned only with pensioners and dependants of pensioners. He is clearly right about that.

173. Proviso (d) is concerned with active members and deferred pensioners. The temporal limitation demonstrates that this proviso is directed only at persons who were Members prior to 1 January 1973. The protection it affords is only in relation to "interests…..in respect of contributions received…. prior to 1 January 1973". The proviso is curiously worded (although I understand quite a common form) and is open to different interpretations.

174. Proviso (e) is also concerned with active members and deferred pensioners. Here there is a different protection and a different temporal limitation. The protection relates to the aggregate value of the retirement benefits payable. And that value is not ascertained by reference to "interests… in respect of contributions received prior to 1 January 1973" but rather by reference to "retirement benefits payable…. in respect of contributions already received" (*ie* received by the date of the amendment).

175. Mr Simmonds addressed the argument made by Mr Stallworthy, relying on *UED*, that "interests" in proviso (d) include prospective interests in surplus on winding-up. That case was, on its facts, far away from those in the present case, and the material restrictions on the amendment power very different. The power of amendment contained a proviso to the effect that no amendment could be made in relation to a member if it "would reduce or adversely affect that member's interest in the fund". The actual amendment made was to replace an obligation to apply surplus in winding-up in the augmentation of benefits with a requirement to pay it to the employer. The Judge held this to be an impermissible derogation from the members' rights: the members did not have a mere expectancy nor even a mere right to be considered for any discretionary allocation.

176. And so in the present case, Mr Stallworthy argues that the members have an interest in surplus in the same way that the members in *UEB* had an interest in surplus.

177. There are, however, two important and material distinctions to be drawn in the present case. The first is that each of the provisos has to be construed as part of the scheme of protection which is found in Clause 4 taken as a whole. Mr Simmonds submits that when the provisos are taken as a whole – particularly provisos (c), (d) and (e), it can be seen that the "interests" in proviso (d) cannot be given the wider interpretation given in *UEB*. The second distinction, which may simply be a particular example of the first, is that, in the present case, provisos (d) and (e) both contain a temporal limitation which fits uncomfortably with the idea that an opportunity to share

in surplus is protected.

178. Those are important distinctions. As to the first distinction, the first point to note is that proviso (c) only protects the pension payable to a person who is entitled to a pension at the effective date of the alteration. I agree with Mr Simmonds when he says that the protection relates only to the pension payable at the date of the alteration. It does not extend to any increase in the pension which might be made if the scheme were to go into winding-up and if it were then in surplus.

179. The second point to note is that proviso (e) does not use the word "interests" at all; rather it relates to the "retirement benefits payable under the Scheme to any Member" and what is protected is the aggregate value of all such benefits. The idea behind that, it seems to me, is that the Actuary will be able to identify the benefits which the Scheme provides and will be able to place a value on them making appropriate assumptions as he would do in an actuarial valuation of the Scheme as a whole. It is the aggregate value which has to be maintained, but that does not mean that some benefits may not be reduced provided that others are increased. That does not fit at all comfortably with that idea that the prospect of sharing in surplus, if there is one, on a winding-up, if there is one, is somehow part of the retirement benefits which have to be valued under the Scheme.

180. The third point is that both provisos (d) and (e) each treat active members and deferred members in the same way. If Mr Stallworthy is correct in his construction of provisos (d) and (e), the result is that the opportunity for a deferred pensioner to share in surplus is protected as an "interest" under proviso (d) or as part of "the retirement benefits payable" under proviso (e). But, for reasons already given, proviso (c) does not extend to the protection of that opportunity to pensioners. In other words, deferred pensioners obtain a protection which pensioners do not. That would be a very surprising result.

181. In my judgement, Mr Simmonds' approach is more coherent and leads to a more sensible result. The protection afforded to pensioners relates to their actual benefits in payment and extends to contingent benefits in respect of pensioners. Active members and deferred members are treated together because their benefits are not in payment and the eventual amounts payable are not known and indeed a particular benefit (*eg* a pension) may not even come into payment, for instance in the event of death before the pension comes into payment. Instead protection is afforded under proviso (e) in respect of the retirement benefits which will become payable under the scheme in different events (*eg* surviving to normal pension age or dying prematurely); those benefits can be ascertained and a value can be placed on them. It is not clear why a different formulation is found in proviso (d) nor why the majority can bind the minority by giving consent to an amendment in contrast with the position in relation to proviso (e). Proviso (d) would appear to afford protection in relation to each interest under the Scheme separately, whereas proviso (e) is expressly directed at the aggregate value of all retirement benefits.

182. The second distinction is that both provisos (d) and (e) contain a temporal limit to the protection, either 1 January 1973 (proviso (d)) or the date of the amendment (proviso (e)). Mr Stallworthy has drawn attention to the fact that the protection is given in relation to interests or benefits payable "in respect of contributions received by 1 January 1973" (or "already received"). The protection is not expressed to be given by reference to benefits earned by service up to those times. I find the actual wording of the provisos in that regard curious. I suspect that it was a form of words adopted many years ago which has found its way into common usage. It seems to me, however, that it can be referring only to interests or benefits arising under the Scheme in respect of periods for which the contributions (by employer and member) have been paid. In practical terms, there should be little, if any, difference in the result from a formulation based on benefits earned by service up to 1 January 1973 (or the date of the amendment). But I suppose that if contributions are paid in advance so that the Trustee has received contributions in respect of benefits accruing for a period after the date or payment, there could be a difference. But that is fine distinction and I do not consider that it has a material effect on the argument.

183. The protection thus afforded can therefore be seen to be one which relates to interests or benefits earned by reference to a period of service. It is to my mind a more natural interpretation of both provisos to see that protection as excluding something as uncertain as an augmentation on a winding-up which may never happen out of a surplus which may or may not exist even if it does. I do not say that such a protection could not be

drafted without, I dare say, much difficulty. But these provisos do not, in my judgement, achieve that result.

184. I would therefore answer Mr Simmonds' first question this way. The interests and the retirement benefits protected by the fetters in Clause 4 of the 1983 Trust Deed and Rules include the final salary link but do not include any opportunity to share in surplus on a winding-up.

The second question

185. Mr Simmonds' second question is whether the Exclusion Power *prima facie* prejudices the rights that are protected by the fetters in Clause 4. I proceed, in dealing with this question, and the third question on the footing that the Exclusion Power, on its true construction, does have the scope for which IBM contends (a matter to be decided under Issue 2). The assumptions, therefore, are (i) that IBM can serve a notice in relation to the entire membership of the Main Plan and the entire membership of the I Plan save for excepted individuals and (ii) that there are no implied restrictions on the apparent width of the power read literally. By way of reminder, I set out that power, as it appears in the Main Plan Definitive Trust Deed, again:

> "4. **Exclusion by Principal Employer from Membership**
>
> The Principal Employer may by notice in writing to the Trustee direct that any specified person or class of persons shall not be eligible for membership, or shall cease to be a Member or Members. Such a notice shall override any provisions of the Plan that are inconsistent with it."

186. Mr Simmonds accepts that the answer to his second question is "Yes" so far as concerns final salary linkage. That is the clear effect of the Rules which apply when a person ceases to be a member.

187. But he maintains that the answer is "No" in relation to access to surplus. The question only arises if his (and my) answer to the first question is wrong. But the point has been fully argued and I propose to deal with it. The reason for his answer is that the right is only to participate in surplus if the employer decides to put the scheme into winding-up. A member, of course, had no right under the 1983 Trust Deed and Rules to put the scheme into winding-up, nor could the members collectively, or the Trustee do so. But if the scheme does go into winding-up, the opportunity to access surplus remains precisely what it always was.

188. In that sense, the present case is not merely different but wholly distinguishable from *UEB* where the amendment purported to divert the surplus from the members to the employer. I consider that Mr Simmonds is correct to draw that distinction and I gain no assistance from *UEB* in relation to access to surplus.

189. It is, moreover, important to recognise that none of the provisos relates to benefits earned in respect of future service and, indeed, proviso (d) does not relate to service after 1 January 1973. Quite clearly, future service benefits could be adversely affected: there could be no objection, as a matter of construction of the 1983 Trust Deed and Rules, to IBM and the Trustee agreeing to reduce the accrual rate for future service. Whether the Trustee could properly agree to such a reduction would, of course, depend on the particular facts of the case at the time of the amendment. Such an amendment would be likely to have an impact on how surplus would in fact be distributed in the event of a subsequent winding-up but it cannot seriously be suggested that it would infringe the fetters on the power of amendment.

190. Once it is accepted, as I think it must be, that an amendment to reduce future accrual of benefits would not breach any of the fetters on the power of amendment, I see no reason in principle why IBM and the Trustee should not be able to agree to an amendment which does not bring about an immediate reduction in the accrual rate but which introduces a new power for IBM unilaterally to do so. The rate of future service accrual is clearly not an entrenched provision so that an amendment which adversely affects future service accrual is not to be ruled out as a possibility; such an amendment does not raise the sorts of issue which arise when an amendment is sought to be made to an amendment provision which is hedged about with restrictions so as to remove those restrictions, with the amended power subsequently being used to do something which would have been prevented under the original amendment power.

191. Moreover, I do not see any reason in principle why the reduction in benefits under such an amendment should not, as a matter of construction of the provisions of the 1983 Trust Deed and Rules, be reduced to nil. The structure of those provisions did not, it is true, include a power for IBM unilaterally to reduce future accrual to nil or indeed at all, although IBM did have power to terminate contributions (and thus accrual of benefits) either in relation to a specified category of member or in relation to a Participating Employer, in the latter case bringing about a partial winding-up. I see no reason to think that that part of the structure was a necessary and enduring part of the architecture. I do not consider that the provisos to the power of amendment preclude a new way of dealing with what is to happen in the event of the termination of contributions. Thus, had an amendment been agreed by the Trustee (again, the facts would have to justify the Trustee acting in this way) under which the default position was changed so that, instead of termination of contributions resulting in a total winding-up with an option for the Trustee to continue the scheme as a closed scheme, the scheme was to continue as a closed scheme with the Trustee having an option to place the scheme into winding-up, I do not see why this should be seen as infringing the fetters on the amending power. The amendment will give rise to a change in the structure but will not compromise the essential architecture of the scheme.

192. Mr Simmonds' third question is what, as a matter of law, is the impact of the fetters on the 1983 Amendment Power on the Exclusion Power in terms of the validity of the rule and whether it is wholly invalid (as the RBs contend) or can be saved in part. I refer to paragraph 157 above for the basis on which I deal with this question.

193. In the light of my conclusions in relation to precisely what it is that the fetters protect, the only issue on this question relates to the final salary linkage, although I will say a little about access to surplus in case I am wrong in my conclusions in relation to that.

194. There is one point of construction which I wish to dispose of at the outset. The structure of the 1983 Amendment Power is to give the Trustee the power to amend the Scheme after consulting the Actuary and with the consent of IBM. That wide power is then subjected to the five provisos set out. Proviso (a) contains an absolute bar: nothing shall authorise or allow the deed or rules to be altered to authorise the transfer of payment of any part of the fund to any Participating Employer in any circumstances. Proviso (b) provides that no alteration shall be made "as shall operate" to effect a change in the main purpose of Scheme. Proviso (c), (d) and (e) each provide, as I have explained, that no alternation shall be made which "in the opinion of the Actuary, shall operate…" in the proscribed way.

195. Some of the cases to which I have been referred, where defective amendments have been given partial validity, contain wording which has a slightly different focus from the present case. In those cases, the restriction is along the lines "no such alteration shall operate" in contrast with the present case where the restriction is "no such alteration or modification shall be made which shall operate". In the former case, it could be said that what is restricted is the operation of the amendment once effected and that a failure expressly to spell out in the amendment the relevant restriction does not preclude an exercise of the amended provision in a way which would not operate in the forbidden manner. In contrast, in the present case, it can be said that the restriction is on the alteration itself (and not merely on the operation of the amended provision) so that a failure to spell out the restriction in the amendment is fatal.

196. In my judgement, this is a distinction without a difference. In applying the principle (when the facts justify it) that an apparently excessive exercise of an amending power is valid to the extent that it is not excessive, it would be wrong to allow this narrow difference in wording to defeat the principle of validation (subject to the constraints within which that principle can be applied, to which I come in a moment). Accordingly, I do not consider that the presence of the words "shall be made" affects the outcome.

197. This is a convenient place to mention one aspect of Millett J's decision in *Re Courage Group's Pension Schemes* [1987] 1 WLR 495. That case concerned a prospective exercise of a power. The Judge held that the power could not properly be exercised in the way proposed. He did not address – the question did not arise – what if any effect would have been given to the amendment if it had already been made. It does not follow from the fact that, prospectively, a power of amendment cannot properly be exercised in a particular way that, if it has been exercised in that way, the exercise is wholly invalid.

198. Similarly, in the present case, it would no doubt be the case that, had the Actuary been asked for his opinion knowing that the final salary link had to be preserved but was not in fact preserved, he would have expressed a negative opinion in relation to the introduction of the Exclusion Power. But it does not follow from that conclusion that the Exclusion Power was wholly invalid.

199. In support of his submission that the court can and should give partial effect to the Exclusion Power, Mr Simmonds relies on three authorities: the decisions of Neuberger J (as he now is not) in *Bestrustees plc v Stuart* [2001] PLR 283, of Lightman J in *Betafence Ltd v Veys* [2006] PLR 137 and of Arnold J in *HR Trustees Ltd v German & IMG* [2009] EWHC 2785, [2010] PLR 23.

200. In *Bestrustees*, Neuberger J felt able to treat an amendment as valid insofar as it was prospective in effect but invalid insofar as it infringed a proviso protecting accrued rights. The amendment related to the definition of normal retirement age and was intended to bring about equalisation between men and women. The amendment was valid so far as it concerned future service but not past service.

201. In *Betafence*, a proviso precluded amendments prejudicially affecting benefits secured up to the date of amendment. The amendment which had been made introduced a requirement for employer consent in relation to early retirement where none had existed before. Instead of striking down the offending amendment altogether, the Judge upheld it to the extent that the proviso was not infringed, holding at [69] that the amendment "must be construed as having effect subject to the overriding limitation on the power of amendment contained in the proviso" although, as the Judge observed "All that is required is that the distinction between what is and is not objectionable is clear and that the meaning and application of what is unobjectionable is clear".

202. In *HR Trustees*, the constraint on the amending power precluded amendment which had the effect of "reducing the value of benefits secured by contributions already made". Arnold J held that this protected the value of members' accrued rights calculated by reference to their pensionable service at the date of the amendment and their final pensionable pay. An amendment to convert these benefits to money-purchase benefits was permissible "but only subject to an underpin preserving the future monetary value of the proportion of Final Pensionable Pay which the member has accrued in respect of pre-amendment service".

203. Mr Stallworthy argued that those three cases dealt with amendments which were not concerned with the introduction of new powers exercisable in the future, but instead dealt with specific situations at which a once-and-for-all amendment was directed. I have already addressed this argument in paragraph 163 above. My conclusion is that it would have been possible to create, in 1990, an amendment which then terminated future accrual (without triggering a winding-up) provided that it had been made subject to a proviso protecting the final salary link. Mr Simmonds asks rhetorically "Why should it not be possible to create a power for IBM to do just that at a later date?". My answer is that there is no reason at all.

204. But that is jumping ahead, and I shall mention two other cases relied on by Mr Stallworthy in this context which are *Air Jamaica* and *IMG*. The relevant passage appearing in the speech of Lord Millett in *Air Jamaica* is this, at [121];

> "their Lordships are satisfied that the plan could not be amended in order to confer any interest in the trust fund on the company, this was expressly prohibited by clause 4 of the trust deed. The 1994 amendments included a purported amendment to the trust deed to remove this limitation, but this was plainly invalid. The Trustees could not achieve by two steps what they could not achieve by one."

205. The question was whether one amendment power could be replaced by another, the exercise of which would breach the fetters on the original amending power. The real point, it seems to me, is that the original amendment power was effectively entrenched as an essential element of the architecture of the scheme there in question.

206. This was the approach adopted by Arnold J in *IMG* in the passage relied on by Mr Stallworthy at [123]:

> "Counsel for the employers argued that these authorities should be distinguished from the present

case on the ground that the relevant provisions in those cases contained restrictions that were clearly intended to be permanent, whereas clause 7.1 did not. I do not accept this argument. Clause 7.1 of the 1977 deed was plainly intended to protect the interests of the members by preventing amendments which had an effect detrimental to their interest. In my judgement it cannot have been the draftsman's intention to permit such amendments by an indirect route when he had prohibited them directly. Accordingly I consider that the reasoning in UEB, Air Jamaica and BHLSPF is applicable to the present case."

207. So there we see Arnold J applying the principle that you cannot get round a prohibition on doing something directly, in one step, by doing it indirectly, in two steps. That principle must not be pushed too far. As Millett J recognised in *Courage*, a series of perfectly valid amendments over a period of time may, at least where not all planned as a single scheme of amendments, result in an end-point which it would not have been possible to reach by a single amendment at the beginning: see his reference to *Thellusson v Viscount Valentia* [1907] 2 Ch. 1 and the Hurlingham Club at p 506. That is not the present case, however, because the question is whether the first (and only relevant) amendment, the introduction of the Exclusion Power, was valid. It does not seem to me that the proposition that you cannot do in two steps what you cannot do in one has any scope for application. An amendment in 1990 to terminate future accrual would have been valid provided that the final salary link had been preserved. So too the introduction of the Exclusion Clause would have been valid if it had contained an express override preserving that link.

208. The limitation which Mr Simmonds submits should be applied is similar to the one implied by Arnold J in *IMG*. Although the drafting of such a limitation is not entirely straightforward, the concept is, I think clear: namely that a Member concerned should be entitled, if it produces a better result for him than statutory revaluation of his leaving service benefit, to a pension based on his period of service to the date of the exercise of the Exclusion Power and on his salary at the date when he actually ceases to be an employee.

209. I agree with Mr Simmonds' submissions, and, for the reasons which he gives, I reject Mr Stallworthy's argument that the Exclusion Power is wholly void.

210. In practical terms, Mr Simmonds submits that such a limitation would be of no practical effect because of the 2009 Non-Pensionability Agreements. Under those agreements, each affected Member agreed to limit the amount of his pay which would be pensionable in respect of his past service. If these agreements are valid, the final salary link will have been broken by agreement. Whether those agreements are in fact valid is a different question, but the answer to that is not relevant to the issues now under consideration. I only comment here that the answer to that question may be influenced by the fact that the Members concerned may well have entered into the agreements on the basis that the Exclusion Power was valid and that the final salary link was broken.

211. If I am wrong about access to surplus being outside the fetters on the exercise of the 1983 Amendment Power, then it is necessary to analyse what precisely it is that had to be preserved. My own view is that it would be the opportunity to access surplus on a winding-up if and when that took place on the basis of benefits accrued to the date of exercise of the Exclusion Power. That is precisely what is in fact preserved so long as the proviso which I have discussed in relation to final salary linkage is to be implied into the Exclusion Power.

212. The alternative view is that the only way in which the opportunity to access surplus can be properly preserved is to permit that to be done at the time of the exercise of the Exclusion Power at least in a case where that exercise relates to all active Members. This is on the footing that such a comprehensive exercise of the Exclusion Power is a *de facto* termination of contributions which would have triggered a winding-up under the unamended 1983 Trust Deed and Rules.

213. But in that case, Mr Stallworthy is met with what I think is an unanswerable point made by Mr Simmonds. It is that, as a matter of fact, there was no relevant surplus in either 1990, when the amendment was made, or in 2011, when the exercise of the Exclusion Power took effect. The winding-up rule provided for the purchases of "Paid-up Policies securing benefits", that is to say the purchase of annuities and deferred annuities, for pensioners, deferred pensioners and active members (and their dependants): see Rule 57(d)(1) to (5). Any remaining surplus

is dealt with under Rule 57(6) but if there is no surplus, the Rule has no scope of application. At all material times the Main Plan was in substantial deficit on a buy-out basis. The 2009 AVR showed an ongoing deficit of £667m at the end of 2009 with only 69% cover on a buy-out basis. The schedule of deficit contributions agreed in 2011 contemplated that the scheme would not be restored to balance even on an ongoing basis until 2020. I agree with Mr Simmonds when he says that it is fanciful to think that there was any surplus which would have been available on a winding-up in 2009 or 2011 or any time in between and therefore fanciful to think that the members were deprived of any opportunity to share in that surplus on the alternative view now under consideration. This is, in any case, a hypothetical issue given my conclusions on the first two questions posed by Mr Simmonds so far as concerns access to surplus.

Issue 2 - whether the purported exercise of the Exclusion Powers (and/or any other relevant powers vested in Holdings) in the manner envisaged by Holdings in the Exclusion Notices falls within the terms and scope of the Exclusion Powers in the Plans and/or those other relevant powers.

214. I have already noted that this Issue and Issue 1 are interdependent. But it is Issue 2 which raises more directly the proper meaning of the Exclusion Power. The discussion of Issue 1 has really side-stepped that question and has focused on the position which would obtain if, as a matter of construction, it apparently allowed IBM to terminate the membership of all active members of the Main Plan or all of the active members of the I Plan save for the excepted individuals (subject to the discrete point about Postponed Retirees to which I will come).

Principles of construction

215. The principles of construction applicable to pension scheme documentation are now well established. I do not need to say a great deal about them. The classic statement remains that of Millett J in *Re Courage Group's Pension Schemes* [1987] 1 WLR 495 at 505:

> "...there are no special rules of construction applicable to a pension scheme; nevertheless, its provisions should wherever possible be construed to give reasonable and practical effect to the scheme, bearing in mind that it has to be operated against a constantly changing commercial background. It is important to avoid unduly fettering the power to amend the provisions of the scheme, thereby preventing the parties from making those changes which may be required by the exigencies of commercial life."

216. I considered the principles and re-stated them in my judgement in *PNPF Trust Company Limited v Taylor* [2010] EWHC 1573 [2010] PLR 261 at [127] to [145]. I see no reason to depart from what I said there and I see no merit in repeating it. For present purposes, it is necessary only to mention two aspects.

217. The first is to re-iterate that, under the process of construction, apparently wide words may be "read down" in one of three ways:

> i) first, as a matter of narrow interpretation solely of the words in context;
>
> ii) secondly, because a term restricting the power should be implied; or
>
> iii) thirdly, (in accordance with the *Hole v Garnsey* line of authorities) because the exercise of apparently wider powers
>
> > "must be confined to such [uses] as can reasonably be considered to have been within the contemplation of the parties when the [deed] was made, having regard to the nature and circumstances of the [deed]"
>
> although, as I concluded at [145], *Hole v Garnsey* is itself to be regarded as one aspect of the exercise of interpretation of the document.

218. The second aspect is to draw attention to what Arden LJ said in [29] of her judgment in *British Airways Pension*

Trustees Ltd v British Airways plc [2002] EWCA Civ 672, [2002] PLR 247 which I cited in [129] of my judgment in *PNPF*, where she noted that pension schemes are often subject to considerable amendment over time. The general principle is that each new provision should be considered against the circumstances prevailing at the date when it was adopted rather than as at the date of the original trust deed. Likewise, the meaning of a clause in a scheme must be ascertained by examining the deed as it stood at the time the clause was first introduced.

219. There is a preliminary point which needs to be made. Issue 2 as formulated relates to both the Main Plan and the I Plan. Both parties agree that the same answer should be given to Issue 2 in the case of both Plans. But they say so for very different reasons. Mr Stallworthy starts with his interpretation of the Exclusion Power in the Main Plan and says that the Exclusion Power in the I Plan should be given the same restrictive interpretation. Mr Simmonds originally submitted that the Exclusion Power in the Main Plan was entirely valid; it was only in his oral closing submissions that he realistically accepted, having heard Mr Stallworthy's submissions, that there had to be an implied limitation on the Main Plan Exclusion Power to reflect the fetters on the 1983 Amendment Power. If his original submission had been correct, then there would clearly have been no reason to apply a different interpretation to the Exclusion Clause in the I Plan. The concession which he made in relation to the Main Plan does not need to be made in relation to the I Plan because the I Plan contained, from its inception, the Exclusion Power. It is still open to him to argue that the Exclusion Power in the I Plan has the wide meaning for which he contends and that the meaning of the Exclusion Power in the Main Plan is precisely the same but, in order to reflect the fetters, is partially invalid. Partial invalidity does not affect the meaning of the provision: indeed, it only makes sense to speak of invalidity in the context of a provision which, according to its true construction, infringes the fetters.

220. Having referred to what Arden LJ said in *British Airways* at [29] to [30] quoted by me in *PNPF* at [129], Mr Stallworthy submits that the question is what a reasonable person having all the background knowledge available to the parties would have understood the Exclusion Power in the Main Plan to mean. In the 1990 Trust Deed and Rules, the power was to be found at Rule 6 Schedule C and is in the same form as it is now to be found at Clause 4 of the Main Plan Definitive Deed.

221. Mr Stallworthy's submission is that Rule 6 is unlikely to have been intended or understood to be a unilateral termination power to close the Main Plan to future accrual given:

    i) The lack of any such power in the 1983 Trust Deed and Rules.

    ii) The fetters on the 1983 Amendment Power by which the 1990 Rules were introduced.

    iii) The location of Rule 6 within the structure of the 1990 Rules.

    iv) The wording of Rule 6 and its surrounding provisions.

222. I will come to each of those in more detail later.

223. Mr Simmonds starts from a different place. The central question, he suggests, is this: Can the Exclusion Power which gives power to Holdings to direct that "any specified person or class of persons shall….cease to be a Member or Members" be exercised in respect of the whole class of Members or, in the case of the I Plan, with the exception of certain specifically excluded Members? He says that it is for the RBs to demonstrate why the whole of the active membership does not constitute a "specified… class of person".

224. The well-known principles of construction which I have referred to show, of course, that words must be construed in their context. A particular word can have different meanings and which meaning is to be ascribed to it depends on its context. Each of those meanings might be described as an "ordinary" meaning of the word; but in context, it might be necessary to give the word a meaning different from each of those ordinary meanings. Similarly, a phrase might have different "ordinary" meanings and the context will disclose which of those ordinary meanings is appropriate; and, again, it may be necessary to depart from each of those ordinary meanings to give the phrase the meaning which it really has in the context in which it is used. In construing a

word or phrase in a particular context, it is important not to lose sight of the fact that words and phrases can have one or more ordinary meanings. It is often, perhaps always, relevant to consider the ordinary meaning or meanings in order to understand which ordinary meaning is intended or whether it is appropriate to depart from all of those ordinary meanings to give effect to what the words used actually mean in their context.

225. Thus Mr Simmonds' starting point is that an ordinary meaning of the words "any specified person or class of persons", indeed the ordinary meaning of those words, includes the whole of the active membership of the Main Plan and the whole of the active membership of the I Plan with the exceptions specified in the I Plan Exclusion Power. He submits that the fallacy of the RBs' whole approach is exposed by asking this question: What proportion, or what identifying features I might add, of the membership amounts to a "specified….class of persons"? Thus he asks in his written closing submissions: Would a class comprising the entire membership less one person be a specified class of persons? Or less ten? Or less one hundred? Given that it must be accepted that Holdings had the power to terminate future accrual in respect of any given person by means of the service of a notice to the Trustee directing that such person should cease to be a member, why can Holdings not serve several separate notices in respect of several specified persons? If so, why can Holdings not serve as many notices as there are active members of the Plans, each directing that the person specified in the notice should cease to be a member? And once one reaches that point, what possible reason is there why Holdings cannot do by one step (*viz* a single notice in respect of each of the Plans) that which it could do by several thousand individual notices?

226. According to him, the fact is that there is no rational or logical point at which to draw the dividing line. This in turn is indicative of the fact that, when given their natural and ordinary meaning, there is nothing in the words of the Exclusion Power that requires one to draw a distinction between a class consisting of the entire membership and a class consisting of a particular cohort or sub-set of that membership. Mr Stallworthy answers that rhetorical question by saying that there is such a dividing line and that it is to be found where the 1983 Trust Deed and Rules draws it.

227. Before coming to the arguments in more detail, it is to be noted that Mr Simmonds' approach as revealed in that short summary of his position proceeds on the basis that it must be accepted that Holdings had the power to terminate future accrual in respect of any given person. I am not sure that Mr Stallworthy would accept that since the old Rule 56 only permitted termination in respect of "persons in a specified category or specified categories". But Mr Simmonds' questions remain pertinent because, both under the old Rules and under the 1990 Trust Deed and Rules, it is possible to terminate contributions in relation to a specified category or class so he could replace reference to an individual with reference to an identified small class (*eg* employees in a particular location with very few employees).

228. The scheme of Mr Simmonds' argument has the merit of starting with the ordinary meaning of the words used. He notes the following features:

> i) The Exclusion Power expressly refers to a "class of persons" as well as to "any specified person". I would add that clearly the power can be exercised in relation to a collection of individuals even though they do not form a class.
>
> ii) There is nothing in the words used nor is anything required as a matter of logic, to suggest that a "class of persons" cannot comprise the whole Membership of the Main Plan; and see iv) below in relation to the I Plan. Whether the context requires the more restricted meaning to be given to "class of persons" is at the heart of the matter and I will come to it in due course.
>
> iii) The Exclusion Power refers to a class of persons not to a class of Members. A class comprising the Members of the Plans is clearly a class of persons.
>
> iv) On any view, a "class of persons" must embrace a class that comprises the whole of the membership with the exception of certain specified individuals. The Exclusion Notice in relation to the I Plan does not purport to exclude all the Members of the I Plan from Membership and, indeed, the I Plan Exclusion Power does not permit this. The excluded persons are on any footing a class of

persons less than the entire Membership.

229. IBM's position is clear: the entire active membership of the Main Plan comprises a "class of persons" and the entire active membership of the I Plan with the exclusion of the specified persons is, *a fortiori*, a "class of persons".

230. What is the RBs' position on this? Mr Stallworthy addresses that by reference to the decisions of Morgan J in *Capital Cranfield Trustees Limited v Beck, Re: the A.C. Skelton Pension & Life Assurance Scheme* [2008] EWHC 3181, [2009] PLR 71 ("***CCTL v Beck***") and of Henderson J in *Capita ATL Pension Trustees Ltd v Gellately* [2011] EWHC 485, [2011] PLR 153 ("***CATL v Gellately***") as to each of which see below. His submission is that there is a distinction between the generality of members and a limited cohort of members to be affected because of characteristics specific to those members. The Exclusion Power is, he submits, subject to an implied restriction that it can only be used to cause existing Members to cease to be Members on the basis of objectively demonstrable changes to the terms of their employment. Alternatively, or as well, the Exclusion Power is limited by the *Hole v Garnsey* principle which circumscribes the purposes for which the power can be used; as Mr Stallworthy puts it, the power can only be used "to refine the definition of the description or category of employment to which the Main Plan relates, not to close the Main Plan to accrual by all or the generality of Members".

231. Mr Simmonds is highly critical of that. He says that there is no convincing explanation of why there is a need for the cohort to be limited and no attempt to explain where the dividing line is to be drawn. In particular, no explanation is given why such an approach is appropriate in the context of a power that, on its face, is expressed to "override any provisions of the Plan that are inconsistent with it". That is not quite fair to Mr Stallworthy. He does, in his detailed comparison of the old rules and the new rules, explain that those words are "required to allow Rule 56 to operate notwithstanding Rules 1 & 2(1), not because Rule 6 is intended to confer a wide-ranging power circumventing and abrogating the amendment power". Whether that explanation is at all convincing is an entirely different matter. It seems to me to be nothing more than an assertion of the conclusion which Mr Stallworthy wishes me to reach.

232. It is convenient at this point to look at the authorities relied on by Mr Stallworthy which I have just mentioned. The first is *CCTL v Beck*. This concerned a definition of normal retirement age at 65 for men and 60 for women "or such day as the Employers shall determine in any particular case and notify in writing to the Member concerned". The important words, for present purposes, are "in any particular case" since Morgan J's judgment focused to a considerable extent on the difference between a particular case (or a number of particular cases) and a class. In the present case, there is no similar limitation. Both Mr Stallworthy and Mr Simmonds cite [37] in their written closing submissions:

> "[37] These questions therefore arise: can the power be exercised not only in one particular case, but also in several cases, and, indeed, can it be exercised by reference to a whole class of Members or to all Members. The definition, as I have emphasised, expressly refers to 'any particular case' and the words suggest an important limitation on the type of case which will fall within the power. If the power is available to be used in a particular case, it is of course hard to avoid the conclusion that it can also be used in two particular cases or several particular cases. Nonetheless, it seems to me that there is difference in kind, and not just a difference in number, between a particular case of a Member or particular cases of Members (on the one hand) and a class of Members, or all Members (on the other). If the power in the definition were to be available to be used in the case of a class of Members and, even more so, all Members then one has moved away from exercising a power 'in any particular case', and it is only 'in any particular case' that the power is available to be exercised.

233. Mr Simmonds, hardly surprisingly, says that, given the absence of a limitation to 'any particular case', the present case falls within the second of the two categories in the above passage (a class of Members, or all Members). The word 'particular' connotes a part rather than the whole; by contrast, the word 'specified' connotes indication of the person or class to be affected but does not qualify the meaning of the word 'class' in a way that limits it to something less than the whole.

234. Mr Simmonds also perceives what Morgan J says as unsatisfactory (to use my word): it suffers from the same difficulties that are faced by the RBs in the present case, namely the failure to identify where a difference in number becomes a difference in kind so that there is no rational or logical explanation as to where the line ought to be drawn. The inability to identify where the line ought to be drawn points, in his submission, towards the conclusion that the distinction is not a valid one.

235. Mr Stallworthy, relying also on [38] and [39] of Morgan J's judgment, reaches a different result. These read as follows:

> "[38] What the Announcement sought to do in this case was not the determination of a day for a 'Member concerned' in 'any particular case' but was something different from that. In substance, it was an alteration of the Rules of the Scheme itself. The Rules make express provision for how, and in what circumstances, the Rules may be altered; that is provided for by Rule 41. In my judgement, the alteration of the Rules intended to have effect, as per the Announcement, falls squarely with Rule 41 and does not fall squarely within the definition of NRD in Rule 3. In that case, one should not construe the power in the definition in Rule 3 more widely than it clearly provides (that is, confined to a particular case or particular cases) because one would thereby produce a power to alter the Rules in a most important respect, that is the NRD for Members, without complying with the safeguards expressly laid down in Rule 41.
>
> [39] The above reasoning is decisive of this case. Based on that reasoning, I would hold that the result sought to be achieved by the Announcement was not within the power contained in the definition of NRD."

236. Mr Stallworthy submits that it seems improbable that Morgan J would have reached a different conclusion if the notice in that case had sought to characterise a class of member as having been specified as 'particular cases' for whom an equalised NRD at age 65 should apply. I have no idea whether that is improbable or not. Morgan J's analysis would have led to the need to determine, in such a case, whether there was, indeed, a collection of particular cases of Members (on the one hand) or of a class of Member (on the other hand). There is no *prima facie* correct answer to that issue: it would depend on a close examination of the facts.

237. The next case is *CATL v Gellately*, in which Henderson J was concerned with a power in a wider form. There the provision at issue defined NRD as age 65 for men and 60 for women "except where otherwise stated or otherwise agreed by the Employers and the Trustees" (without any express requirement that members affected be notified). Henderson J, at [58] contrasted the wording with that found in *CCTL v Beck*:

> "The wording in the present case, by contrast, is far more general, and is not confined to determination of a particular day in a particular case which then has to be notified to the member concerned. I have those differences well in mind, and it is of course true that a decision on the scope of a differently worded power in the context of a different pension scheme can be of no more than persuasive assistance to me. Nevertheless, I draw comfort from Morgan J's approach in [38] to the relationship between the power in the definition and the general amendment power in rule 41, because it seems to me that a similar approach points the way to the solution in the present case."

238. Henderson J's conclusion and reasoning was given at [59]:

> "In my view, construing the 1995 Deed and Rules as a whole, the parties did not intend that the power to agree a different NRD should be able to prevail over the formal requirements of clause 21 where the proposed change to NRD was of general application. Where a scheme-wide amendment to the rules is in issue, one expects to find that certain formalities have to be complied with, and it is to the amendment clause that one turns in order to find out what those formalities are. In the present case, the formalities are a deed or (in the case of the Rules) a deed or a board resolution. In either case, there will be a formal document setting out the changes and evidencing the requisite consent to them of the Trustees. It is inherently most improbable that the parties ever contemplated the

possibility of making changes, across the board, to something as basic as NRD for all members, without having to comply with the formalities prescribed by clause 21. Furthermore, a definition in the Rules is not where one would expect to look to find a general power of that nature. I am satisfied, therefore, that the power in the definition should be construed as confined in its scope to special arrangements made in relation to individual members, and that it was not wide enough to authorise a general equalisation of NRD in respect of all future service. What is the point, one may ask, of having a circumscribed power of amendment, if it does not apply to something as fundamental as that?"

239. Mr Stallworthy submits that in the same way in the present case; the provision "that any specified … class of persons … shall cease to be … Members" is not to be interpreted as a general power to specify all or the generality of Members as ceasing to be Members and thereby to terminate accrual without triggering a winding up.

240. He also says that the description by the RBs of the word "specified" is "effectively akin" to the word "particular" in *CCTL v Beck*. That point I can reject immediately. What followed from the use of the word "particular" in that case was the distinction between identified individuals on the one hand and a group of individuals identified as a class. I see no reason for drawing the same distinction between a sub-set of active members on the one hand and the set of all of the active members on the other hand. Both sets are a class (or, if the word "specified" in the Exclusion Power is said to qualify "class of persons" as well as "person" both sets are a specified class). Accordingly, I agree with Mr Simmonds when he says that the suggestion that "specified" is effectively akin to "particular" is inappropriate and, in the circumstances, that case is of no assistance to them.

241. Mr Simmonds submits that *CATL v Gellately* does not assist. The Exclusion Power provides that a notice served in exercise of it "shall override any provisions of the Plan that are inconsistent with it". In the circumstances, the fact that the Exclusion Power may be exercised without the formalities required by the 1983 Amendment Power is beside the point.

242. He makes this additional submission which I cannot sensibly paraphrase and so set out in full:

> "Moreover, both *Beck* and *CATL v Gellately* were dealing with provisions that were said to be an alternative way of amending the definition of normal retirement date contained in the relevant governing provisions. In both cases, this amounted, in substance, to an amendment to the governing provisions. In such circumstances, it is not surprising that the Court felt compelled to ensure that such a scheme-wide amendment complied with the requirements imposed by the express power of amendment. But that is not what has occurred in the present case. The effect of the exercise of the Exclusion Power is not to amend the governing provisions of the Plans in any way, so the arguments that found favour in *Beck* and *Gellately* are of no relevance. This is not the case of an attempt to achieve by the back door of an alteration to a definitions section that which could not be achieved by the front door of an express exercise of a power of amendment. On the contrary, and unlike in *Beck* or *Gellately*, IBM has exercised an express power to direct that a class of persons shall cease to be members of the Plans. It has not sought to amend the governing provisions of the Plans. The circumstances are very different, therefore, from those that obtained in *Beck* or *Gellately*."

243. I now return to the first factor identified at paragraph [221(i)] above and the point which Mr Stallworthy makes about the 1990 Trust Deed and Rules being intended to replicate the 1983 Trust Deed and Rules, with changes specifically addressed by the Trustee and IBM but no other changes, in plain English where possible, reference being made by him to Nabarro's instructions. I have said that I doubt the admissibility of that factor in relation to the exercise of interpretation in contrast with rectification. But even if it is admissible, it is still important to discover what the plain English used means and to start with its ordinary meaning. If it does not mean what the Trustee and IBM intended it to mean, the remedy is rectification and not to give the words a meaning which they cannot bear. Further, Mr Stallworthy's submission has to start with the proposition that everyone concerned knew what the old provisions meant. It is possible that the draftsman of the 1990 Trust Deed and Rules intended them to mean what IBM says they mean because he thought that that was what the old provisions meant. That,

however, is speculation. What I must do is interpret the words used in their context. This is, ultimately, why I do not consider that it makes any difference to the point of interpretation whether one admits the Nabarro instructions or not. It is for similar reasons that I would also reject Mr Stallworthy's submission based on what one would or would not expect to see unannounced as a significant new power. In any case, Mr Tennet accepted in his reply (in the absence of Mr Stallworthy) that Rules 5 to 7 were no more than a replication in plain English of what had gone before.

244. One thing is, to my mind, clear, namely that on any interpretation of the words used (but subject to the *Hole v Garnsey* argument), the Exclusion Power goes beyond what was contained in the 1983 Trust Deed and Rules. Mr Simmonds accepts that. I understand the competing arguments. But it is necessary to explain the structure of Rules 1 to 7, Rule 6 appearing within the schedule dealing with eligibility for membership, Schedule D. Within Schedule D:

> i) Rule 1(1) provides that "every regular Employee who (a) has reached age 25; and (b) has not reached age 58; shall be treated as having satisfied the eligibility conditions";
>
> ii) Rule 2(1) deals with initial admission to membership for "every regular Employee", providing that after admission "his membership shall continue until the occurrence of any event referred to in (2) below";
>
> iii) Rule 2(2) provides that a Member "shall cease to be a Member of the Plan" who (a) reaches NRD; (b) ceases to be a regular Employee; (c) opts out in writing; (d) enters a personal pension arrangement which is inconsistent with continued membership of the Plan; or (e) "is precluded from continued membership of the Plan by the Employers under Rule 5, 6 or 7 of this Schedule";
>
> iv) Rules 5 to 7 provide as follows:
>
> > "5. Subject to Clause 4 of this Part, a statement in writing signed by or on behalf of an Employer, to the effect that any of its Employees as specified in the statement is or is not eligible to be or become a Member, shall be conclusive evidence of the truth of the contents of that statement.
> >
> > 6. The Principal Employer may by notice in writing to the Trustees direct that any specified person or class of persons shall not be eligible for membership, or shall cease to be a Member or Members. Such a notice shall override any provisions of the Plan that are inconsistent with it.
> >
> > 7. (i) The Principal Employer may at any time by notice in writing to the Trustee direct that membership of the Plan shall be closed to new entrants, and from then on no person shall be entitled to become a Member without the consent of the Principal Employer. …"

245. Mr Stallworthy comments that Rule 5 broadly corresponds to the provision previously appearing within the 1983 Trust Deed and Rules at the end of the definition of "Eligible Employee"; Rule 6 broadly corresponds to the provision previously appearing within the 1983 Rules in the second sentence of the definition of 'Eligible Employee' and Rule 7 builds on those provisions, permitting the Principal Employer to close the Main Plan to new entrants by directing that employees should no longer be eligible for admission to the Main Plan as new joiners without the consent of the Principal Employer.

246. I do not agree with his comment in relation to Rule 6. What the second sentence of the definition provided was that a person would cease to be an Eligible Employee on his name ceasing to be recorded in the register of employees. As I have already explained, it was not possible to preclude a person from joining or continuing as a Member by the simple expedient of removing his name from the register. If a person's name was not included in the register, he was not eligible to be or to continue as a Member with the decision of the Principal Employer being conclusive but only in cases of doubt, as I have explained. It seems to me that Rule 6 cannot be seen

clearly as doing no more than to "broadly correspond" with the second sentence of the definition. The task of construction is not that straightforward.

247. I therefore agree with Mr Simmonds when he says that Rule 6 was a new provision; from which he draws the conclusion that there is no reason why the project to re-write the existing provisions in plain English should have any bearing on the construction of Rule 6, a conclusion with which I agree. I record the forensic point made by Mr Simmonds, which cannot be used as an argument actually to support the conclusion which he draws, that until quite recently both the Trustee and IBM and their respective advisers considered that the Exclusion Power did have the meaning for which IBM now contends.

248. It follows that I do not consider there is anything in the first factor set out at paragraph [221(i)] above (the lack of any Exclusion Power in the 1983 Trust Deed and Rules).

249. The next factor relied on by Mr Stallworthy is the effect of the fetters on the 1983 Amendment Power. He submits that on any objective basis, the 1990 Trust Deed and Rules are unlikely to have been intended and understood by its parties as having an effect that would (unless the Actuary made an error of law and therefore failed to express appropriate opinions under provisos (c)-(e)) engage the fetters on the amendment power and invalidate the offending provisions of the 1990 Rules. That is to say that, if an interpretation which results in the fetters not being breached is possible, it is the one which should be adopted in preference to one which does. He puts it rather higher: absent unequivocal terms which cannot be given any other meaning, the provisions of the 1990 Trust Deed and Rules ought to be interpreted on a basis consistent with the restrictions which the Actuary was required to police; and thus on the basis that the Actuary was correct in giving no opinion engaging those provisos. The reasonable person with all the background knowledge available to the parties would have understood them to be producing amendments falling within the ambit of the restrictions which the Actuary was required to police. In other words, one should search for a construction which complies with the fetters rather than imposes a limitation to give partial validity to an otherwise invalid provision, which is IBM's solution. Under the construction for which Mr Stallworthy contends, IBM could not exercise the Exclusion Power in the way it has purported to do.

250. He goes on to say, for reasons I will come to, that such an interpretation may be reached simply on the wording of the Exclusion Power by implying a restriction to its scope or (on a *Hole v Garnsey* basis) construing the scope of the Power confined to such uses as can reasonably be considered to have been within the contemplation of the parties when the deed was made, having regard to the nature and circumstances of the deed. On this basis, the Exclusion Power would be restricted to causing existing Members to cease to be Members only on the basis of objectively demonstrable changes to the terms of their employment (*eg* a substantial reduction in their contractual hours) such as might even under the 1983 Trust Deed and Rules have justified their removal from the Employer's register of permanent full-time employees.

251. Mr Simmonds submits that reliance on the fetters does not advance the case of the RBs in relation to the interpretation of the Exclusion Power. Even accepting that the fetters are engaged so far as concerns preservation of the final salary link, the correct way of continuing the link is by the introduction of the implied limitation which I have discussed at length under Issue 1. This has no bearing, it is said, on the question whether a single notice exercising the Exclusion Power can specify a class of persons comprising the whole of the membership of the Main Plan. I agree with that last proposition. Mr Stallworthy's argument based on the fetters applies as much to an exercise of the Exclusion Power in relation to a group of persons who undoubtedly do form a specified class as much as it does to an exercise of the power in relation to the whole active membership.

252. As to the I Plan, it should be remembered that the fetters have no relevance to the interpretation of the Exclusion Power in the I Plan. If the meaning of the Exclusion Power in the Main Plan is a factor to be brought into account in the interpretation of the Exclusion Power in the I Plan, it does not, in my view, carry much weight. This is especially so given what the parties to the I Plan actually thought it meant. As to that, the pointers, such as they are, are that everyone involved thought that it had the meaning for which IBM now contends. That makes the actual meaning of the Exclusion Power in the Main Plan a wholly unreliable guide to the meaning of the Exclusion Power in the I Plan. Indeed, if it is right that the Exclusion Power in the Main Plan is to be held valid

pro tanto with an implied limitation to preserve the final salary link, that result is reached by construing the Exclusion Power in the first instance as meaning what it apparently says (*ie* as breaking the final salary link) but imposing a limitation on it to preserve the final salary link. In the I Plan, the same exercise results in the Exclusion Power meaning what it apparently says without the need to introduce any limitation. It would be quite wrong, in my view, to impose the same limitation on the Exclusion Power in the I Plan simply because it uses the same language as the Exclusion Power in the Main Plan.

253. The third factor relied on by Mr Stallworthy is the location of Rule 6 within the structure of the 1990 Rules. It appears within the "Membership" section of the 1990 Trust Deed and Rules, at Schedule D. It does not appear within the "Termination of Plan" section at Schedule M nor even within the provisions within the "Reorganisation" section at Rule 5(1) Schedule L for "Withdrawal of an Employer" which no longer wishes to participate in the Plan. Mr Stallworthy submits that, as a matter of drafting practice, one would expect to find a power to close a scheme to future accrual within the scheme's termination provisions (or perhaps within its employer cessation of participation provisions, with closure to accrual being a consequence of an employer's withdrawal): just as in *CATL v Gellately* Henderson J considered that "a definition in the Rules is not where one would expect to find a general power of that nature" [59] (there to alter NRD for existing members), the eligibility provisions of a scheme's rules are not where one would expect to find a general power to close a scheme to all on-going accrual.

254. Mr Simmonds' riposte to that submission is that the Exclusion Power is not found in the sections of the 1990 Trust Deed and Rules dealing with termination of the Plan or with withdrawal for the simple reason that it is not concerned with termination or withdrawal. It is concerned with membership of the Plan (hence its inclusion in Schedule D makes perfect sense): but the inability to accrue benefits is a natural corollary of not being a member.

255. In my view, the location of the Exclusion Power is entirely neutral. It is not at all surprising to me that it is found where it is, for the reasons given by Mr Simmonds. Suppose that the Exclusion Power had been drafted in such a way which made the RBs' construction unarguable and IBM's construction obviously correct, would the informed reader respond by saying "What a strange place to find this provision"? I venture to say that the answer would be "No". Having expressed that view, I ought to note that the implied limitation necessary to preserve the final salary link would have an impact on other provisions of the 1990 Trust Deed and Rules because, somewhere, one would need to find a provision (implied) qualifying the level of benefit of a Member who ceased to be a Member as a result of the exercise of the Exclusion Power rather than as the result of, for instance, ceasing employment with IBM to take a job outside IBM. That consideration does not, however, mean that the Exclusion Power itself is found in a surprising location.

256. The fourth factor relied on by Mr Stallworthy relates to the provisions surrounding Rule 6. The first point is that what has been referred to as the Exclusion Power does not, in fact, include the words "exclude" or "exclusion" in its text. The heading does so, but the Rules contain the common provision that "headings are for ease of reference only, and do not form part of the Rules". Mr Stallworthy says that, since the heading is not part of the Rules, it does not inform or affect their interpretation. I do not derive much from that observation since, even on the construction which Mr Stallworthy invites me to adopt, the result is a power to exclude certain people from membership: it is simply that the circumstances and manner in which such power can be exercised are narrower on the RBs' case than on IBM's case.

257. It is said by Mr Stallworthy that Rule 7 sheds light on the true scope of Rule 6 both structurally and in its wording. Essentially, there would be no reason to make specific provision for closing the Main Plan to new entrants under Rule 7 if Rule 6 already provided a broader power to direct that all such employees should be ineligible to become Members. Rule 7 would be superfluous if Rule 6 conferred a generalised power to render them ineligible; which makes it even more improbable that Rule 6 was wide enough to terminate accrual by all existing Members. The fact that a separate and explicit power was needed to permit closure to new entrants surely means that a separate and explicit power would likewise have been needed to permit closure to all accrual by existing Members. He relies on the fact that Rule 6 makes no provision for the Members affected even to be informed that their Pensionable Service is being terminated. He suggests that it is surprising, if Rule 6 was

intended to give the Principal Employer a unilateral power to terminate accrual at will, that it makes no provision for the Members affected to be notified at all.

258. Mr Stallworthy submits that the scope of Rule 6 is also informed by the termination provisions within the 1990 Rules.

> i) Schedule L, Rule 5(1) provides for an Employer, including the Principal Employer, to withdraw from participation in the Plan with the consequence that the final salary link is broken; but Rule 5(1) provides that where that happens "the Trustee shall set aside a portion of the Fund" to be applied in respect of previously active members by way of transfer or buy out. Withdrawal of every Employer would in effect trigger a winding up of the Plan so far as it related to those members who were active as at that date.
>
> ii) Schedule M, Rule 1 provides for the Principal Employer to terminate the Plan by written notice, but with the Trustee thereupon being required to wind up the Plan. Schedule M, Rule 2(6) then provides for any surplus applicable on winding up to be applied in benefit increases.

259. It would seem surprising he says for the termination provisions of the 1990 Rules to provide expressly for termination only with winding up (at least as regards active members); but then to find elsewhere a unilateral power by which the Principal Employer could terminate accrual for all or specified categories of active members without a corresponding winding up for such members.

260. I do not see much force in that submission. The Exclusion Power is not restricted to the same circumstances as would give rise to a partial or complete termination of the Plan leading to a partial or full winding-up (and even then, subject to the Trustee's power to continue to run the Plan as a closed scheme). The Exclusion Power can be used in relation to an individual member or specified members in circumstances where the termination power would not apply. In any event, the focus is entirely different. The powers to which Mr Stallworthy refers in this part of his argument relate to one or more Participating Employers whereas the Exclusion Power relates to members. The consequence of the exercise of those two powers may, in some circumstances, be similar, namely the cessation of benefit accrual for a group of members and the end of a contribution obligation in respect of future service. But the route to that result is different.

261. Mr Simmonds accepts that Rule 6 is of broader scope than Rule 7 and that there is nothing that can be done pursuant to Rule 7 that could not be done pursuant to Rule 6. It is a realistic acceptance for the purposes of the particular question at issue, but I consider he accepts too much. Rule 6 results in an affected Member ceasing to be eligible for Membership. In contrast, Rule 7 says nothing about eligibility: the closure to new entrants means that nobody has the right to join the Plan but it does not result in otherwise eligible persons ceasing to be eligible. The consequence of closure is not that no person shall be entitled to become a Member but that he shall not be so entitled without the consent of the Principal Employer. So Rule 7 permits something to be done which cannot be done under Rule 6.

262. Quite apart from that, Mr Simmonds says that the conclusion which the RBs seek to draw from all of the above is to circumscribe the scope of the Exclusion Power in a manner which goes beyond the natural and ordinary meaning of the words used. It is difficult not agree with Mr Simmonds, even taking his acceptance of the broader scope of Rule 6 on its face, when he says that it is by no means unheard of for the governing documentation of a pension scheme to contain superfluous provisions. Such superfluity is particularly unsurprising given that the governing provisions of pension schemes are the product of amendment and re-statement over an extended period. And that is as true of the "plain English" exercise as of any other amendment. Mr Simmonds points to a (small) example of incorrect drafting in Rule 2(2)(e) which refers to a member who is "precluded from continued membership of the Plan by the Employers under Rule 5, 6 or 7 of this Schedule". Rule 7, he correctly points out, has nothing to do with continued membership. It is clear what it means but such less than perfect drafting is only to be expected and no criticism can really be made.

263. Mr Simmonds also accepts that there is no provision for the affected Members to be notified that their pensionable service is being terminated. In any case, it is equally true that the rule relating to termination of the

Main Plan (whether by the Principal Employer or by the Trustee) does not require individual notification to Members either. This does not seem to me to be a matter of any real significance. In practice, it is inconceivable that neither the Trustee nor IBM would inform the Members concerned of termination of pensionable service and the theoretical possibility that they might fail to do so cannot, in my judgement, have any impact on the true interpretation of the Exclusion Power.

264. There are two subsidiary issues which arise. The first relates to "Postponed Retirees" that is to say a former Member who remains in Service after his NRD with IBM's consent. Mr Simmonds no longer contends that the Exclusion Notices were effective in relation to Postponed Retirees who therefore continued as Members unaffected by those Notices. I need say no more about this issue.

265. The second issue concerns the effect of a notice pursuant to the Exclusion Power. The power, it will be remembered, permits IBM to direct that an existing member "shall cease to be" a Member. The RBs say that this must mean, in the case of the Main Plan, that an individual will cease to be a Member of the whole Plan and not just of the DB section of it. IBM agrees with that proposition.

266. The RBs submit that it follows that a DB Member precluded from membership of the Main Plan by an exercise of the Exclusion Power can only resume membership of the Main Plan within the M Plan under the Money Purchase Rules if the Trustee agrees to that. An employee becomes a member of the Money Purchase Section under Rule 1(2)(b) unless he is precluded from membership of the Plan by an employer under Clause 4 of Part V (that is to say the Exclusion Clause) among other matters. And Rule 2(1)(e) provides that a Member (*ie* of the Money Purchase Section) shall cease to be a Member if he is precluded from continued membership under that same provision. And so it is said a person can only become a Member or resume Membership with the consent of the Trustee. Membership can be resumed under Rule 3 "at the sole discretion of the Trustee" or can be commenced for the first time under Rule 1(5) provided that the Trustee waives the eligibility and entrance requirements.

267. Mr Simmonds presents a different interpretation. He notes, as the RBs have themselves noted, that the words "exclude" and "exclusion" do not feature in the text of the Exclusion Power. The Exclusion Power contains two limbs: a power to direct that a person or class "shall not be eligible for membership" and a power to direct that a person or class "shall cease to be" a Member or Members. It is therefore possible, he says, for IBM to direct that a member shall cease to be a Member without thereby rendering him ineligible for membership. That, according to him, is exactly what the Exclusion Notices did, in the case of the Main Plan expressly stating that it did not constitute a direction that the persons so ceasing to be members of the Main Plan should be ineligible to join the M Plan.

268. In any case, he says that even if, as the Trustee now argues, the Exclusion Notice meant that the affected Members could not join the M Plan without the consent of the Trustee, that does not mean that the Exclusion Notice was ineffective to bring about a cessation of membership of the Main Plan.

269. I have to say that the interaction of the Exclusion Power and the eligibility and membership provisions of the M Plan is not entirely clear. The difficulty with Mr Simmonds' primary position is this: If a Member ceases to be a Member as the result of a notice under the Exclusion Power but is not subject to a direction that he is ineligible for membership, what is it that precludes an entitlement immediately to rejoin the Plan without any consent at all, whether from IBM or the Trustee? On the facts of the present case, IBM might be content to say that there is nothing to prevent that but since the C Plan is closed, the individual would only be able to join the M Plan. But suppose that IBM had simply wanted to exclude employees working at a particular location from membership of the C Plan, wishing them to join the M Plan and had served a notice to that effect, what would there be to stop the members concerned from rejoining the scheme? The solution would be for IBM to serve a notice precluding the affected employees from eligibility. But if that is necessary, what then, one might ask, is the content of the power to bring about a cessation of membership?

270. Accordingly, it seems to me that it is inherent in the power to exclude a person from membership that he thereby becomes ineligible for membership and that the reason for the two limbs of Rule 6 is to deal separately with

those who are and those who are not already Members. But the effect is the same in each case, namely that the individual concerned is not eligible to be Member in the future.

271. This does not mean that the affected Members cannot join the M Plan since the Trustee has sufficient powers under Rule 1(5) to waive the eligibility requirements to allow the Member to rejoin under Clause 3: see paragraph 266 above. But I agree with Mr Stallworthy when he says that the consent of the Trustee is required for an employee, who has been the subject of an exercise of the Exclusion Power, to join the M Plan.

272. But in my judgement, Mr Simmonds is also correct when he says that that does not mean that the Exclusion Notice was ineffective to bring about a cessation of Membership of the Main Plan. This may have implications in the context of Project Waltz, but that is a different matter.

273. I will consider the argument based on *Hole v Garnsey* later.

Issue 3 - whether the purported exercise of the Exclusion Powers (and/or other relevant powers as mentioned under Issue 2 above) in the manner envisaged by Holdings in the Exclusion Notices involves the exercise of the Exclusion Powers (and/or such other relevant powers) for an improper purpose

274. The RBs contend, in the alternative, that the Exclusion Notices were a purported use of the Exclusion Powers for a collateral and improper purpose and as such invalid. They assert that on any basis the Exclusion Powers were quite clearly not included within the governing provisions of the UK DB Plans for the purpose of closing the plans to accrual (either partially or totally). And they assert that even if the Exclusion Powers were considered to permit Holdings to exclude specified classes of employee from the description or category of employment to which the plans relate, that is not the purpose for which Holdings has now sought to use the Exclusion Powers.

275. Rather, the purpose for which Holdings sought to use the Exclusion Powers was a closure of the UK DB Plans to all DB accrual by all Members, save those protected by contractual arrangements namely in both the Main Plan and the I Plan, the Enhanced Deferred Members and additionally in the I Plan, the exempted members listed in Appendices A-F to the Exclusion Notice.

276. This it is submitted is consistent with how IBM itself has characterised this aspect of Project Waltz. It has been described as a closure of the UK DB Plans to future accrual (save by exempted members), not as an adjustment to the description or category of employment to which the UK DB Plans related. That is certainly how Mr Riley has, I accept, described it; see his email dated 7 July 2009 set out at paragraph 18 above.

277. Mr Stallworthy submits that the fact that the Exclusion Power was being used for a collateral and improper purpose is starkly demonstrated in the case of the Main Plan by the form of the original 2010 Exclusion Notice. Exercise of the Exclusion Power sought to achieve two things: first that "all Members currently accruing benefits under the Defined Benefit Rules shall cease to be Members of the Plan with effect on and from the 6 April 2011" but secondly (and he would say inconsistently) "this does not constitute a direction that the persons so ceasing shall not be eligible to join the M Plan …". The lack of consistency stems from the fact that the Exclusion Power operates in relation to the whole Plan: a Member ceases to be a Member of the Plan, not just of a section of the Plan. Thus it can be seen that IBM invited affected Members immediately to rejoin the very plan from which they had just been "excluded".

278. And so it is said that IBM's true purpose and objective was not to preclude affected Members from membership of the Main Plan (as demonstrated by the proposition that they should be eligible immediately to rejoin the Main Plan within the M Plan), but rather collateral and improper purposes of seeking (a) to break final salary linkage (without triggering a winding up); and (b) unilaterally to force affected Members from the DB section to the M Plan in a way that could otherwise only be achieved by amendment with the cooperation of the Trustee.

279. The Trustee has raised the possibility that it might be relevant that members were not directly transferred by Holdings from the DB section to the M Plan, but were given a choice as to whether to be admitted to the M Plan, the alternative choices being an offer to earn DC benefits in the IBM UK PPP or to receive no pension provision from IBM at all. In my view the fact that affected Members were offered a choice cannot alter the

correct identification of IBM's true purpose and objective in exercising the Exclusion Power.

280. Mr Stallworthy next refers back to the fetters on the 1983 Amendment Power, saying that IBM had no power to break the final salary link because of those fetters. He points out (i) that the amendment power in the 1997 version of the Main Plan Deed is subject to the same fetters and (ii) that the amendment power in the I Plan (in the exercise of which in the Principal Employer must act "in a fiduciary manner" and only with the Trustee's consent) is subject to a proviso prohibiting retrospective amendments "which would result in the reduction of any rights of [a beneficiary]".

281. It is submitted, therefore, that there was an attempt by IBM to achieve by two steps (namely an exercise of the Exclusion Power followed by re-admittance to the Main Plan within the M Plan) what could not be achieved by one step (namely by an amendment bringing about a break in the final salary linkage applicable to past accrual combined with changing future accrual from DB to DC). That result was not a purpose for which the Exclusion Powers were conferred. Further, to have achieved the change in one step would have required an amendment (even if it could have been done without breaching the fetters) which involved the participation of the Trustee and could not have been achieved unilaterally.

282. The thrust of those submissions is that the Exclusion Power, assuming it to have been properly introduced, was actually exercised for an improper purpose, not to bring about an end to the membership of the Plans but only of the DB sections of the Plans in order to force the Members into the M Plan (albeit with a choice to go into the IBM UK PPP or to have no pension provision at all).

283. Mr Simmonds explains why the Exclusion Notices took the form which they did. The explanation is that IBM wanted former DB members to have the choice between joining the M Plan or entering into the IBM UK PPP arrangement. At that time, given the Trustee's concerns regarding the lawfulness of the Project Waltz changes, it was not prepared to consent to anything. IBM considered it arguable that, in the absence of a direction that relevant members were not eligible to join the M Plan, those members had the right (without requiring Trustee consent) to join the M Plan under Rule 1(1) of Schedule B to the 1997 Money Purchase Rules. I do not propose to go into the merits of that argument other than to say it draws a distinction between being "precluded from membership" and being "precluded from continuing membership" in two different rules, namely Rule 1(2)(b) and Rule 2(1)(e) of Schedule B to the 1990 Trust Deed and Rules. It was to leave that option open as a possibility to the Members concerned – that is to say, to join the M Plan without the need for the consent of the Trustee – that this proviso was inserted into the Exclusion Notice. The argument may be a good one, it may be a bad one: I do not need to decide. If it is a bad one, then Trustee consent is required, but it does not impact on the validity or otherwise of the Exclusion Notice in terms of improper purpose, although it may have an impact in relation to the *Imperial* duty.

284. I say that the argument just referred to does not impact on the validity of the Exclusion Notice because Mr Stallworthy's arguments do not depend on whether or not the consent of the Trustee was required to join the M Plan. The point is that the purpose of the exercise was not genuinely to remove the affected members from the Main Plan; it was a different purpose of removing them from the DB sections of the Main Plan.

285. IBM denies that it was forcing any member to join the M Plan and submits that it cannot on any view have been improper to have exercised the Exclusion Power in such a way that kept open that opportunity for Members. For my part, I have found it helpful to consider a slightly different scenario in assessing the validity of the exercise of the Exclusion Power. Suppose that, instead of offering membership of a DC section of the Main Plan, IBM had created a new, free-standing, money purchase arrangement and given Members precisely the same option of joining such new arrangements as was given in relation to joining the M Plan. The fact, if it be a fact, that the Exclusion Power was being used to bring about a situation where Members would, it was hoped, join the new arrangements does not mean that the Exclusion Power was being used for an improper purpose. The Exclusion Power, again assuming it was validly introduced, would surely be being used for precisely the purpose for which it was given, namely to bring about an end to membership of the Main Plan or I Plan and, in consequence, to bring about a cessation of further benefit accrual. If that is right, then I do not see why it would be improper to achieve the same result by providing benefits through the M Plan.

286. There is one other point made by Mr Stallworthy which I should mention. He says that the governing provisions of the UK DB Plans did not give Holdings a unilateral power to close the UK DB Plans to DB accrual without triggering a winding up. Accordingly, this was an attempt to use the Exclusion Powers for a purpose foreign to that for which they were conferred.

287. Mr Simmonds says that that is quite simply wrong. He accepts that there was no such power in the 1983 Trust Deed and Rules, but according to him, the effect of the 1990 Trust Deed and Rules and the introduction of the Exclusion Power was to confer just such a power on Holdings. He is right about that. If one accepts that the 1990 Trust Deed and Rules, including the Exclusion Power, were valid in their entirety (subject to the limitation concerning the preservation of the final salary linkage), then there was such a power in the Main Plan. The I Plan contained such a power from its inception.

288. Drawing all of this together, I repeat that Issues 1 to 3 (and in particular Issues 1 and 2) are closely interdependent. I have set out the arguments and made various comments and observations on them as I have gone along. I therefore propose to express my conclusions briefly.

289. In my judgement;

> i) First, the Exclusion Power was validly introduced into the Main Plan; on any footing, it is a valid provision in the I Plan.
>
> ii) Secondly, as a matter of construction, the Exclusion Power in the Main Plan permitted IBM to give notice directing that the whole of the active membership of the Main Plan (other than Postponed Retirees) shall cease to be Members. Similarly, as a matter of construction, the Exclusion Power in the I Plan permitted IBM to give notice directing that the whole of the active membership of the I Plan (other than the particular specified classes) shall cease to be Members.
>
> iii) In the Main Plan, however, the Exclusion Power was subject to an implied limitation to preserve the final salary link. I perceive that limitation as one to be implied into the 1990 Trust Deed and Rules (and subsequent iterations) so that the benefits applicable on the exercise of the Exclusion Power are the greater of (i) the ordinary leaving service benefits (based on salary at the date of exercise of the Exclusion Power and carrying statutory or scheme revaluation) and (ii) an underpin based on salary at the date when the Member concerned actually leaves service or reaches NRD but not carrying revaluation between the time of the exercise of the Exclusion Power and the date just referred to.
>
> iv) The Exclusion Notices were not made for an improper purpose. Although I have held that the Members concerned were able to join the M Plan only with the consent of the Trustee, this will only arise as a practical question only if the Trustee seeks hereafter to assert that the Members affected are not, after all, entitled to benefits from the M Plan. I express this caveat to those conclusions namely that they are subject always to any challenge on the basis of the "good faith" challenge to the whole of Project Waltz or any of its elements.

290. In reaching the first three of those conclusions, I have formed the firm view that the narrowest interpretation for which Mr Stallworthy contends cannot be right. It is, in effect, to treat the 1990 Trust Deed and Rules as reflecting precisely the provisions of the 1983 Trust Deed and Rules save where Nabarro's instructions were to the contrary. In my judgement, it is not possible to arrive at that conclusion in the light of the language actually used. Whatever the strengths of the arguments in favour of the view that the Exclusion Power does not extend to the exclusion from membership of the whole of the active membership of the Main Plan (other than the Postponed Retirees), I can see no justification for excluding an exercise of the Exclusion Power in relation to a class of persons (*eg* employees at a particular location).

291. Nor do I accept Mr Stallworthy's application of the *Hole v Garnsey* principle which, for reasons already given and which he himself contends, is really to be seen a part of, or certainly closely linked to, the question of

implied terms. At its root, his submission is really to the same effect as the submission that the Exclusion Power is no more or less than a reflection of the pre-existing provisions of the 1983 Trust Deed and Rules. If one moves away from that root, as I consider one must, there is no reason for identifying the purpose of the Exclusion Power in the very narrow way for which Mr Stallworthy contends. I do not, therefore, consider that it is right to "read down" the provision as he would put it "back to the 1983 rules" nor do I consider that he gets to where he wants by an appeal to the contemplation of the parties on a purposive basis.

292. I have also formed the firm view that, once it is accepted that the Exclusion Power can be exercised in relation to a class of Members in a way which is not restricted to the manner in which Mr Stallworthy's primary submission would require, it is permissible to exercise the Exclusion Power in the way in which it was in fact exercised subject to the exclusion of Postponed Retirees. Since the amendment introducing the Exclusion Power is subject to the implied limitation which I have discussed, the result of the exercise will be to preserve the final salary link. For reasons already given, I do not find Mr Stallworthy's submission in relation to *CCTL v Beck* and *CATL v Gallately* persuasive. This is a case where, in my judgement, it is appropriate to determine that the introduction of the Exclusion Power was, *pro tanto*, valid.

293. The answers to Issues 1 to 3 are as follows:

> i) Issue 1: The Main Plan Exclusion Power was validly introduced into the Main Plan but the amendment introducing it includes an implied limitation the effect of which is to preserve the final salary link.
>
> ii) Issue 2: The purported exercise of the Exclusion Powers (and/or any other relevant powers vested in Holdings) in the manner envisaged by Holdings in the Exclusion Notices falls within the terms and scope of the Exclusion Powers in the Plans and/or those other relevant powers. The answer to Issue 1 entails that the final salary link is preserved.
>
> iii) Issue 3: The purported exercise of the Exclusion Powers (and/or other relevant powers as mentioned in paragraph ii) above) in the manner envisaged by Holdings in the Exclusion Notices does not involve the exercise of the Exclusion Powers (and/or such other relevant powers) for an improper purpose.

294. These answers are without prejudice to any issues which arise in relation to the *Imperial* duty.

295. I now turn to issue 4 and 4B. I propose to deal with matters under the following main headings:

i) **The Evidence**: under this heading I provide an introduction to the expert witnesses and witnesses of fact.

ii) **The *Imperial* duty**: under this heading I discuss the implied duty of trust and confidence between an employer and members of a pension scheme.

iii) **NPPC**: under this heading I describe one of the accounting concepts which is central to an understanding of the motivation for Project Waltz.

iv) **Culture Clash**: under this heading I consider a little of the history of IBM's business and the changing corporate culture which has resulted.

v) **Project Ocean**: this deals with the events leading up to and including the adoption of the Ocean changes, including a lengthy review of the Webcast (as referred to at paragraph 613 below).

vi) **Project Soto**: this deals with the events following the implementation of the Ocean changes and leading up to and including the adoption of the Soto changes.

vii) **Conclusions on Project Ocean and Project Soto**: this summarises the result of the considerations under the previous two headings.

viii) **Post-Soto and Pre-Waltz events**: this deals with the events following the implementation of the Project Soto changes prior to the formulation of the Project Waltz proposals.

ix) **Project Waltz**: this deals with the formulation and implementation of the Project Waltz proposals.

x) **IBM's business justification for Project Waltz**: this explains IBM's rationale for making the Project Waltz changes. It deals with the global and local strands of that justification.

xi) **The RBs' alleged absence of any justification and IBM's riposte**: this deals with the RBs' criticism of IBM's business case and with IBM's answers to those criticisms.

xii) **Discussion and conclusions**: this contains my assessments and conclusions in relation to Project Waltz.

xiii) **Consultation on Project Waltz**: this deals with the RBs' secondary case that the consultation with employees on Project Waltz was flawed and gave rise to a breach of Holdings' *Imperial* duty.

The Evidence

296. The quantity of the documentary evidence relevant to Issues 4 and 4B is huge with over 28,000 pages of contemporaneous documents having been inserted into the trial bundles. In addition, there are several files of trust and trustee documents, actuarial valuations, pension plan annual reports, funding surveys, member reports and financial reports and statements, running to several thousand more pages. Luckily for me (and everyone else concerned in the trial) it was necessary to refer to only a small proportion of those documents.

Expert witnesses

297. I received expert accountancy and actuarial evidence on behalf of the RBs and IBM running to over 800 pages:

> i) On the actuarial side, Mr Ronald Steward Bowie of Hymans Robertson LLP gave evidence on behalf of IBM and Mr David Edward Clare of Barnett Waddingham gave evidence on behalf of the RBs.
>
> ii) On the accountancy side, Mr David Robbins of Deloitte LLP gave evidence on behalf of IBM and Mr E Bradley Wilson, a former audit partner and Chief Administrative Officer of Grant Thornton's US operation, gave evidence on behalf of the RBs.

Perhaps their most important task was to attempt to educate me about the intricacies of the relevant accounting principles under US GAAP relating to pensions.

298. All four experts were impressive in the way in which they gave evidence and in how they expressed, and defended, their views. There was a considerable measure of agreement between the experts in each discipline. Where there was disagreement, it was principally in areas where different professional persons can reasonably take different professional views. I do not consider that any of the experts expressed a view which was not defensible or outside the range of reasonable views. I only comment at this stage that it is difficult to see how some, indeed most, of the questions which the experts have, on instructions, dealt with are of other than peripheral, if any, relevance to those issues. A considerable amount of material which they have produced is, in consequence, also of marginal, if any, relevance.

Witnesses of fact

299. So far as witnesses of fact are concerned, I propose, first, simply to identify them and to state the positions they held. I will then go on to make some observations about some of them.

The witnesses – who they are and the positions they held

300. On behalf of IBM, the following six witnesses were called and were cross-examined by Mr Spink and by either Mr Tennet or Mr Stallworthy:

i) Mr William Mortimer Chrystie: Mr Chrystie was at the material time (and at the time of the trial), the Chief Financial Officer of IBM UKI, the IBM business covering the UK and Ireland. He held that position from the spring of 2009 when he was appointed in the circumstances to which I will come.

ii) Mr Jonathan Ashley Ferrar: Mr Ferrar is currently Vice President, Human Resources, Workforce Analytics, IBM Worldwide. He was, from January 2007 until March 2010, Director of Human Resources for IBM UKI and part of the Executive Leadership Team of IBM UKI led by Mr Brendon Riley during the period relevant to this litigation. Mr Ferrar was thus closely involved with the development and implementation of Project Waltz.

iii) Mr David Michael Heath: Mr Heath became Human Resources Director for IBM UK in September 2003. He continued in that role until he left the company in January 2007. He had no role in Project Waltz but was able to give evidence in relation to the Plans in respect of the period 2004 to 2006 and could thus speak to both Ocean and Soto.

iv) Mr Lawrence Herbert Koppl: Mr Koppl is a lifelong IBMer. He started working for IBM Corporation in 1978. He has been involved in finance within IBM Corporation since the mid-1980s. His current role is (as it was at material times) Director of Pension Analytics within the Finance function at CHQ. He has never been employed by Holdings or IBM UK. He was involved in developing for, and advising, IBM Corporation certain financial aspects of Project Waltz,and giving advice about those aspects.

v) Mr James Randall MacDonald: Mr MacDonald was at the material time (and at the time of the trial) Senior Vice-President, Human Resources, within IBM Corporation, a role he had held since joining IBM in 2000. He, like Mr Koppl, was based in Armonk. He was responsible for the global resources practices, policies and operations of the IBM enterprise worldwide. He reported to the Chairman, President and Chief Executive Officer of IBM Corporation. Although he held a very senior position, he did not sit on the board of IBM Corporation. He was directly involved in the formulation and approval of Project Waltz, although the actual implementation was carried out by executives and staff in the UK.

vi) Mr Brendon James Riley: Mr Riley no longer works for IBM. His most recent post was that of General Manager of IBM North East Europe. From April 2008 to January 2010 he was General Manager of IBM in the UK and Ireland. He took a lead role in deciding on and implementing Project Waltz.

301. On behalf of the RBs, the following eleven witnesses were called and were cross-examined by either Mr Simmonds or Mr Newman and, in some cases, by Mr Spink:

i) Mr Robert Frank Buxton: Mr Buxton was an employee of IBM UK from August 1990 to April 2010. He left his employment during the early retirement window offered by IBM under Project Waltz. He is now aged 59. He is a pensioner within the C Plan.

ii) Mrs Mary Cordina: Mrs Cordina was an employee of IBM UK from 1975 until April 2010. She also left her employment during the early retirement window. She is now aged 56. She is a pensioner within the N Plan.

iii) Mr Mark Johnson: Mr Johnson was an employee of IBM UK from October 1977 to March 2010. He also left his employment during the early retirement window. He is now aged 55. He is a pensioner with benefits from both the C Plan and, as an Enhanced M Plan member, from the M

Plan.

iv) Mr Ian Mills: Mr Mills was an employee of IBM UK from 1974 to 2010. He also left his employment during the early retirement window. He is now aged 61. He is a pensioner under the C Plan.

v) Mr Neale Turner: Mr Turner was an employee of IBM UK from 1979 to 2010. He also left his employment during the early retirement window. He is now aged 54. He is a pensioner under the C Plan. He took all his benefits accrued as an Enhanced M Plan member between 2006 and 2010 as a cash lump sum on retirement.

vi) Mr Stuart Dalgleish: Mr Dalgleish is the First Defendant. He is a current employee of IBM UK which he joined in 1988. He is now aged 50. He is a C Plan member who is:

a) "active" if the purported cessation of his defined benefit accrual is found to be invalid; or

b) "hybrid deferred", with ongoing accrual within the M Plan, if the cessation of his defined benefit accrual is held to be valid.

vii) Mrs Lizanne Harrison: Mrs Harrison is the Second Defendant. She is a current employee of IBM UK. She joined in 1996 on a TUPE transfer from General Accident. She is aged 54. She is an I Plan member who, like Mr Dalgleish, is:

a) "active" if the purported cessation of her defined benefit accrual is found to be invalid; or

b) " hybrid deferred", with ongoing accrual within the M Plan, if the cessation of her defined benefit accrual is held to be valid.

viii) Mr Kevin McRitchie: Mr McRitchie is a current employee of IBM UK which he joined in November 1996. He is now aged 50. He is an I Plan Member who is:

a) "active" if the purported cessation of his defined benefit accrual is found to be invalid; or

b) "hybrid deferred", with ongoing accrual within the M Plan, if the cessation of his defined benefit accrual is held to be valid.

ix) Mr Mark Newton: Mr Newton is a current employee of IBM UK which he joined in 2000. He has only ever been a member of the M Plan which he joined when first employed by IBM. The Project Waltz changes therefore have no impact on his benefits.

x) Mr Colin Scott: Mr Scott is a current employee of IBM UK which he joined in 1996. He is now aged 51. He is an I Plan Member who is:

a) "active" if the purported cessation of his defined benefit accrual is found to be invalid; or

b) "hybrid deferred", with ongoing accrual within the M Plan, if the cessation of his defined benefit accrual is held to be valid.

xi) Mr Stephen Wilson: Mr Wilson had a 25 year career with IBM between 1984 and 2009 when he resigned from his position as Vice President and CFO of IBM UKI. He had been appointed to that office in 2008 when the business regions within IBM were realigned, having previously been (since early 2002) CFO for IBM North Region (UK, Ireland, Netherlands and South Africa). He was also, from 2002 until his resignation as CFO, a director of Holdings and IBM UKL. By virtue of his office, he was in an important leadership role within IBM at the time of Ocean, Soto and the early stages of Project Waltz.

302. I have also read a witness statement from Mr Larry Hirst ("**Mr Hirst**"). He was unable to attend the trial due to health problems. His witness statement was the subject matter of a Hearsay Notice. Mr Hirst was a very senior IBM employee. He is a former director of Holdings and IBM UKL. His career at IBM spanned 1977 to July 2010 when he retired from his then role as Chairman of IBM Europe, Middle East and Africa ("**EMEA**") and Chairman of IBM Netherlands. From 2001 to 2008 (when Mr Riley took over his role), Mr Hirst was General Manager of IBM North Region and then of IBM UKISA (UK, Ireland and South Africa).

303. On behalf of the Trustee, the following three witnesses were called and were cross-examined by either Mr Simmonds or Mr Newman and by either Mr Tennet or Mr Stallworthy:

> i) Mr James Summers Lamb: Mr Lamb was a director and the chairman of the board of the Trustee. He became an employee of IBM UK in 1971 and for the following 31 years was engaged in a number of roles including Controller and Treasurer. He became Director of Finance and Planning of IBM UK in July 1994 when he also became a director of Holdings. He was also appointed as a director of the Trustee in July 1994. He retired from employment with IBM on 5 April 2002 at which time his directorships of the group companies, but not of the Trustee, ceased. He became chairman of the Trustee on 6 April 2002. He has been closely involved with the negotiations which took place within the contexts of Ocean, Soto and Project Waltz.
>
> ii) Mr David Newman: Mr Newman is currently a pensions adviser (retained on a consultancy basis) to the Trustee. He was previously an employee of IBM. He joined IBM UK in 1985 as a Financial Analyst. He held a number of roles within IBM UK up until 1995 when he became the Chief Accountant, a role he performed until 1999. In 1999, he was appointed as Pensions Manager within Pensions Trust, IBM's in-house pensions administration organisation. It was created in the 1980s to provide a dedicated resource to the Plans and the Trustee. Mr Newman held the post of Pensions Manager until 2011; he held, it can be seen, that role during the course of Ocean, Soto and Waltz. During his period as Pensions Manager, Mr Newman was also company secretary of the Trustee. Although he was never a director of the Trustee, he attended its board meetings and meetings of the Trustee Management Committee and the Investment Committee, acting as secretary to both those committees. He therefore had a detailed knowledge of the decisions of those bodies and of the implementation of their decisions.
>
> iii) Mr Robert Hugh Bridges: Mr Bridges is client director of Capital Cranfield Trustees Ltd and provides professional services as an independent trustee. For the period 26 February 2004 to 31 October 2012 he was a director of the Trustee. Throughout that period he was one of only two independent directors of the Trustee, that is to say a director who has never been employed by IBM and who is not a member of an IBM pension plan.

The witnesses – some observations

304. I have thought it helpful to collect my observations about the witnesses in one place, and to put these observations near the beginning of my consideration of the evidence. This section of my judgment cannot be made proper sense of until later sections of the judgment, where I deal with the history of the development of Ocean, Soto and Project Waltz in some detail, have been digested. In particular, there is reference in this section to events and concepts which I identify and describe much later on and, until those events and concepts are understood, I am afraid that certain things will, on a first reading, seem obscure or even incomprehensible to a reader coming afresh to this litigation.

305. I start with IBM's witnesses.

Mr Chrystie

306. Mr Chrystie's first involvement of any sort was on 20 February 2009 when he attended a meeting with Mr Koppl. This was after the "**3 plays**" (see paragraphs 1182*ff* below) had been agreed on 4 February. He was briefed by Mr Koppl about the UK pensions changes that were being made to assist in safeguarding "**the 2010**

EPS Roadmap" (see paragraph 1075 below). He did not have any part in the conference call on 3 March 2009. Although he visited the UK between 21 March 2009 and 31 March 2009 it does not appear that he had much, if anything, to do with pensions issues. There was a conference call about pensions on 23 March 2009 which he says in his witness statement that he participated in, although he was not listed as an attendee in the minutes. I consider that it is clear from all the evidence that his involvement in pension matters was peripheral even at this stage. Further, Mr Chrystie himself acknowledged that he was a complete novice in relation to pensions.

307. Mr Chrystie himself came across as something of an advocate in IBM's cause in his oral testimony. I do not, however, doubt his honesty or integrity, although as will be seen later, his focus on the UK may have caused him to lose sight of the bigger (from CHQ's perspective) picture if, indeed, he had ever appreciated its full scope.

Mr Ferrar

308. I did not find Mr Ferrar to be an impressive witness. In certain respects, I found his evidence unreliable and he was, on any view I think, inappropriately defensive. He was prepared to downplay his involvement in Project Whisper (see 1109*ff* below) and his understanding of it when, in my assessment, he knew that it was more than contingency planning for hypothetical options as he had sought to explain his understanding of the project. In his original evidence, his summons to the US to take part in the Project Whisper meeting from 15 to 19 October 2008 was not mentioned; nor were the slides for the "work-plan" to reduce DB liabilities under Project Sapporo mentioned let alone disclosed. He failed to disclose to the Trustee board of which he was a member, material which would have been germane to its consideration of Project Waltz.

Mr Heath

309. Mr Heath, as Director of Human Resources for IBM UK from September 2003 to January 2007, was the man responsible for communicating the Ocean and Soto Proposals to members. He prepared the relevant communications with the involvement of CHQ and they were approved by CHQ. His evidence about what it was that IBM wanted to convey and about the impressions that members in fact received therefore comes from an authoritative source.

310. I find him to be an honest and straightforward witness whose evidence I can rely on. He attempted to explain his recollection of events truthfully and clearly. Inevitably, almost, at this distance of time he was occasionally confused, with one example of a need for further cross-examination again following re-examination after his initial cross-examination. His honesty however is not, in my mind, in question. Further, he was clear about what he could and what he could not remember, albeit that his recollection was not always perfect. I accept the accuracy and reliability in respect of the matters which he said he could remember.

Mr Koppl

311. Mr Koppl is in some respects a surprising witness. Not because he is unreliable or in any sense untruthful – quite the reverse – but because his evidence is not particularly helpful to IBM when it comes to establishing the reasons for the pension changes in the UK. Mr Koppl, as I have said, is and was Director of Pension Analytics within the Finance function at CHQ in Armonk. I think it is fair to say from an assessment of all the evidence that he was pivotal in (Mr Tennet would say the mastermind behind) the development of the Soto changes and that he was heavily relied on by CHQ and by the UK teams in the formulation of Project Waltz.

312. Mr Tennet's assessment of Mr Koppl was this: he was a frank and honest witness. The impression he gave was that he was genuinely trying to explain his own recollection of events and thought processes at the relevant time accurately and fairly. His recollection of events was good, and he indicated clearly when he could not remember a particular matter. I agree with that assessment.

313. One thing that came across clearly from his evidence was the involvement which he had in formulating the Project Waltz proposals and the readiness with which they were accepted by CHQ. Mr Koppl was concerned with the global picture and not with the development of justifications on a country-by-country basis and in

particular with the communication exercise for UKI. He clearly had a great deal of influence in the CHQ decision-making process on the Project Waltz changes.

Mr MacDonald

314. I have found Mr MacDonald a very difficult witness to assess. He is a man of charm and charisma. But he also has, it appears to me, a quite dominant character. He consults with those who work under him and around him but he clearly "calls the shots" in his own area of responsibility and the extent to which he hears, rather than simply listens to, those he consults is perhaps not always clear. I do not question his honesty and integrity. But having said that, I have to say that in some areas his evidence is really based on reconstruction rather than recollection. That he has no actual recollection of some matters is no surprise; the events took place quite some time ago and Mr MacDonald is a senior manager whom one would not expect to be involved in the detail of implementation of pension changes.

315. His own evidence in that last respect used a colourful (or I suppose colorful in his case) turn of phrase: he had to take a view from no lower than "a 50,000 foot level". Mr MacDonald was, by his own admission, not a "pensions man" to use my phrase; nor was his expertise in finance or accounting. His evidence showed that he was heavily reliant on others (such as Mr Koppl). His lack of financial/pensions expertise led him into error: for example, his witness statement stated that after Soto "costs continued to increase year on year" but, having been shown a document in cross-examination, he accepted that it demonstrated that pension costs would decrease.

316. Mr MacDonald's recollection was not always accurate. Mr Tennet refers to one example concerning the meeting at the Marriott Hotel in Portsmouth (UK) (as to which see paragraph 813 below). This was an important meeting, during the course of which Mr MacDonald used the words "push back". It is clear that both Ms Jennifer Bell of Nabarro and Mr Alexander of Watson Wyatt, on behalf of the Trustee, were present at the meeting, although Mr MacDonald could not remember their presence. Some of those attending that meeting have given evidence. All of them apart from Mr MacDonald himself say that the impression given by Mr MacDonald was that he would resist any future changes to pension provision in the UK: that is what they thought he meant in saying that he would "push back" if anyone sought to re-visit the UK pension issues. Mr MacDonald alone has a different recollection. This, however, is a case where I am sure that the recollection is really no more than reconstruction and I cannot take this part of his evidence as establishing what he actually meant to communicate let alone the impression he actually created. I deal with this more fully later.

Mr Riley

317. I have to treat Mr Riley's evidence with a degree of caution. He was, I think, an honest witness although he did occasionally need to change his position as a result of cross-examination. Mr Tennet gives one example concerning his "sametime" exchange with Mr Chrystie on 17 March 2009. He initially denied having warned Mr Chrystie not to speak to Mr Wilson about pensions issues. But when shown this "sametime" exchange, he accepted that he could well have told Mr Chrystie that he was not to discuss Project Waltz with Mr Wilson. I do not suggest there was any dishonesty here; indeed, in that relevant exchange, Mr Riley sought to explain what his understanding had been and why he had given the earlier answer which he had.

318. As with Mr Ferrar, his original witness statement can now be seen to be interesting for what it failed to say. Its purpose was, as he put it, to focus on the business reasons behind the decision to adopt Project Waltz. But he made no mention at all of one business reason, namely a directive from CHQ that retirement related costs savings be made as a matter of urgency to fix NPPC and ensure that the 2010 EPS Roadmap was met. And yet, in cross-examination, he not only accepted that this was a reason, but he also accepted that it was an important motivation for the changes.

319. One positive matter which he stated in his witness statement was that he was leading a transformation of the business at the time of Project Waltz:

> "Optimisation of profit performance was an important part of this transformation. A review of the cost implications of our retirement plans, and in particular our defined benefit schemes, was a focus

area."

320. That sits very uncomfortably with his oral evidence during the course of which it became clear that reviewing the cost implications of the Plans was no part of the UKI Transformation strategy until CHQ made it a requirement for retirement-related costs savings to be achieved at the end of October 2008. Consistently with that, the minutes of the TMM on 23 October 2008 record Mr Riley as saying that there were "currently no discussions going on as regards the IBM UK pension plans".

The RBs' witnesses: the member witnesses

321. In IBM's skeleton argument, the point was made that the evidence of the member witnesses is not relevant or, at the very least, their evidence is no more relevant than other evidence to the effect that other members of the Plans did not have the same understanding about IBM's commitment to continue DB accrual. That point is repeated in the written closing submissions. It is one which I will need to address more fully later on.

322. Mr Simmonds, in addition, draws attention to the following aspects which he detects in the member witnesses' evidence:

> i) There was no uniformity concerning the source of their understanding of IBM's commitment to keep the DB sections of the Plans open. Some relied on the guarantee which they had been told about, some from the comfort which they received in the knowledge that the funding of the Plans was secure going forward, so that there would be no need to terminate DB accrual in the future, and others from their belief that IBM did not have the power to change the benefit structure of the Plans. Mr Simmonds is obviously right when he says that this is hardly surprising in the absence, as he contends, of any clear and unequivocal representation of such a commitment anywhere in the relevant documents.
>
> ii) That there was a wide disparity about the precise terms of the commitment, again is unsurprising in the absence, in his submission, of a clear and unequivocal statement of those terms. This disparity of views amongst the members shows precisely, he says, why IBM cannot be held legally to any commitment with regard to future DB accrual under the Plans: the evidence as to what that commitment entails is far too exiguous.
>
> iii) The resentment on the part of the members at IBM's conduct during Project Waltz clearly showed during the member witnesses' evidence. It is understandable and inevitable that the members' views as to what they believed they were being promised in 2004 are coloured by the events of 2009. Mr Simmonds submits that I should take particular note of the witnesses' explanations of their understanding in giving oral evidence in contrast with the far more uniform and bland contents of their witness statements.

323. Having noted those observations, which have some force, I should add that all of the member witnesses struck me as honest and doing their best to help the court. If their evidence is not relevant, as Mr Simmonds suggests, that is not their fault. But as with some of the evidence given on behalf of IBM, not everything is recollection, some is reconstruction perhaps coloured by the resentment to which Mr Simmonds has referred.

324. In dealing with these witnesses generally, I have found it helpful to start with Mr Simmonds' assessment as set out in the written closing submissions and to say where I agree or disagree, taking account of everything I have heard from the witnesses and from Mr Tennet. I have found helpful his approach of identifying, in the case of each witness, the source of the understanding of IBM's commitment which the witness relies on, by far the most important sources being Mr Heath's Webcast and the terms of the guarantee. I have described the guarantee at paragraph 111 above. A description of the Webcast can be found at paragraphs 614*ff* below; a general understanding of it is necessary to understand the evidence of the member witnesses and what Mr Simmonds has to say about that evidence.

325. Now, it may be that a very detailed analysis, sentence by sentence, of the Webcast (and the Funding Agreement

including the guarantee) and questions closely focused on each sentence in the light of that analysis, demonstrates that there is no clear statement that the Plans will be kept open for future accrual for any particular period or at all. But I have to assess what the impact of the Webcast as a whole can be taken to be. To the extent that the evidence of individuals about what they understood is relevant at all, the issue for me is not so much what they might reasonably have understood if a tutor, such as Mr Simmonds, had been whispering in their ears, inviting them to ask themselves the right questions, but rather the issue is the impression which they actually gained from the Webcast as a whole. In making that assessment, I must, of course recognise that there may be elements of reconstruction, especially in the light of the resentment which Mr Simmonds has identified, and perhaps elements of wishful thinking.

326. I also need to point out that much of Mr Simmonds' cross-examination was directed at showing that, on a careful reading of the Webcast and the guarantee, the understandings which the member witnesses say they had were not justified. To some extent he succeeded in that because, on a sentence by sentence analysis, each witness broadly accepted many of the propositions put to them. He did put to each of them that there was nothing in the Webcast or the guarantee to justify the conclusion that IBM was undertaking that future service accrual in the DB Plans would continue for any period, but he did not suggest that they were making up their evidence about what they understood at the time.

327. I must add at this point that the members were never shown, nor were they able to obtain, the Funding Agreement (containing the guarantee) itself. All they knew about the contents of the guarantee were what they were told in the Webcast and in other communications. It is by reference to what they were told, rather than the actual terms of the guarantee, that their expectations must be assessed.

328. Taking the preceding three paragraphs together, I reject any suggestion that any of the member witnesses is simply making things up to suit their case.

329. It is to the individual member witnesses that I now turn, in each case starting with Mr Simmonds' assessment. I accept his assessment as fair, subject to the particular observation which I make.

Mr Buxton

330. Mr Simmonds' assessment:

> i) Mr Buxton understood that the guarantee related solely to funding and his understanding of IBM's commitment came from his belief that, once the funding issue had been repaired by the Funding Agreement and the guarantee, there would be no need to close the Plans. This explains why Mr Buxton would not have considered the early termination provisions of the guarantee to have affected his understanding.
>
> ii) However, when it came to justifying his belief that IBM had made a continuing commitment in respect of future service, Mr Buxton was vague as to the scope of that commitment: he accepted that the future of the Plans may depend on future events, and that future events may include legislative changes, but he was not prepared to accept that future economic conditions would justify changes, because he believed that they would be relevant only to past service benefits, and that he would not have anticipated economic circumstances affecting IBM UK's business causing changes. IBM submits that these qualifications cannot reasonably be drawn from anything in Mr Heath's Webcast.
>
> iii) Mr Buxton's difficulties increased when the question arose as to the duration of the commitment. He would not accept the logic of his position that, if the deficit problems were fixed, the Plans should remain open indefinitely. Instead: (1) in cross-examination, he plumped for a period of ten years, which happened to be roughly the same length as the guarantee; but (2) in re-examination, he had moved to ten years as a minimum, the period now being ten to twenty years.

Mrs Cordina

331. Mr Simmonds' assessment:

i) Mrs Cordina's source of comfort also seems to have been Mr Heath's Webcast. She remembered from the Webcast Mr Heath's statement that "[w]ith these proposals IBM is taking action with the intention of securing the sustainability of our defined pension schemes". She accepted that this was a statement of intent. But she thought that a statement of intent was the same as a firm promise.

ii) As to the guarantee, which she also relied on, she understood it as being related to funding and that that funding would shore up the pension fund so as to allow the Plan to carry on for the future, at least until 2014: as she said:

> "No, I didn't think that that was their intention [*ie* to cease future accrual of benefits]…This plan was put in place to stop that from happening."

iii) Thus it can be seen that Mrs Cordina did not understand IBM's commitment to be enshrined in the actual terms of the guarantee. This, according to Mr Simmonds, explains how she was able to reconcile that with the early termination provisions explained in the 2004 members' report; but when explained carefully to her, Mrs Cordina understood that the early-termination provisions were inconsistent with a commitment to keep the Plans open until 2014.

iv) Any suggestion that Mrs Cordina's understanding emanated directly from what was said in the Webcast is undermined by the fact that, although she understood that the Plans' benefits could change in the future, she did not equate this with closure of the Plans. She therefore could not have taken from the Webcast a commitment that the Plans would not close, as she believed that they could not close in any event.

Mr Johnson

332. Mr Simmonds' assessment:

i) According to his witness statement, Mr Johnson understood that the funding arrangement and the guarantee related solely to funding, describing it as a deal being offered by IBM in return for employees contributing towards the increased cost of future pensionable service. He was of the view that that left the Plans fully underpinned and guaranteed until at least 2014, and that Mr Heath's references to sustainability meant that the Plans could continue substantially unchanged and that there would be no further changes until he retired in 2013/14.

ii) From this, it appears that Mr Johnson was not reading the commitment from the guarantee itself, but from what the guarantee stood for, *ie* putting the Plans on a firm footing thereafter. But the difficulty with this is how he gets from there to an understanding that the commitment is to last for a particular period of time – *ie* until 2014 – without reading that commitment into the guarantee itself, for there is no other source for that time period. Mr Johnson accepted that things could change after 2014.

iii) Mr Johnson was constrained to include the guarantee as an integral part of the commitment in order to get a commitment lasting until 2014:

> "Yes, but to me it was very clear that a guarantee of company contributions to 2014 meant that, to me, there would be no change until 2014, but there could *be changes after that.*"

iv) Mr Johnson asserted his understanding to have been that the guarantee meant that there would be no further changes in the DB sections of the Plans, including benefit improvements, irrespective of any changes in circumstances, other than the ability of IBM Corporation to afford to fund the commitment.

v) IBM submits that Mr Johnson was trying to justify the future-accrual commitment to 2014 by reading that commitment into a guarantee that related only to funding, and that such a justification is unconvincing. I agree.

vi) As regards later documents, Mr Johnson effectively conceded that, once he had formed his understanding from Mr Heath's Webcast, he took no account of Mr Lamb's letter to members.

Mr Mills

333. Mr Simmonds assessment:

i) Mr Mills considered the Webcast to be a communications document, not a document designed to give binding legal commitments:

> "A. The commitment was made to me, as I said, was in the sum of the tone of the overall communication. The communication could have said other things. It could have said, 'We are going to close the scheme', it could have said, 'We are going to change the scheme'. It didn't. It said, 'We want to try and keep the scheme alive'.
>
> Q. Yes.
>
> A. That is, therefore, management giving the commitment that that is what they are going to try and do.
>
> Q. A commitment that that is what they are going to try to do?
>
> A. Yes. In business all you can do is try to do things. You guarantee very little."

334. Mr Mills understood the nature of Mr Heath's statements as indicating IBM's hope that the Plans would remain open, whilst not guaranteeing the same.

335. To similar effect, Mr Mills subsequently described IBM's position "as an intent not to make a change, an intent to make it happen and a commitment to do certain things along the way…like pay in the money". He saw that the only commitment was to fund the Plans; and that the consequent intent to keep the Plans open was just that – a statement of current intention.

336. Finally, when discussing Project Soto, Mr Mills said as follows:

> "…management do not make very many commitments, actually because they are like guarantees: they are very dangerous things to give. What you do is say: I have a plan to address the issue, I am trying to address the issue to the best of my abilities. And that is what both these announcements effectively said to me."

337. Nonetheless, Mr Mills' overall understanding as explained in his witness statement was that the Plans would not be closed during the period of the guarantee which had been put forward as part of the reasons why the Plans were sustainable. It is also appropriate to mention at this point that Mr Mills qualified his answer concerning IBM simply providing a statement of intent by saying that IBM could only change its mind in exceptional circumstances, such as a collapse of its business.

338. Mr Simmonds' response to that is that an intention not to do something save in exceptional circumstances is not the same as a warranty that changes will not be made outside of those circumstances: a qualified intention remains an intention, and not an unequivocal representation capable of being given legal effect. I will be dealing with the communications in due course and with this submission in particular.

Mr Turner

339. Mr Simmonds' assessment:

i) In his witness statement, Mr Turner appeared to found his belief in the DB accrual commitment squarely on the guarantee:

> "I believed that the guarantee ensured that there would be no further changes for the duration of the guarantee, because IBM World Trade Corporation was standing behind the defined benefit pension schemes and was making a commitment to support the pension schemes."

ii) However, when faced with the possibility that the guarantee could terminate early, Mr Turner sought to rely on the guarantee only to give support to those convictions and intentions expressed by Mr Heath in the face of the changes he was making, but this backtracking is unconvincing and contrary to the thrust of his evidence.

iii) It was pointed out to him that the guarantee related to funding, and not to accrual. He then relied on the fact that the funding related to future service accrual as well, which he said was a "strong indication that the company is going to contribute in terms of future service benefits".

iv) Mr Turner had no answer to why a guarantee to contribute money in the future prevented the future termination of DB accrual.

v) The credibility of Mr Turner's alleged understanding of IBM's commitment to future accrual is undermined by his stance on its consequences for the ability of IBM to make changes to the Plans after 2004. He did not suggest that that commitment meant that the benefit structure would remain unchanged at all times in the future, but that it meant that any changes should be:

> "incremental where possible, and if they are sort of more radical where necessary, then those should come infrequently, with a period of stability following them."

vi) Mr Turner confirmed that these changes could occur before 2014.

vii) No doubt that is what Mr Turner would have liked, but IBM submits that such an understanding cannot reasonably be derived from Mr Heath's Webcast; and it is a long way from what Mr Turner said in his witness statement:

> "I believed that the guarantee ensured that there would be no further changes for the duration of the guarantee."

viii) When pressed with this, Mr Turner claimed that there was no inconsistency in his position because:

> "…we would hope for no further changes, and I think there should be no further changes, but it is an uncertain world."

ix) IBM submits that, although that statement does explain the inconsistency, it also reveals Mr Turner's real belief: a hope for no changes rather than an understanding of a commitment that there would be no changes. The "uncertain world" described by Mr Turner perfectly encapsulates why IBM would not give, and did not give, the kind of guarantee now claimed by the RBs.

x) Yet, extraordinarily, in re-examination Mr Turner reaffirmed his initial stance that IBM's commitment was that there would be no changes in the long term, which he explained as being

"approximately ten years" which just happened to coincide with the length of the guarantee.

xi) Mr Turner sought at several points to contextualise his understanding by reference to the long-term nature of a pension scheme, but apparently he did not consider the specific context of the changes that were the subject of the Webcast, which related exclusively to funding and not to future accrual.

xii) Mr Turner demonstrated the tendency of some of the member witnesses to read into documents that which accorded with their alleged understanding of IBM's commitment to continuing future DB accrual under the Plans, irrespective of what was actually written in the documents. Indeed, Mr Turner went so far as to read such a commitment into documents that pre-dated Mr Heath's Webcast, such as the reference in the 2003 members' report to

> "the Company's current intention to continue to support the Plan through the payment of employer contributions in accordance with the provisions of the governing Trust Deed and Rules."

xiii) Mr Turner admitted that he read that reference with a pre-conceived assumption that the benefits would remain unchanged, even though he later admitted that the wording actually used allowed the employer to change the benefits in the future.

xiv) In any event, IBM submits that Mr Turner undermined the relevance of his evidence as to what a reasonable employee would have understood about IBM and the DB sections of the Plans by:

a) admitting that he had not realised at the time that IBM had the right to change benefits for future service;

b) admitting that he had probably not then read the C Plan explanatory handbook; and

c) displaying a general lack of knowledge of the way in which DB benefits accrued under the Plans.

340. That Mr Turner's evidence may have contained some inconsistancies and that he was unable to controvert some of the propositions put to him by Mr Simmonds is true. If it is suggested that he was deliberately giving evidence which he did not believe was true, I reject it. I do, however, think that some of his evidence is reconstruction and reflects a degree of wishful thinking.

Mr Dalgleish

341. Mr Simmonds' assessment:

i) Mr Dalgleish was not aware in 2004 that IBM could change the Plans' benefits for future periods of service. He was also under the impression, therefore, that benefit levels were "to all intents and purposes fixed". As Mr Dalgleish himself said, in relation to Project Soto:

> "I was also surprised that the pensionability part now seemed that the company could change that, whereas I, obviously incorrectly, had assumed that that could not be changed."

ii) Hence, Mr Dalgleish questioned the nature of IBM's commitment during and after Soto.

iii) Mr Dalgleish seemed to backtrack from this in re-examination, claiming that he was aware in 2004 that the Plans could close, but IBM submits that his answers in cross-examination on this subject ought to be preferred. I agree.

iv) Mr Dalgleish readily admitted that Mr Heath gave no explicit commitment in the Webcast that

the Plans would stay open to 2014, but stated that that was the overall impression. He relied on a mixture of the guarantee and the words used by Mr Heath.

v) Mr Dalgleish agreed with the following as a reasonable summary of his understanding:

> "Given the understanding that you had, taking that from your evidence yesterday, that the future benefit levels were not changeable, I can understand why you reached the conclusion you did from a guarantee of company contribution levels; because in your mind, if the contributions are going to be paid and the fund will be kept going to 2014, this is a scheme which, to my mind, has a benefit structure that can't be changed. Therefore, accrual will remain open to 2014."

vi) IBM submits that this understanding derived, at least in part, from a misunderstanding of the extent of IBM's powers to change benefits for future service and that, whilst his misunderstanding did not extend to IBM's power to terminate DB accrual, IBM submits that his understanding of IBM's commitment from the Webcast must have been influenced by his belief that both future funding and future benefit levels were safe until 2014, whereas the truth was that benefit levels could have been changed at any time for future service.

vii) Further, Mr Dalgleish displayed a disinclination to accept that his understanding gleaned from the Webcast may have been affected by subsequent documents, on the basis that he did not consider those subsequent documents to be relevant given that he had already formed such an understanding: as regards the further information, he said that "I'm not going to ignore it if I need it, but if I don't think I need it, I'm not going to read it". IBM submits that this stance is most unreasonable, not least because Mr Dalgleish was unable satisfactorily to answer the follow-up question: On what basis do you decide whether you need it or not? There is force in that last point. But given my approach to the information which a hypothethetical reasonable member would take (see paragraphs 479*ff* below) it is not of importance whether Mr Dalgleish did or did not read subsequent communications: the reasonable member would have done so.

Mrs Harrison

342. Mr Simmonds' assessment:

i) Mrs Harrison admitted that she had little interest in, or knowledge surrounding, pensions during most of her career and did not recall asking for or receiving a copy of the I Plan handbook: as she said: "I wasn't thinking back then in terms of pension and handbooks. It wasn't an area of my life that I was interested in".

ii) IBM submits that her recollection of, and understanding from, Mr Heath's Webcast should be considered in that light, and in the light of her statement in paragraph 14 of her first witness statement that, in 2004, "I was not thinking about retirement and so I did not get into details beyond a general understanding that things were ok".

iii) Mrs Harrison described her understanding that nothing at all would change in terms of the benefits provided by the Plans until 2014, whether improvements or otherwise, but it transpired that her belief that IBM would never close the I Plan was because she thought IBM could never close the I Plan, due to the fact that she was unaware that IBM had a right to do so. She subsequently admitted that her belief stemmed from this, and not from anything that Mr Heath had said in his Webcast. IBM submits that her evidence in respect of the Webcast on the question of closure to future accrual should accordingly be disregarded. I do not disregard it, but I do think it carried little weight.

iv) Mrs Harrison was therefore understandably vague about the relationship between this belief and

her belief as to the effect of the guarantee: "I expected [the I Plan] to stay in place until 2018 [the date of her (expected) retirement], but I thought it was fundamentally and completely guaranteed until 2014". She later admitted that the distinction between 2014 and 2018 was something to which she never gave any thought.

v) But, in fact, Mrs Harrison knew full well the limits of the guarantee, as she subsequently testified that her understanding of the guarantee in 2004 accorded precisely with its terms, *ie* that it was there to ensure that the increased employer contributions agreed to be paid by IBM UK were paid, if necessary, by IBM WTC.

vi) As stated above, her understanding as to the commitment of IBM with regard to future DB accrual stemmed from her ignorance of IBM's power to cease accrual, and her consequent assumption that IBM had no such power. That may well be so. But that does not mean that she did not have an expectation that DB accrual would continue or that she could not reasonably have seen the communications as re-inforcing her understanding that DB accrual would continue.

vii) There is, accordingly, nothing in Mrs Harrison's evidence that supports the RBs' case on member expectations, either from Mr Heath's Webcast or, for that matter, from anything said or done during Project Soto. Her evidence in this respect should be disregarded. As with Mr Scott (see paragraph 345iii below) I do not disregard it but it carries little weight.

Mr McRitchie

343. Mr Simmonds' assessment:

i) Mr McRitchie was uninterested in explanatory documentation for the I Plan. Accordingly, he was not aware in 2004 either that the I Plan benefits could change for future service or that IBM could close the Plans (short of a company insolvency situation). He may not have been aware of that in the sense that he had an understanding to the contrary. It is quite possible that he had no understanding one way or the other. To the extent that communications gave him to understand that DB accrual would continue, his evidence is as relevant as that of any other member.

ii) Mr McRitchie understood that the guarantee related to funding alone and that it had nothing to do with benefit levels: his understanding as to the continuation of DB accrual in the future arose from his assumption that, once their funding had been sorted out, there would be no reason to close the Plans. He accepted that this conclusion did not derive from the guarantee but from a process of reasoning based on the consequences of the funding arrangement and the guarantee. As he later described it: "It's an expectation based on those facts that were laid out before me".

iii) Mr McRitchie's complaint essentially boiled down to the failure of Mr Heath to spell out the absence of a commitment to continue DB accrual in more detail – a fact he would have known had he read his I Plan handbook. But this complaint involves a large measure of hindsight: no such explicit statement was made at the time by Mr Heath because that did not accord with either his or IBM's current intentions, and would have created entirely the wrong impression to members. Insofar as Mr Simmonds' observations here are directed to a commitment, in the sense of a legal promise, I agree with what he says about Mr McRitchie's evidence. But this is not an answer to his evidence insofar as it can be relied on in the context of Reasonable Expectation (see paragraph 386(iv) below).

Mr Newton

344. Mr Newton is a member of the M Plan. His evidence went to a rather different aspect of the case. One of the reasons for the Project Waltz changes is said by IBM to have been the need to deal with the disparity of pension treatment as between DB and DC members. It is said that DC members (including, but not restricted to DC members in the UK) were concerned that their prospects of obtaining salary increases were being harmed by the

costs of DB accrual. Mr Newton provided evidence saying that he was not aware of any ill-feeling amongst his fellow DC members. Mr Simmonds says that this gets the RBs nowhere. It turned out in cross-examination that he worked with a maximum of 25 members of the M Plan out of 11,000-odd members. It is said that his evidence shows nothing of value. I deal with this issue of Mr Newton's evidence later at paragraph 1335 below.

Mr Scott

345. Mr Simmonds' assessment:

> i) Mr Scott relied on the terms of the guarantee itself as meaning that there would be no further changes to pension benefits to 2014, although that reliance is undermined by the fact that he was not aware in 2004 that the I Plan benefits could be changed or that the I Plan could be closed to future accruals (short of IBM becoming insolvent).
>
> ii) Questioning in re-examination perfectly encapsulated the difficulties with Mr Scott's position, and his answer betrayed the paucity of his reasoning:
>
> > "Q. I am just trying to fit together the two answers that you have given, where you seem to be, I think, questioning whether a plan could be closed for the future, but you then say that there was a guarantee being given that it would go forward?
> >
> > A. I thought so.
> >
> > Q. How do those two answers fit together? Why would there be a need for a guarantee that it would go forward to 2014 unless it could be changed?
> >
> > A. I don't know. You would have to ask IBM that."
>
> iii) IBM submits that Mr Scott is therefore in the same position as Mrs Harrison, and that his evidence as to his understanding of the Webcast must be similarly discounted. I make the same observation as I did in relation to Mrs Harrison.

346. I do not propose to enter into a detailed analysis or discussion of Mr Simmonds' assessment of the RBs' witnesses. What he records them as saying is, I believe, accurate, certainly accurate enough for present purposes, and Mr Tennet has not made any serious criticism about that. Many of Mr Simmonds' observations about inconsistency between the different witnesses, and even within the evidence of an individual witness, are self-evident from what he has recorded them as saying.

347. It is fair for him to say, as he does, that there was a general confusion amongst many of the member witnesses between benefits and contributions, in particular in assuming that IBM's power to alter benefits for the future was limited to increasing employee contributions (as both Mr McRitchie and Mrs Cordina seem to have assumed judging by their answers in cross-examination). Similarly, in 2004 Mr Mills was not sufficiently informed about pensions to understand the difference between past and future service when it came to considering deficit and surplus.

348. By detailed questioning in relation to the Webcast and other communications (and also in relation to the guarantee which, as I have noted, the members never saw, their only understanding of its nature being what they were told by IBM and the Trustee), Mr Simmonds was able to establish that different members had different understandings of the starting point (in terms of what IBM could and could not do) and different understandings of what the Webcast and other communications were saying: they took different messages away. In those circumstances, he says that the understandable ignorance of at least some members giving evidence should make me very slow to bind IBM to the understanding of such members as to the effect of statements made on the future of the Plans' benefits. I should not be persuaded to construct a legally-binding arrangement from words that are, as he puts it, clearly not fit for that purpose.

349. I take those cautionary words on board. But, on the other hand, the Webcast and communications were directed at people who, although a comparatively sophisticated group, perhaps, compared with the membership of many other large UK pension schemes, are not pensions experts. I must attempt to interpret the Webcast and the other communications in the way that the hypothetical reasonable and objective member would understand them; and I must do so realising that the members will not have had the benefit of an appropriately qualified professional explaining in detail the nuances of the communications when subjected to detailed examination and realising that the hypothetical reasonable and objective member might not give the full attention to these communications which IBM's case might be seen as requiring them to have undertaken. I deal with this aspect of the evidence further when considering the topic of Reasonable Expectations (see paragraph 386 (iv) below).

350. What is clear from the evidence is that all of the members who actually gave evidence now regard IBM as having breached commitments to the members generally; and there is evidence to suggest that there were very many members (both DB and DC members) who regarded the Project Waltz changes at the time they were announced not merely as unfair but far more seriously, "betrayal" and "breach of trust" perhaps summing up the thrust of the complaints. I am quite sure that all of the members who gave evidence were being honest in the evidence which they gave. But I am also conscious that there is a real danger of a potent mix of reconstruction and wishful thinking about what they actually thought at the time rather than what they now say about the changes. Having said that, I do not doubt that they all genuinely considered at the time that the changes were unfair. I do not know whether even IBM would dispute that: it does not matter, because unfairness, on any view, is not enough to get the RBs home as I will explain.

The Trustee's witnesses

351. I say only a very little about the Trustee's witnesses at this stage. I have no doubt that all of them were honest witnesses doing their best to assist the court. Mr Lamb was an impressive witness. In contrast with the RBs' witnesses, I do not have any concerns about reconstruction or wishful thinking. I consider that when Mr Lamb says he understood what he was being told in a certain sense, that is indeed what he understood. Whether what he was told justified his understandings gives rise to different issues.

352. There is one final witness whom I should mention, Mr Wilson. He was called on behalf of the RBs. As with the Trustee's witnesses, I say very little about him at this stage. He was, in my assessment, an honest and reliable witness. As with Mr Lamb, I have no concerns about reconstruction or wishful thinking. I will consider relevant parts of his evidence in due course

The *Imperial* duty

353. The phrase "implied duty of good faith" is regularly used as a shorthand expression to describe the implied duty which arises in a pensions context, an obligation on both an employer and a member (whether an employee or ex-employee) not to destroy or seriously damage the relationship of trust and confidence between them. It is, apparently, a duty also owed to other beneficiaries of a pension scheme (*eg* widows and dependants) who have never been in a contractual relationship with the employer. It is a rather more complex duty than those simple words "implied duty of good faith" might suggest; these words are found in the cases and are the ones the parties have adopted in their agreed list of issues. The shorthand must not, however, be allowed to distort the content of the duty. As Knox J observed in *Hillsdown Holdings plc v Pensions Ombudsman* [1996] PLR 427 at [91]:

> "Browne-Wilkinson V-C used the expression 'the obligation of good faith' as a form of shorthand for the implications set out above and in adopting it I should like to emphasise that it is a convenient shorthand only and, in particular, does not carry the implication that a failure to observe the implied obligation would amount to bad faith in the pejorative sense in which that expression is often used."

354. Mr Simmonds refers to it as the *Imperial* duty, by reference to *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589 ("***Imperial Tobacco***") where Sir Nicolas Browne-Wilkinson V-C first formulated the duty in a pensions context. That is how I will refer to the duty in this judgment in order to distinguish it from the duty which is implied into a contract of employment. Whatever reservations one might have had about the creation of what was, essentially, a new duty, it is now well established. It is easy to state but

often very difficult to apply in practice: the present case is an example of difficulty in practical application.

355. Since the extent of the implied duty of good faith in an employment contract and the *Imperial* duty are of central importance in the present case, I will need to spend some time on them.

356. The authorities were reviewed by Newey J in *The Prudential Staff Pension Scheme, Prudential Staff Pensions Ltd v Prudential Assurance Co Ltd & others* [2011] EWHC 960 (Ch) ("***Prudential***"). I said a little more about the subject in my supplemental judgment in the Rectification Action: see [2012] EWHC 2766 (Ch) ("**the second rectification judgment**"). In the trial bundle are two editions of *Prudential* published at [2011] PLR 223; one is at Bundle K/48 and one at K/48A. They have different paragraph numbering after [135], as the result of a printing error which omitted parts of [135] and [136]. I use the version at K/48A to which my paragraph references relate.

357. Both sides start with the well-known articulation of the principle established in relation to contracts of employment:

> "…there is implied in a contract of employment a term 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 employee…"

358. This principle is firmly established. One sees it clearly articulated by Browne-Wilkinson J in *Woods v WM Car Services (Peterborough) Ltd* [1981] ICR 666 (giving the judgment of the EAT). It was approved by Lord Steyn in *Malik v Bank of Credit and Commerce International SA* [1998] AC 20 ("***Malik***"). And it was extended by Browne-Wilkinson V-C (as he had become) in *Imperial Tobacco* so as to apply to the exercise by an employer of its powers and discretions under a pension scheme. Mr Simmonds accepts that in a pension scheme, the implied term operates to constrain the exercise by the employer of any power vested in it under the governing provisions of the scheme, insofar as such exercise affects members of the scheme. But that is not to say that the content of the principle in the context of a contract of employment and in the context of a pension scheme is identical. The two situations must not be elided.

359. In the second rectification judgment, I identified four matters which I regarded as clear. I remain of the views I expressed there, but I should develop each of them to some extent. There is also a fifth matter which I also mention at this stage. The four previous matters and the fifth matter are these:

i) First, the exercise of a discretion, such as the exercise of the Exclusion Powers, requires "a genuine and rational" as opposed to an "empty or irrational" exercise of the discretion.

ii) Secondly, the correct test is <u>not</u> one of fairness.

iii) Thirdly, whatever the test is, it is a "severe" one.

iv) Fourthly, the test, whatever it is, is objective.

v) Fifthly, the employer's financial and other interests are relevant.

360. I take those in more detail in turn.

361. **A genuine and rational exercise of the power**. I do not think that this is a controversial proposition. However far the *Imperial* duty may go or not go, it is right to conclude that an employer must not act in an "empty or irrational" way. The word "empty" is not mine but has been used on several occasions and denotes, to my mind, an absence of any reason. I think the words "empty" and "irrational" inform each other so that the composite "empty or irrational" has a pretty clear meaning. But this has nothing to do with fairness and little, if anything, to do with objective reasonableness. As Newey J put it in *Prudential*, assessing whether a decision is irrational or perverse (in the sense in which he was using those words) is not to be equated with the application of an objective standard of reasonableness.

362. **Not a test of fairness**. In *Imperial Tobaco*, Browne-Wilkinson V-C himself rejected the test of fairness and Newey J reached the same conclusion (see for instance at [142] of his judgment). *Imperial Tobacco* was approved in *Malik* and although this point did not need to be addressed in that case, there was no hint of qualification or reservation by the House of Lords in what it said. I do not consider that there can be any doubt that the test is not one of fairness. The essential reason is that appeals to fairness do not solve the problem. What is fair to one person may seem unfair to another; both the employer and the employees may have perfectly reasonable views even though those views are diametrically opposed. It is not for the court to take on the mantle of arbiter of fairness. Some other test has to be found.

363. **A severe test**. Newey J, at [132] of his judgment, described the test as a severe one, citing Hale LJ (as she then was) in *Gogay v Hertfordshire CC* [2000] IRLR 703 ("***Gogay***"). That was said in the context of an employment contract and not of a pension scheme. If the test is severe in that context then, *a fortiori*, it is severe in a pensions context. However, what Hale LJ meant by severe was that the conduct must be such to destroy or seriously damage the relationship so perhaps that takes one no further. Whether the severity is such that the test is actually one of irrationality or perversity is a matter I will come to.

364. **The test is objective**. I do not think that the RBs disagree that the test, whatever it may be, is objective. It is the approach which Newey J took in *Prudential* and which I took in the second rectification judgment.

365. There is a gulf between the RBs and IBM about the content of the test, but as to objectivity, they seem to accept objectivity as a guiding principle. Thus in the RBs' written closing submissions we find this:

> "However, at the end of the day, the only relevant test is whether the impact of conduct complained of has, objectively, seriously damaged the relationship of trust and confidence"

366. I am sure that it is right. It is supported by what Lord Nicholls said in *Malik* at p 35 ("The conduct, must of course, impinge on the relationship in the sense that, objectively, it is likely to… breach the implied duty of good faith") and by Lord Steyn at p 47 agreeing with an article by Mr Douglas-Brodie who wrote that, in assessing whether there has been a breach:

> "it seems clear that what is significant is the impact of the employer's behaviour on the employee rather than what the employer intended. Moreover, the impact will be assessed objectively."

367. It follows that, in taking this approach, the court is concerned with a "reasonable employee" and not with any particular actual employee or group of employees. No doubt the court needs to be put in a position, so far as it is possible to do so by proportionate means, to understand as fully as possible the context in which the actions (including what was said or not said to employees) said to give rise to breach of the implied duty of good faith occurred. That will include evidence being given to the court by members about what they were told. The court can, of course, look at the documents; it can also look at slides prepared for presentations. But what it cannot do is put itself in the chairs of the employees who attended meetings (save where videos are available). To learn what was actually said, the evidence of those attending is relevant. Further, it is relevant not only to what was actually said, but also to the way in which it was said and the impressions which, objectively, might reasonably have been gained. And it is relevant to establishing what IBM could reasonably have considered the level of understanding of the target audience might be. I do not consider that such evidence is irrelevant.

368. Nonetheless, I see it as far less relevant, if relevant at all, to know the subjective impressions gained by the small number of individuals who have actually given evidence even if I accept that their understandings are representative of a large number of other members. This is an aspect I deal with below when considering the topic of Reasonable Expectations.

369. **The employer's financial and other interests**. Browne-Wilkinson V-C recognised that, in exercising the discretionary powers under consideration in that case and, I would say, in exercising IBM's powers in the present case, the employer is entitled to take account of its own financial and other interests subject to any constraint imposed by a requirement (if one exists) of consistency with any expectations on the part of the

members. The employer's financial and other interests are factors to be taken into account in assessing whether there had been any breach of the employer's duty of good faith. Other authorities have adopted the same approach: see for instance Robert Walker J in *National Grid Company plc v Laws* [1997] PLR 157 at [88], Pumfrey J in *Hoover Ltd v Hetherington* [2002] PLR 297 at [53] and my own decision in *Bradbury* at [103]. Other things being equal, an employer is therefore entitled, quite clearly in my view, to prefer his own economic interests to those of his employees. By doing so, he may create all sorts of problems in terms of workforce motivation even leading to strikes and the like, but that is a matter for his commercial judgment. If a breach of the *Imperial* duty is to be established, there has to be more than a decision which the employees consider to be unreasonable: there has to be something more substantial. That is no doubt why the RBs in the present case place so much reliance on what was said to the members in the implementation of Ocean and Soto and do not simply rely on the terms of Project Waltz being in themselves so monstrous, to use my own word, that taken in isolation they breach the *Imperial* duty.

370. The parties have a very different view of the role of legitimate expectations in the scope of the *Imperial* duty. The RBs submit that it is central. IBM says that the concept, at least as developed in public law, has no part to play: the (only) test is whether the employer has acted irrationally or perversely. It follows that unless it would be irrational or perverse to depart from the members' legitimate expectations, there would be no breach of the duty. I return to legitimate expectations later in this judgment.

371. I should here record that there are two strands to the RBs' case. There is the first limb, the contractual arm, where reliance is placed on the well-established implied term in an employment contract, that neither employer nor employee will, without reasonable and proper cause, conduct himself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence between employer and employee; and there is the second limb which is that an employer and a member of a pension scheme are under the *Imperial* duty. Both of these duties are admitted as matters of principle and it is also admitted that they apply to IBM's powers under, and in relation to, the Plans. Both strands are relevant in the present case, because not all of the Project Waltz proposals were to be implemented under powers in the Plans. They involved other aspects, such as the 2009 Non-Pensionability Agreements and the alleged pressure placed on members to enter into them.

372. In relation to a power vested in an employer under a pension scheme, the effect of the *Imperial* duty is to place a limitation on the manner in which an apparently unfettered power may be exercised. Quite what the consequences of a breach of duty are is not entirely clear. One view is that in most, if not all cases, a breach of the duty leads to invalidity of the exercise of the relevant power. But care must be taken with that proposition as with all extreme propositions. There may be cases where it would not be just or proportionate to strike down the exercise of the power at all; and there may be cases where the result is partial, rather than total, invalidity of the exercise of the power.

373. Mr Tennet submits that the origin of the *Imperial* duty entails that the two duties I have just identified have the same content in terms of what sort of conduct would be likely to destroy or seriously damage the relationship of trust and confidence between an employer and its employees. One consequence of that, if it is correct, is that the authorities concerning the implied duty in an employment contract will be relevant to the *Imperial* duty in a pensions context as well. Mr Tennet developed that submission in the RBs' written opening submissions. Without retreating from those submissions in any way, his case has moved on with a new focus which I shall come to in a moment. I do not therefore propose to address in any detail what was said in the opening although I have taken all of it into account in reaching the conclusions which I do.

374. Mr Simmonds' position is that little assistance can be gained from the employment law cases and that they are not binding on this Court in relation to the issue of the scope and application of the *Imperial* duty. It is neither sensible nor appropriate simply to bolt on employment law to the law relating to the exercise of discretionary powers under an occupational pension scheme. Moreover, to do so would be contrary to Newey J's decision in *Prudential*.

375. The RBs' case on the scope of the *Imperial* duty now rests on the identification of a "two-pronged test" to use Mr Tennet's words. The test, as established by the employment law cases, is that the employer shall not (i)

conduct itself in the proscribed manner (ii) without reasonable and proper cause. He acknowledges that the issue of "reasonable cause" might sometimes impinge on the issue of whether trust and confidence have been damaged, but refers to some authorities where the matter has been approached in two stages. In his closing, Mr Tennet relied on *Gogay* at [55] and *Attrill and Annar v Dresdner Kleinwort* [2012] EWHC 1189 (Ch) at [199].

376. Since the hearing before me, the second of those cases has been to the Court of Appeal: see [2013] EWCA (Civ) 394 ("***Attrill***"). Elias LJ, with whom Beatson LJ and Maurice Kay LJ agreed, said this at [101]-[102]:

> "101. The issue here is whether the introduction of the MAC clause amounted to a breach of the duty of trust and confidence. In dealing with the relevant law, the Judge cited passages from the judgments of Lords Nicholls and Steyn in the leading case of Malik v Bank of Commerce and Credit International SA [1998] AC 20 and summarised the relevant principles as follows:
>
> > "…in considering whether the introduction of the MAC clause amounted to a breach of the duty of trust and confidence, it is necessary to consider whether, on an objective view,
> >
> > (a) the introduction of the clause was calculated or likely to destroy or seriously damage the relationship of mutual trust and confidence between the claimants and DKL, and if so
> >
> > (b) whether it was introduced without a reasonable and proper cause."
>
> It is not suggested that there is any error in this approach.
>
> 102. The second issue involves asking two questions: first, what was the reason the employer acted as he did? Second, did that reason constitute reasonable and proper cause?"

377. Mr Tennet relies strongly on that to demonstrate that the two-pronged test is the correct approach. But for the avoidance of doubt, he makes clear that the RBs continue to maintain that a breach of the *Imperial* duty should be found even if I were to reject the two-pronged test notwithstanding the guidance given in *Gogay* and *Attrill*.

378. Mr Simmonds submitted in his oral closing that this approach by the RBs was simply an attempt to justify the introduction of the test of reasonableness which had been rejected right from the beginning by Browne-Wilkinson V-C in *Imperial* and consistently by other Judges since then. He submits that there is no basis for a two-stage approach even after the decision of the Court of Appeal in *Attrill*. The correct approach in relation to the exercise of discretionary powers (he makes no submission about other contexts) is what I can describe as a multifactorial approach (a jargon phrase familiar to intellectual property lawyers) or, more colloquially, everything goes into the melting pot. Everything is taken into account but the ultimate question is whether the employer has acted irrationally or perversely. His key point is that it is "simply not appropriate to enter into an analysis, an evaluation of the merits of the employer's decisions by reference to criteria that are essentially designed to answer the question: was this a reasonable thing to do?". He could make the same points even if a two-pronged approach is to be adopted, but on the basis that the "reasonable and proper cause" prong is satisfied provided that the employer can at least demonstrate a rational reason for his decision.

379. In the absence of authority, I would certainly agree with Mr Simmonds. I have already suggested that there is a conceptual problem about dividing the issue into two separate components. It is not unhelpful to do so as one way of illuminating the answer. But, to repeat, the words of Browne-Wilkinson V-C are not legislation and he was simply attempting to articulate, at the very beginning of the development of the duty, its core elements. Logically, if an employer has a reasonable cause or excuse to conduct himself in a way which might give rise to a question as to whether what he is doing is proper because on the face of it the result looks surprising, then he is not in breach of duty. Indeed, whether Mr Tennet is right or Mr Simmonds is right on this issue, the result will be, if there is a reasonable cause or excuse, that the *Imperial* duty is not breached at all; it is not that there has been a breach of duty which the Court then goes on to treat as no breach or as a breach which carries no remedy. In any case, when it is remembered that the essence of a breach of the duty is conduct which damages the

relationship of trust and confidence, I have to say that I find it difficult to see how conduct for which there is a reasonable and proper cause can be such as seriously to damage that relationship in the first place. Surely an employee who accepts that his employer has a reasonable and proper cause for doing what he does, even if the employee does not like it, can hardly say that the relationship of trust and confidence is seriously damaged?

380. That is not to say that the two-pronged approach is not of assistance at all. In *Gogay*, for instance, the facts were fairly extreme. An allegation of sexual abuse is clearly likely seriously to undermine the relationship of trust and confidence in both directions. If the allegation turns out to be true, the relationship of trust and confidence is likely, nonetheless, to have been seriously undermined if not altogether destroyed. But there will have been no breach of the implied duty of good faith on the part of the employer because his conduct (the making of the accusation) would have been with proper cause (unless, for instance, made unnecessarily public until proven).

381. However, where the conduct is not of that nature but is such that a careful enquiry is needed to weigh the conduct in the balance against, for instance, reasonable expectations, the two-pronged approach appears to me to be a less than helpful approach. My strong inclination is to reject it, in a case such as the present, as a reliable guide.

382. Does *Attrill* require me to conclude otherwise? Nowhere in the judgments, in particular not in the passage relied on by Mr Tennet which I have quoted at paragraph 376 above, did the Court of Appeal say anything about this aspect of the *Imperial* duty, nor did it need to do so. Given that reasonableness is not the test for breach of the *Imperial* duty, as *Imperial* itself and *Malik* make clear, Mr Simmonds is correct to say that the approach adopted by Owen J and, without further analysis, by the Court of Appeal should not be allowed to re-introduce the rejected test.

383. Since the Court of Appeal simply followed Owen J, it is helpful to consider why Owen J articulated the test in the way which he did. Mr Simmonds submits that Owen J in reality applied a unitary test. He adopts what Mr Spink said in his oral closing submissions.

384. The case concerned employee bonuses. As Mr Spink helpfully described the case, bonus promises had been made to a pool of employees which were then watered down contractually by the insertion of a rather significant clause the effect of which was that the bonuses would only be paid in certain circumstances. In that context, Owen J did seem to suggest that there was a two-stage test to be discerned from *Malik*: see [199] of his judgment. Mr Spink's submission is that when Owen J actually came to what constituted a breach of duty, he really applied a rolled up unitary test, referring me to [200] to [202] and [222] and [223]. Mr Spink is correct, in my view, when he says that Owen J did not make a finding that the relationship of trust and confidence was damaged until he had been through all aspects of the matter, including the question whether or not the offending contractual clause was inserted with reasonable or proper cause. And I agree with him when he suggests that Owen J's decision is not a clear authority for the requirement that there must be a formal two-stage test. It was not until [223], having been through the evidence, that Owen J was able to say that the introduction of the offending clause was regarded at the time as likely seriously to damage the relationship of trust and confidence. He did not subsequently go on to address whether that conduct, even though likely seriously to damage the relationship could nonetheless be conduct with a reasonable and proper cause.

385. In my judgement, the authorities do not force the court into the adoption of a formal two-pronged approach as advocated by Mr Tennet. That approach will, no doubt, sometimes provide a sensible reality-check in relation to a decision reached on a unitary approach adopting the multifactorial analysis already referred to. In some cases – and *Gogay* would appear to be one example – it may provide more than a reality-check and in fact represent the correct approach: if conduct cries out for an explanation and none can be given, the conclusion may well be that there is a breach of duty.

386. Whether I am right or wrong on that, Mr Tennet makes a number of submissions about the *Imperial* duty which I should in the first place identify:

i) There is no limit to the type of conduct which is capable of being destructive of the relationship of trust and confidence.

ii) The duty to maintain trust and confidence applies to the exercise of powers under a pension scheme in the same way as conduct by an employer.

iii) It does not matter that the conduct complained of falls literally within the employer's powers or that it is not otherwise actionable.

iv) Reasonable expectations are relevant. Mr Tennet adopts the terminology of "reasonable expectation" in order to distinguish it from what he calls a "mere expectation". By "reasonable expectation" he means 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. A "mere expectation" is one which an employee may have in fact as to the future, in the sense that they anticipate, assume or expect that something (*eg* a discretionary increase) will happen in the ordinary course of events if things "carry on as they are". Employees may have a mere expectation independently of any encouragement by the employer. Since "reasonable expectation" is being used as a term of art, I propose to use the words "Reasonable Expectation" with upper case leading letters; otherwise, there is a danger that, by repeated use, anything which is reasonable will be seen as a "Reasonable Expectation". Thus, a mere expectation may be perfectly reasonably held by an employee but that will not turn it into a Reasonable Expectation, and use of those words without upper case leading letters can only cause confusion. I consider the correct approach to Reasonable Expectations later in the next section of my judgment starting at paragraph 450. In particular, I address Mr Simmonds' arguments to the effect that a merely negligent statement cannot give rise to any breach of the *Imperial* duty.

v) It is not necessary to demonstrate irrational or perverse behaviour.

387. Mr Tennet also has a number of submissions in relation to *Prudential* and why it does not detract from the submissions above.

388. If, contrary to my view, a formal two-pronged approach is to be adopted, Mr Tennet also makes these points (although I should add that each of those points can I think be made, albeit in very slightly different language, if the unitary approach is correct):

i) As was made clear in the RBs' written opening submissions, there may be circumstances, particularly when it comes to considerations of the employers' own financial circumstances and economic interests, in which an employer, *in extremis*, could establish a reasonable and proper cause for reneging on assurances and confounding employees' Reasonable Expectations. But a desire simply to make more profit than the employer is already making cannot, he says, be a legitimate reason to do so: it could never be a reasonable cause or excuse.

ii) The legitimate interest of employers in making money is relevant to the first stage of the enquiry as to whether the employer's conduct complained of is objectively destructive of trust and confidence. It is relevant because employees must be taken to be aware that employers are in business to make money and may, in the normal course of events, have to take decisions against the interests of employees for that reason. That cannot of itself destroy trust and confidence. But a desire to make money does not entitle employers to act perversely, or to say one thing and do another.

389. Having identified the propositions which Mr Tennet seeks to establish, I remind myself what this case is really about so that my focus is on the legal aspects which really matter. As Mr Simmonds puts it, and I agree so far as their primary case is concerned, the RBs case rests on two pillars:

i) The Project Waltz changes were contrary to the reasonable or legitimate expectations (*ie* Reasonable Expectations) on the part of the members as to the future of the Plans, expectations which had been engendered by IBM, particularly during the run-up to and implementation of Soto. I add that, in order to succeed, the RBs have to show, even on their own approach, that this confounding of expectations was such as to destroy or seriously damage the relationship of trust and confidence between Holdings and the members.

ii) There was no justification for IBM acting contrary to those expectations.

390. That is how I perceived the nub of the case, particularly in the light of the written closing submissions from all parties by the time oral submissions began. As I put it to Mr Tennet as a summary:

> "Your case is to attempt to elevate what is at best a representation into a legally binding commitment through the interposition of the *Imperial* duty. Is that what it comes to?"

391. In his closing oral submissions Mr Tennet confirmed that the RBs were not submitting that the severity of the cuts, in the absence of Reasonable Expectations, which were imposed on members, was a breach of the *Imperial* duty. He does, however, rely on the severity of the cuts as a factor "suggesting….. that there was a failure to maintain trust and confidence in this case". This is important because, as Mr Simmonds submits, if there were no reasonable or legitimate expectations which had been engendered by IBM prior to Project Waltz and which Project Waltz would have dashed, then Project Waltz, of itself, is not a breach of the *Imperial* duty. As to the 2009 Non-Pensionability Agreements, Mr Tennet accepted that, by themselves and absent any Reasonable Expectation, they did not give rise to any breach of the *Imperial* duty. I think he is right to accept that because, absent any expectations, it would not have been unreasonable for IBM to say that it would not, until 2011 (note not indefinitely) grant any pay rises unless the agreement was signed, especially given that the member was still able to sign up to the agreement after the original deadline so far as concerns 2010 and 2011. For this detail see paragraph 1326 below.

392. In the context in which I asked Mr Tennet the question which I did, he did not take exception to the way I put it. But it would be entirely wrong to view the entirety of the case that way. Representations giving rise to expectations certainly have a part to play in the present case; indeed, the issue is of central importance. But that is not the beginning and end of the matter since serious challenges are made by the RBs to the alleged justifications for Project Waltz which they say are no justifications at all. If that is right, then the purported reliance on such matters is at the very least a factor to be taken into account in assessing whether or not a breach of the *Imperial* duty is established. Further, the RBs say that IBM's statements about the sustainability of the Plans means that IBM must have believed, on the basis of the information available to it at the time, that its statements were true. Or, if IBM did not believe those statements or had no justification for making those statements because it had not taken steps to confirm them, it would be a breach of the *Imperial* duty to act in a way that is inconsistent with the truth of those statements: in other words, if there was no significant change in financial circumstances between the time when the statements were made and the time of Project Waltz, IBM cannot, according to the RBs, rely on non-sustainability as justification for the later changes.

393. At this stage, it is convenient to give further consideration to the severity of the test applicable to the *Imperial* duty. As I have mentioned, the RBs rely on some of the employment law cases to identify the scope of the *Imperial* duty but IBM submits that these cases do not assist. Mr Simmonds' position is that the bar has been set very high – he would say at the level of perversity or irrationality – and that the RBs seek to lower the bar by reference to the employment law authorities which do not admit of sensible application in the context of a pension scheme.

394. It is certainly correct that there is no reported pensions case where the *Imperial* duty has been applied which cannot be explained by reference to the test of perversity or irrationality. Perhaps *Imperial* itself is the nearest to a counter-example but there the facts were quite extreme and the duty was breached, if not because of perversity, then because the power of amendment was being used for an inadmissible purpose. As I said at [100] of my judgment in *Bradbury*:

> "In that case [*Imperial*] it was a very important consideration that the employer was (a) seeking to force members to give up their accrued rights by moving to another scheme and (b) to take for itself the benefit of a surplus which under the rules of the existing scheme would be applied for the benefit of the members and former members of the scheme…In rejecting Mr Mowbray's argument, the Vice-Chancellor was clearly influenced to a large extent by the possibility that the sole purpose of the employer withholding consent to increase benefits out of the fund might well have been to

> force its present and past employees to give up their accrued rights in an existing fund so as to confer on the employer benefits that it could not enjoy unless the members give up such rights. It was that which, in his judgment, conflicted with the employer's duty to act fairly and in good faith to its employees."

395. Mr Tennet is, of course, right to say that the employment law cases were the foundation on which Browne-Wilkinson V-C built the *Imperial* duty. But equally, the *Imperial* duty is not simply an application of employment law to a particular facet of the employment contract. It has to be recognised that it was a new duty whose justification and rationale was the parallel employment law duty. But what Browne-Wilkinson V-C did not do, at least expressly, was to import lock, stock and barrel, into the new duty all of the attributes of the established employment law duty. Had he done so, he would no doubt have explained in more detail than he did the parallels which could properly be drawn.

396. That he did not do so is entirely unsurprising. As I remarked in my judgement in *Bradbury*, Browne-Wilkinson V-C gave his judgment under considerable time-pressure and, against his inclination, gave some guidance about how the new principle would work in practice. And just as some of those examples are not entirely easy to understand as fitting within the new principle, perhaps because thought of in some haste, so too his statement of the new principle cannot be taken as a rigorous articulation of the scope of the *Imperial* duty. Moreover, even in an employment law context, there is support for the conclusion that, in some cases, the test of irrationality or perversity is the correct test: see *Horkulak v Cantor Fitzgerald International* [2005] ICR 402 ("***Horkulak***") and *Clark v Nomura International plc* [200] IRLR 766 ("***Clark v Nomura***"). Mr Simmonds also relies on what Newey J said in *Prudential* at [142]. I will come to the relevant passages in a moment.

397. Thus, although the duty in the employment law context and the duty in the pensions context can be stated in the same language (*ie* an employer should not without reasonable and proper cause conduct himself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence between employer and employee) the content may differ. It is certainly true that the *Imperial* duty is not contractual not least because otherwise it would not be owed to persons (such as a member's dependants) who had never been in an employment relationship with the employer.

398. Further, as Mr Simmonds points out, there cannot be a complete elision between the *Imperial* duty and the duty of good faith in an employment context for two other reasons. First, the latter comes to an end when the employment relationship comes to an end: see for instance Lord Millett in *Johnson v Unisys Ltd* [2003] 1 AC 518 ("***Johnson v Unisys***") at [78].

399. The second reason is that, in an employment law context, express and unrestricted powers cannot in the ordinary way be circumscribed by an implied qualification; and that applies as much to the implied duty of good faith as to any other provision. In that context, Mr Simmonds relies on *Reda v Flag Ltd.* [2002] IRLR 747 ("***Reda***") where the Privy Council refused to apply the implied term to constrain the exercise by the employer of its express and unqualified right to terminate an employee's employment without cause. He submits that assimilation of the employment law duty and the *Imperial* duty would prove too much because, in a pensions context, the employer's powers are nearly always unrestricted or restricted in specific ways. On the basis of *Reda*, such unrestricted (or specifically restricted) powers would not be subject to the *Imperial* duty which would then be of very limited scope indeed.

400. In my view, that last submission goes too far. The point which was being made in *Reda* was that the implied term would not constrain the exercise of the power in a way which went against its express terms: in effect, a power to dismiss without cause could not be subject to a constraint which required cause to be shown. In the case of an ordinary power of amendment in a pension scheme, the power is unrestricted only in the sense that, on a literal reading, there are either no express constraints or express constraints usually imposed to protect members' accrued rights. It would not be inconsistent, in the sense that the question was addressed in *Reda*, to subject the amendment power to the *Imperial* duty.

401. Mr Simmonds then places considerable reliance on *Prudential*. To repeat what I said in the second rectification

judgment:

> "Things have, however, moved on since then [the decision in *Imperial*]. As Newey J points out in the *Prudential* case at [141], "it would make no sense to freeze-frame the duty of trust and confidence as it appeared at the date of Browne-Wilkinson V-C's decision"."

402. In moving the camera forward in time, Newey J considered the development of the obligation, drawing a distinction between the employment law context and the pensions context, the two streams as Mr Simmonds describes it. He certainly considered the two separately, considering, in [122] to [128], the following cases: *Stannard v Fisons Pension Trust Ltd* [1991] PLR 225, *National Grid Company v Laws* [1997] PLR 157 (Robert Walker J) and [2001] 1 WLR 864 (House of Lords), *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399 (Privy Council) and a Canadian case, *Lloyd v Imperial Oil Ltd* 2008 BQB 379. Newey J then dealt with some of the employment law cases in [129] to [135]: *Malik*, *Gogay*, *Johnson v Unisys* and *Eastwood v Magnox Electric plc* [2004] UKHL 35, [2005] 1 AC 503 ("***Eastwood***").

403. *Malik* recognised the emergence of the implied contractual obligation of mutual trust and confidence as a sound development; as Lord Nicholls (with whom Lords Goff and Mackay agreed) said the implied obligation was required "if the employment relationship is to continue in the manner the employment contract implicitly envisages". And, as I have already noted, an objective approach is required. Newey J referred to *Gogay* for its endorsement, if further endorsement were required, of the existence of the implied obligation and to Hale LJ's description of the test as a "severe one" such as to "destroy or seriously damage the relationship".

404. In *Johnson v Unisys* at [24], Lord Steyn described the *Imperial* duty as "an employer's obligation of fair dealing". He also noted that *Imperial* "did not involve trust law and the employer was not treated as a fiduciary"; his view was that the case was "decided on principles of contract law".

405. Newey J derived further guidance (see at [133]) about the scope of the contractual duty from a passage in the speech of Lord Hoffmann (with whom Lords Bingham and Millett agreed), at [43]. In this passage, Lord Hoffmann indicated how judicial creativity might be able to provide a remedy in a case such as *Johnson*:

> "In *Wallace v United Grain Growers Ltd* 152 DLR (4th) 1, 44-48, McLachlinJ (in a minority judgment) said that the courts could imply an obligation to exercise the power of dismissal in good faith. That did not mean that the employer could not dismiss without cause. The contract entitled him to do so. But in so doing, he should be honest with the employee and refrain from untruthful, unfair or insensitive conduct. He should recognise that an employee losing his or her job was exceptionally vulnerable and behave accordingly. For breach of this implied obligation, McLachlin J would have awarded the employee, who had been dismissed in brutal circumstances, damages for mental distress and loss of reputation and prestige."

406. In *Eastwood*, Lord Nicholls (with whom Lords Hoffmann, Rodger and Brown agreed) said that the implied contractual duty means:

> "in short, that an employer must treat his employees fairly in his conduct of his business, and in his treatment of his employees, an employer must act responsibly and in good faith."

407. And Lord Steyn referred to a power to suspend an employee being exercised "with due regard to trust and confidence (or fairness)".

408. Newey J also referred to two other cases concerning the payment of discretionary bonuses to employees: *Clark v Nomura* and *Keen v Commerzbank AG* [2006] EWCA Civ 1536, [2007] ICR 623. In *Clark v Nomura*, Burton J rejected the tests of capriciousness, on the one hand, and absence of reasonable or sufficient grounds on the other. He considered that the correct test was one of irrationality or perversity (of which capriciousness would be a good example), adding that this meant "that no reasonable employer would have exercised his discretion in this way". He regarded this as the same test as that applied in what is now the Administrative Court.

409. In *Keen*, Mummery LJ made a number of observations about the provision of information in relation to the award of bonuses. The relevant passages are set out in [136] of Newey J's judgment and I do not repeat them here.

410. It was on the basis of the employment law cases that Mr Rowley, for the beneficiaries of the pension scheme in *Prudential*, argued that the *Imperial* duty involved an obligation to act fairly. He relied not only on *Johnson v Unisys* and *Eastwood*, but also on remarks of Lord Bingham in *Interfoto Picture Library Limited v Stiletto Visual* [1989] QB 433 and *Director-General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481. The latter case concerned the Unfair Contracts Terms in Consumer Contracts Regulations 1994 in relation to which Lord Bingham observed that the requirement of good faith "in this context is one of fair and open dealing…." and made reference to the recognition of good faith in contractual dealings by civil law systems encapsulated by phrases such as "playing fair", "coming clean" or "putting one's cards face upwards on the table".

411. Counsel for Prudential (as it happens, Mr Tennet) put the matter very differently. He recognised that the *Imperial* duty meant that Prudential did not have an absolute discretion and accepted that an irrational or perverse decision could be attacked. The conduct in question must be serious: where a member remains an employee, the conduct must, viewed objectively, be so destructive of the relationship of trust and confidence that the employer may be taken to have repudiated the contract of employment.

412. In his discussion of the cases starting at [142], and after referring to the references to fairness and fair dealing in *Johnson v Unisys* and *Eastwood*, Newey J said this:

> "Even so, I agree with Mr Tennet that the obligation of good faith is not to be taken as requiring an employer to arrive at a decision which is substantively 'fair' when exercising a power given to him in apparently unfettered terms by pension scheme rules. No support for such a requirement is to be found in Imperial or the subsequent pension authorities. In Imperial itself, Browne-Wilkinson V-C rejected in terms 'an implied limitation of reasonableness'; he would surely have been no more receptive to a submission that decisions had to be substantively fair. Nor, to my mind, do the employment law cases suggest that there is such a rule. So far as I am aware, there is, for example, no indication that decisions made as to discretionary bonuses must be substantively fair….."

413. In [143], Newey J noted that in *Imperial*¸ Browne-Wilkinson V-C had said that the *Imperial* duty could be breached if an employer had acted "capriciously" but that with discretionary bonuses a slightly different test had been adopted, a test of irrationality or perversity. He agreed with Mr Tennet that an irrational or perverse decision "by an employer in a pensions context is likewise capable of offending the obligation of good faith". He referred to the judgment of Potter LJ in *Horkulak* (a discretionary bonus case where no issue of expectations, reasonable or otherwise, was in issue):

> "While, in any such situation, the parties are likely to have conflicting interests and the provisions of the contract effectively place the resolution of that conflict in the hands of the party exercising the discretion, it is presumed to be the reasonable expectation and therefore the common intention of the parties that there should be a genuine and rational, as opposed to an empty or irrational, exercise of discretion."

414. And so Newey J concluded in [143] that a power to increase a pension similarly requires "a genuine and rational, as opposed to an empty or irrational, exercise of discretion". This was something different from the application of an objective standard of reasonableness as he said in the opening words of [144].

415. Now, it is to be noted that Burton J in *Clark v Nomura* had expressly adopted his version of the test of irrationality or perversity which should apply in that case. He did not simply say that irrationality or perversity would be sufficient although it would have been sufficient on the facts. It is clear that the focus of Newey J's judgment was on the same test. Not only is that the test which he identified at the end of [143] and contrasted with an objective standard or reasonableness at the beginning of [144], but he also considered other submissions

relating to the *Imperial* duty, testing them against the test of irrationality or perversity: see [146] (saying that there might be cases where it would be irrational or perverse to override expectations which the employer had engendered; and acknowledging that the entitlement of the employer to take into account his own interests must limit severely the circumstances in which a decision could be said to be irrational or perverse), [147] (contrasting a fiduciary power), [148] (the manner of internal decision-making may shed light on whether an employer has acted irrationally or perversely) and [149] (even an irrational or perverse decision may not necessarily breach the *Imperial* duty, for instance if it related to a trivial matter and would not seriously undermine the relationship of trust and confidence).

416. Inevitably, however, the researches of counsel in the present case have revealed one further authority on which Mr Simmonds relies and now is as good a place to mention it as anywhere. It is the decision of the Supreme Court of New South Wales in *Re KCA Super Pty Limited* [2011] NSWSC 1301 ("***KCA***"). There are similarities with, as well as differences from, the present case. There was an application by the trustees of the relevant scheme for directions as to whether or not it could give consent to a determination by the employer to reclassify existing DB members as DC members. In the absence of consent, the employer had indicated that it would wind up the scheme. The purported justification for the changes (which have parallels in the present case) were (i) to eliminate fluctuations in the employer's financial results directly due to the uncertainty of funding DB arrangements (ii) to reduce administration costs (iii) to ensure that all employees enjoyed consistent employment conditions and (v) to align the scheme with "global best practice, both within KC [the employer group] and elsewhere, in providing [DC] arrangements". This was, again, not a case where any issue of expectations arose.

417. Brereton J in referring to the winding-up provisions of clauses 48 and 49 of the scheme's trust deed and to the contracts of employment under which employees agreed to be bound by the deed said this at [71]:

> "A purpose of the power given to the Company by clause 48 is to provide a means by which the Company may at any time free itself of the burdens imposed on it by the Deed. It is to my mind doubtful in the extreme that exercising that power, even if to free the Company of the burdens of the Deed and thereby improve its prospective financial position, would involve a breach of good faith, particularly given that members would still receive the clause 49 dissolution benefits."

418. And so Mr Simmonds submits that there are clear similarities between that case and the present case. In particular, he says that it is clear that, regardless of what the employment-law cases might say about the effect of reduction in an employee's pay, the exercise of a (non-fiduciary) power to cease DB accrual, in circumstances where the purpose of such an exercise is to improve the employer's financial position on an on-going basis, will not constitute a breach of the *Imperial* duty.

419. I now return to the first prong of the two-pronged approach and the five elements identified at paragragh 386 above and which I deal with in turn.

420. **There is no limit to the type of conduct which is capable of being destructive of the relationship of trust and confidence**. I agree with that as a general proposition provided that it was remembered that the conduct must be such as to impinge on the relationship of trust and confidence and that the impact must be assessed objectively: see the passages from *Malik* quoted at paragraph 366 above. So any type of conduct is capable, in principle, of being relevant. But that tells one nothing about the test to be applied in assessing whether conduct of a particular nature does, in fact, breach the *Imperial* duty.

421. **The duty to maintain trust and confidence applies to the exercise of powers under a pension scheme in the same way as it applies to any other conduct by an employer**. If by that it is meant that, once one has identified the correct test, there can be a breach of the *Imperial* duty when that test is applied to the exercise of power under a pension scheme, this proposition is correct but it is trivial because the *Imperial* duty is, of its essence, directed at the exercise of such powers. If by that it is meant, in contrast, that the content of the *Imperial* duty is the same as the content of the implied duty of good faith as a matter of employment contract law, the discussion which I have already conducted shows, in my judgement, that this is not so. One cannot blindly apply employment law principles or cases. Indeed, if it were possible to do so, it would be necessary to

identify which of the several strands of employment law is to be applied. Clearly the strand which suggests that fairness is the governing feature or a feature of real importance is to be rejected; but another strand, such as that demonstrated in *Clarke v Nomura* may provide a real parallel. That parallel, at least, would have the advantage that it related to an element of the remuneration of employees as do benefits under a pension scheme.

422. **It does not matter that the conduct complained of falls literally within the employer's powers or that it is not otherwise actionable**. Mr Tennet relies on what Lord Steyn said in *Malik* at 45 C-F. The duty to maintain trust and confidence will apply in cases even if as a matter of construction or otherwise there is no other implied limitation on the power which would prevent the behaviour complained of:

> "The applicants do not rely on a term implied in fact. They do not therefore rely on an individualised term to be implied from the particular provisions of their employment contracts considered against their specific contextual setting. Instead they rely on a standardised term implied by law, that is, on a term which is said to be an incident of all contracts of employment: *Scally v. Southern Health and Social Services Board* [1992] 1 A.C. 294, 3078. "

Such implied terms operate as default rules.

423. And so Mr Tennet submits that it is clear from this passage that conduct which undermines the relationship of trust and confidence can, and often will, fall within the strict scope of powers vested in the employer (under the employment contract or pension scheme (see above)). However that plainly does not mean that the exercise of the power is not constrained by a duty to maintain trust and confidence. That is true up to a point.

424. It would difficult to maintain, however, that an express qualification of what would be otherwise be implied leaves any room for the implication: in this context, see the discussion of *Reda* at paragraphs 399-400 above. And when asking oneself whether the term which is to be implied in a particular case has a content which precludes action which falls within the literal meaning of the power being taken, the nature of the power is, it seems to me, of central importance when it comes to establishing the scope of an implied restraint on its exercise. Thus I agree with Mr Simmonds when he says that the nature of the power is relevant. Further the fact that the employer's power is otherwise unfettered, either by an express constraint on the power or by making the exercise of that power subject to another's consent, is, as he submits, a relevant factor to take into account in determining the fetter imposed by the *Imperial* duty in that context. The terms on which the employees became members of the scheme, contained in the trust deed and rules and notified to them by way of employee handbooks, are also I consider relevant to the scope of the *Imperial* duty. Newey J clearly took this view when giving his reasons for saying that Prudential had not acted irrationally or perversely or otherwise in breach of duty. One reason (see at [186]) was "crucially, [the relevant rule] conferred on Prudential a discretion which was not subject to any express restrictions". This chimes with the approach of Brereton J in *KCA*.

425. Mr Tennet says it is only the start, but not the end, of the enquiry for the employer to show that what he has done or proposes to do falls literally within the scope of the power concerned. But that is also putting matters too high because it may very well be the end as well as the start of the enquiry. It is for the employee to show that the employer is in breach of his *Imperial* duty so the enquiry does not even begin unless and until the employee shows an arguable case that a breach of duty is involved. So although I agree with the principle articulated by Mr Tennet as stated above, it remains for the employee to show that an exercise of the power which, on its face, is compliant with the power gives rise to a breach of the *Imperial* duty. In assessing whether there is in fact a breach, the court will take account of the nature of the power and the absence of any fetters on the power. Indeed, if there are fetters on the power, the task for those alleging a breach of the *Imperial* duty may be harder than if there had been no fetters at all. The presence of fetters may be seen as at least some indication that the power is intended otherwise to be entirely unfettered.

426. **Reasonable Expectations are relevant**. I will be dealing with Reasonable Expectations in more detail separately. I note that they are relevant at this stage of my judgment.

427. **It is not necessary to demonstrate irrational or perverse behaviour**. That is Mr Tennet's position about the test for which Mr Simmonds contends. But he would say that, at the end of the day, it does not matter because

IBM is guilty of irrationality and perversity: its "conduct in relation to its DB pension schemes can fairly be described as both schizophrenic and perverse".

428. Be that as it may, the only relevant test, according to him, is whether the impact of conduct complained of has, objectively, seriously damaged the relationship of trust and confidence. How one describes the conduct is irrelevant. The behaviour of BCCI in the *Malik* case could not be described as irrational or perverse but it nevertheless represented a potential breach of the duty to maintain trust and confidence.

429. At first sight, that looks like a reasonable submission. But on analysis, it actually takes one nowhere. The real question is whether there has been a breach of the *Imperial* duty. The duty is not, however, a statutory duty and one must be very careful about construing the words of a Judge, however eminent, as if they were legislation. But even if one were to take the words "seriously damage the relationship of trust and confidence" as a quasi-statutory reference point, it tells one nothing about how to assess whether the conduct complained of can be seen, objectively, as doing so. Instead, it is necessary to turn to again Judge-made criteria. Mr Tennet is right, no doubt, that it is not universally the case that there has to be irrationality or perversity in an employment law context as a matter of contract. *Malik* may be an example of that. But *Malik* was not concerned with the exercise of a discretion and gives no guidance about how the exercise of a discretion by an employer is constrained. Again, I suggest that *Clarke v Nomura* provides a more reliable touchstone than a case such as *Malik*.

430. Mr Tennet has referred to various paragraphs of the judgment in *Prudential* where Newey J referred to conduct which was "irrational or perverse or otherwise in breach of the obligations of good faith". Mr Tennet relies on those references to "otherwise in breach….." to support a submission that Newey J was not adopting irrationality or perversity as the test but only as examples of the wider, proper, test for which he contends. I addressed this point, but did not need to decide it, in the second rectification judgment at [19]. There are several paragraphs in Newey J's judgment where such a reference occurs: [161], [162], [163], [164], [169], [176], [178], [183], [185] and [187]. In each case, Newey J was expressing a conclusion that Prudential had not breached its *Imperial* duty.

431. Mr Tennet submits that Newey J's focus earlier in his judgment on irrational or perverse behaviour stemmed from the fact that he had already concluded that employees had no reasonable expectation engendered by the employer that the employer would continue to pay discretionary increases at RPI in future. So all that remained to be considered was whether the discretion could be said to have been genuinely exercised at all. He relies on the reference in [143] (see paragraph 361 above) to "a genuine and rational, as opposed to an empty or irrational, exercise of discretion". And so, he says, Newey J was plainly not suggesting that irrationality or perversity was the only relevant test for whether there had been a breach of the *Imperial* duty.

432. He also relies on [146], where Newey J said this:

> "146. My own view is that members' interests and expectations may be of relevance when considering whether an employer has acted irrationally or perversely. There could potentially be cases in which, say, a decision to override expectations which an employer had engendered would be irrational or perverse. On the other hand, it is important to remember that powers such as that at issue in the present case are not fiduciary. As a result, the donee of the power is, as Mr Tennet pointed out, entitled to have regard to his own interests when making decisions (see paragraphs 121 and 124 above). That fact must limit severely the circumstances in which a decision could be said to be irrational or perverse."

433. There is reference in [124] to the decisions of Robert Walker J and the House of Lords in the *National Grid* case. Robert Walker J had stated that an employer was not prevented from looking after its own interests even where they conflicted with those of members and pensioners. Lord Hoffmann observed that the members had accepted, by the time that the case got to the House of Lords, that Robert Walker J had been right to take the view that the employer was "entitled to act in his own interests provided that he had regard to the reasonable expectations of the members": see [2001] 1 WLR 864 at [11]. I do not know the source of Lord Hoffmann's identification of Robert Walker J's view: so far as I can see, Robert Walker J did not anywhere in his judgment

add that proviso to his description of what an employer could do. It may well be that the members accepted the proposition stated in the judgment (that an employer was entitled to act in his own interests) but only if the proviso were added, but that is a different matter. It would be uncontroversial, I think, to add a slightly different proviso to the effect that an employer could not justify acting in breach of his *Imperial* duty simply by asserting that it was acting in its own financial interests. But that does not assist in judging how far an employer may go in furthering its own financial or other interests before a breach of the *Imperial* duty occurs. In any case, the obligation stated by Lord Hoffmann is only to have regard to the reasonable expectations of members: those expectations were not seen as overriding so it remains for the employer to exercise its discretion.

434. Mr Tennet's reading of [146] of *Prudential* is that Newey J did not decide that members' expectations (even mere expectations) were irrelevant to the question of whether the employer had breached its duty to maintain trust and confidence; on the contrary, that paragraph makes clear that a failure to give effect to reasonable expectations engendered by the employer itself could amount to a breach of the duty to maintain trust and confidence. He levels the "gentlest of criticisms" at the use of the words "irrational or perverse" in the extract quoted as shorthand for conduct destructive of the relationship of trust and confidence, which is the actual legal test. He says that the use of the shorthand is, however, explicable on the basis of the facts of the case and makes complete sense if references to damaging the relationship of trust and confidence were substituted for the references to irrationality and perversity.

435. Well, it is often true that if one rewrites what a judge actually says, he or she can be seen as supporting the view for which the advocate is contending. I would put the matter the other way round and take Newey J as meaning precisely what he said. If one adopts Mr Tennet's substitution, one is thrown straight back to the questions of how you identify conduct which is destructive of trust and confidence and what is the test to apply. It is not that Newey J was using irrationality and perversity as a shorthand, he was using them as the test. It seems to me that [146] actually supports the conclusion that, whilst the overriding of expectations which an employer has engendered is capable of giving rise to a breach of the *Imperial* duty, the test for deciding whether it actually does so is irrationality or perversity in the sense explained at paragraphs 443*ff* below.

436. Mr Tennet submits that it appears from [185] that Newey J also accepted that members' expectations (even apparently mere expectations) were relevant to the decision making process and to whether a breach of the duty to maintain trust and confidence had occurred. That paragraph includes the following:

> "185. The question remains whether the 'very strong expectations of members' made Prudential's decision irrational or perverse or otherwise in breach of the obligation of good faith. I do not think they did. My reasons include these. First, and crucially, rule 7.3 of the current Rules (and its predecessors) conferred on Prudential a discretion which was not subject to any express restrictions. ….. Thirdly, whilst there was an expectation among members that pensions increases would be granted, there was also an appreciation that Prudential had not guaranteed or committed itself to increases…..Lastly, there had been changes in circumstances: in particular, investment returns had declined, longevity had increased, and the Scheme's solvency had deteriorated."

437. The "very strong expectations" were those asserted in Mr Rowley's words as "generated by [Prudential's] long-standing policy, paying only lip-service to a policy dating back more than two decades".

438. I agree with Mr Tennet that [146] and [185] show that Newey J did not reject interests and expectations (in particular Reasonable Expectations and perhaps even mere expectations) as being of potential relevance to the question whether conduct by an employer breaches his *Imperial* duty. Everything must be weighed in the balance. But he clearly saw that relevance as going to the question whether the employer's actions leading to the disappointment of expectations were irrational or perverse or at least something akin to that; that is what the balance is weighing. So while Mr Tennet may be right to say that Newey J held that the employees had no expectation engendered by the employer, all that follows from that is that irrationality or perversity could not be established on the basis of Reasonable Expectations being disappointed.

439. In my view, Newey J cannot have been intending to add to the content of the test of irrationality or perversity by

using the sweep-up words "or otherwise in breach of the obligations…". The use of those words is apposite to cover two matters.

i) First, it covers the sort of conduct which, under established case law, could give rise to a breach of duty. An example of that might be the exercise of a discretionary power by an employer which has failed to take into account material considerations which were known, or at least ought to have been known, to the employer or who had taken into account improper considerations.

ii) Secondly it covers any suggestion that other concepts (perhaps capriciousness is an example) do not comfortably sit within the literal meaning of the words "irrationality" or "perversity" but are concepts having essentially the same content. If Newey J had intended the words relied on by Mr Tennet to cover some distinct concept, he would have had to identify it in order to know that Prudential's conduct did not fall within the concept, otherwise he would have been unable to reach his conclusion that there had been no breach of the *Imperial* duty. And that is so quite independently of Mr Tennet's point that Newey J had decided that no Reasonable Expectations had been established. His judgment contains a full review of the cases and a masterly exegesis of the principles. I cannot think that he would have omitted to refer to some other test if he had thought there was one nor that he would have expressed a conclusion about some other test (*ie* that it was not breached) without identifying it. Indeed, had he thought that it were possible to breach the *Imperial* duty in relation to expectations (whether Reasonable Expectations or any other expectations) in the absence of irrationality or perversity or something very like it, I feel sure he would either have expressed a view or stated that he was not deciding the point.

440. It follows from this analysis that I consider Mr Simmonds to be correct, up to a point, in his submission that the employment law cases do not provide the answer to the scope of the *Imperial* duty. I say up to a point because his submission as I understand it is, essentially, that they provide no useful guidance at all. If that is his submission, it goes too far. In particular, I do not consider that this particular submission justifies a conclusion that expectations engendered by an employer are necessarily irrelevant to the test for the scope of the *Imperial* duty.

441. Moreover, given that Burton J in *Clark v Nomura* was equating the test which he described as irrationality or perversity with the test applied in granting judicial review, as he put it "that no reasonable employer would have exercised his discretion in this way", it seems to me that breach of expectations is, at root, an aspect of irrationality or perversity. In other words, if expectations have been engendered by an employer, that may have been done in such a way that to disappoint those expectations would, absent some special change in circumstances, involve the employer acting in a way that no reasonable employer would act; in which case, irrationality or perversity, as those concepts are to be understood in this context, is established. To that extent, reasonableness does come into the picture. But this is not to bring in, by the back door, the test of fairness rejected in *Imperial* and cases following it since there is no question of choosing one person's (the employer's) idea of fairness rather than another person's (the employee's) idea of fairness. Rather, it is an objective assessment of where the range of reasonable perceptions reaches its limits.

442. Although one must heed Lord Hoffmann's warning in *O'Neill v Phillips* [1999] 1 WLR 1092 (the well-known case concerning unfair prejudice petitions in a company law context) about importing concepts from one area of law to another in an inappropriate way, I do not see any difficulty in using the concepts of irrationality and perversity, as developed in the context of public law, to identify the test for establishing the scope of the *Imperial* duty. That is the sense in which Burton J was using the words in *Clarke v Nomura*. And that is the sense in which Newey J was using the words too. That can best be seen from his reference in [144] to the decision of the Court of Appeal in *Socimer Bank Ltd v Standard Bank Ltd* [2008] EWCA Civ 116, [2008] Bus LR 1304. It is worth repeating part of the citation by Newey J from the judgment of Rix LJ:

> "It is plain from these authorities that a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The concern is that the discretion should not be abused. Reasonableness and unreasonableness are also concepts deployed in

this context, but only in a sense analogous to *Wednesbury* unreasonableness.... Laws LJ in the course of argument put the matter accurately, if I may respectfully agree, when he said that pursuant to the *Wednesbury* rationality test, the decision remains that of the decision-maker, whereas on entirely objective criteria of reasonableness the decision-maker becomes the court itself."

443. That passage is instructive because it shows that honesty, good faith and genuineness, on the one hand, and arbitrariness, capriciousness, perversity and irrationality are two sides of the same coin in the context of employer/employee (and I would say employer/member) relationships. Adopting the approach of Burton J (the "no reasonable employer" approach) to irrationality and perversity, an absence of good faith as properly understood can be seen to be the presence of irrationality or perversity in this sense since an employer could not, in good faith, act in a way in which no reasonable employer would act.

444. In my judgement, the test of irrationality or perversity in the sense in which I have described it is the correct test to apply in relation to the scope of the *Imperial* duty so far as that duty is relevant to the exercise of a discretion by an employer under a pension scheme.

445. But lest there be any misunderstanding about what follows from my conclusion, this does not mean that Reasonable Expectations have no part to play. Not only must they be brought into the balance, they may, on the facts of a particular case, be critical in the sense that conduct which disappoints such Reasonable Expectations will amount to a breach of the *Imperial* duty.

446. It is an uncontroversial proposition that an employer is able to take account of his own financial interests in deciding how to exercise the powers vested in him without thereby putting himself in breach of his *Imperial* duty. Browne-Wilkinson V-C himself acknowledged that in *Imperial*. It is straightforward to accommodate that proposition if the test is as I have identified it: it could in some circumstances be irrational or perverse for the employer to give precedence to its own financial interests rather than to the Reasonable Expectations of members although in other cases (*eg* radically changed financial and economic conditions) it may be entirely reasonable, on any view, to depart from those Expectations. It is not so easy to accommodate the proposition within any other test since whatever the test is, it has to be stated in terms by reference to which the employer may, or may not, properly give precedence to his own financial interests rather than the Reasonable Expectations of members. Indeed, it becomes something of an artificial exercise to attempt to identify such a test: the question whether expectations are Reasonable Expectations or mere expectations must be intimately tied up with what constraints can be objectively established on the extent to which the employer is entitled to take into account his own financial interests. These considerations support, in my view, the conclusion which I have reached about the test to apply and the rejection of Mr Tennet's two-pronged approach to the *Imperial* duty.

Whose duty? And to whom?

447. The *Imperial* duty is expressed as a duty on the employer. There has been more than a hint in some of the submissions which have been made on behalf of IBM that Holdings cannot have been in breach of its *Imperial* duty since its management acted at all times in entirely good faith and rationally. Many of the criticisms of IBM as a whole are made in relation to what are alleged to be misleading financial statements and lack of relevant information. These, even if justified (it being IBM's case, of course, that they are not) are to be laid at the door of the team at CHQ and not at the door of Holdings or its management. The conclusion which IBM draws is that there can have been no breach of duty on the part of Holdings since it cannot sensibly be said that Holdings' decisions, in the light of its own knowledge, could be seen by the members as amounting to conduct which would destroy or seriously damage the relationship of trust and confidence between them.

448. It is more appropriate to deal with this aspect of the case in my discussion of Project Waltz rather than to address it as a point of law to be applied to the facts of the case. But, jumping ahead, I should say that I do not consider that there is anything in the point. For reasons which I will come to, I do not consider that Holdings can shelter behind a business case (if justification is needed at all) based on the need to meet targets imposed by CHQ unless, in turn, a business case can be demonstrated justifying the imposition of the targets. So although the *Imperial* duty is owed only by Holdings, the requirements of CHQ can nonetheless result in Holdings being in

breach of its own *Imperial* duty and it is not necessarily a defence to say that the changes were justified because of targets imposed by CHQ.

449. As to the question, to whom is the *Imperial* duty owed? it is right to note that the authorities have all dealt with a duty owed to the members and beneficiaries of a scheme; and insofar as the cases deal with expectations at all, they deal with statements and conduct which act directly on the members concerned. In the present case, however, some of the statements and presentations on which the RBs rely were made not to the members (or any class of the members) but to the Trustee. Those statements and presentations were, in turn, relied on by the Trustee in making its decision to agree to the amendments required to give effect to Ocean and Soto. More importantly for present purposes, much of the content of those statements and presentations was communicated to the employees: to the extent that content gave rise to Reasonable Expectations, they are, in my judgement, to be attributed to Holdings just as much as statements made directly on behalf of Holdings, for instance in the Webcast and in roadshows. I can see no relevant difference in principle in the context of the engendering of expectation between statements made directly to the members and statements made directly only to the Trustee but which were then communicated by the Trustee to the members with the knowledge and approval of CHQ.

Reasonable Expectations

450. It is convenient, at this stage, having identified the test, to say something more about Reasonable Expectations.

451. Although Mr Tennet suggests that it is self-evident that failing to act in a way that you have led people to believe you will act is going to be destructive of their trust and confidence in you, he recognises the difference between a Reasonable Expectation and a mere expectation as explained already. His case is that an employer's failure to act consistently with Reasonable Expectations which the employer himself has engendered, in relation to a matter as central to the employment relationship as pension provision, is a paradigm example of a situation that is likely to impact on the relationship of trust and confidence. This is particularly so in the circumstances in which employees are relying on the employer to guide and inform their decision making in relation to future pension arrangements as in the present case. Dishonesty or recklessness is not needed to establish breach of the *Imperial* duty in relation to statements made; there is no reason in principle why trust and confidence cannot be undermined by making a false or misleading statement without reasonable cause or negligently.

452. He relies on the decision of the Court of Appeal in *French v Barclays Bank* [1998] IRLR 646. In that case, Mr French had been asked by his employer, the bank, to relocate and had accepted an interest-free "bridging loan" to enable him to move before his old house could be sold. After 6 months (and at a point where he could not sell his old house save at a substantial loss) the bank sought to charge interest. It was held that the attempt to require interest to be paid while Mr French was genuinely attempting to market his former home was a breach of the loan contract. But quite apart from this, it decided that the attempt to withdraw the interest free loan and charge interest was a breach of the bank's duty to maintain trust and confidence under Mr French's contract of employment. This was because of Mr French's expectations as to the nature of the loan transaction in the context of the bank's relocation request. Waller LJ said this at [46]:

> "Furthermore, as it seems to me, that letter was also a breach of Mr French's terms of employment. Anything more calculated to destroy the trust and confidence as between Mr French and the bank is hard to imagine. He had been asked to move. A bridging loan interest-free had been sanctioned to enable him to do so. His expectation would be that the bank would not wish him to suffer financial loss by virtue of the relocation. Now he is being asked to take £40,000 less than the agreed valuation on which he had based the borrowing for and purchase of his new house, or pay interest on his bridging loan which on his salary at the bank he could not begin to pay."

453. That was an application of established principle to a particular set of facts. It seems to me that it would pass the test (in the sense of giving rise to liability) of irrationality or perversity. I find it of no assistance in the present context other than to go this far with Mr Tennet: conduct on the part of an employer which is contrary to a Reasonable Expectation is, in principle, capable of giving rise to a breach of the *Imperial* duty on the basis that the conduct is irrational or perverse. I will be returning to this case later, since Mr Simmonds says that it actually

helps him.

454. The way in which Mr Tennet articulates the difference between a mere expectation and a Reasonable Expectation is explained in paragraph 386 (iv) above. In essence, a Reasonable Expectation is an expectation as to what will happen in the future engendered by the employer's own actions which gives employees a positive reason to believe that things will take a certain course. A "mere expectation" is one which an employee may have in fact as to the future, in the sense that they anticipate, assume or expect that something will happen in the ordinary course of events.

455. Mr Simmonds attaches a great deal of importance to the distinction which, to use his different language, is:

> "a fundamental distinction……between, on the one hand, an expectation engendered by words or conduct amounting to a representation as to current intentions, wishes, hopes or expectations; and, on the other hand, an expectation engendered by a representation that amounts to a promise, commitment or guarantee as to future conduct or future events."

456. There is some underlying commonality in the way Mr Tennet and Mr Simmonds articulate the distinctions which they draw. But the two distinctions are not identical. Mr Simmonds is concerned only with expectations engendered by conduct on the part of the employer: the distinction is between (i) an expectation engendered by a representation as to intention and (ii) an expectation engendered by a representation amounting to a promise, commitment or guarantee as to future conduct or events. He takes it as a given that an expectation which is not engendered by the employer – what Mr Tennet has called a mere expectation – is irrelevant in the context of the *Imperial* duty. Mr Tennet's distinction is between an expectation engendered by the employer (the Reasonable Expectation) and one which is not (the mere expectation). For him, Mr Simmonds' distinction appears to be no distinction at all.

457. Clearly, there is no inconsistency between the two distinctions: it is simply that they cover different ground. In my view, they are both relevant distinctions. The distinction drawn by Mr Tennet is not a particularly interesting distinction in the present context because it cannot be seriously contended that a mere expectation by itself can be the foundation on which a case alleging breach of the *Imperial* duty is built. It is only once there is some expectation which has been engendered by the employer that the question of breach of the *Imperial* duty arising out of expectation can arise (always excepting the truly exceptional case, an example of which is difficult to construct). The distinction drawn by Mr Simmonds then becomes important. If, on the facts of a particular case, the evidence establishes that the employer has made a representation only about his current intention, then, assuming that the employer was being honest about its intentions, the most that the members could expect (applying an objective assessment of what it would be reasonable to expect) would be that the employer would not change his intention without some rational ground for doing so. Or, to put it in terms of the test which I have concluded should apply, the members could succeed in a challenge only if it would be irrational or perverse of the employer to change its intention in the sense that no reasonable employer would do so.

458. But if the representation goes further than that, the members may be entitled to expect more. Whether the employer's subsequent conduct, or proposed conduct, would be irrational or perverse in the context of the representation which engendered the expectation concerned, will then be heavily fact-dependent. It does not necessarily follow, however, that absent a statement or course of conduct expressing a commitment, promise or guarantee, there can be no breach of the *Imperial* duty. That conclusion is, however, one which Mr Simmonds urges on me. He contends that the distinction which he draws is fundamental for two reasons:

i) the nature and scope of the *Imperial* duty, a private-law duty, said to arise by reason of the making of statements or representations, must cohere generally with private-law concepts relating to the liability that attaches to makers of statements or representations (*ie* in contract or in estoppel), where the distinction which he draws is key. The application of the *Imperial* duty must not be allowed to undermine the general law relating to liability for statements and should not be exploited as a backdoor route for imposing liabilities on employers where there would, under the general law, be no such liability. He submits that, particularly in relation to negligent mis-statements, the scope of the *Imperial* duty is actually narrower than the general law relating to

liability for mis-statements. I note that he accepts that a dishonest statement or a reckless statement, made not caring whether it was true or false, would be capable of giving rise to a breach of the *Imperial* duty; and

ii) it is a distinction that is, or should be, easily understood by the lay employee to whom the statements were made.

459. As to the first of those, he relies on a number of cases:

i) *Courtaulds v Andrew* [1979] IRLR 84: This was a case where the offensive statement made by one party was not only wrong but was known to be wrong when it was made so that the statement could not be said to have been made in good faith.

ii) *French v Barclays Bank* (see paragraph 452 above): Mr Simmonds refers to this case because it is a case of a contractual promise; and there is no case, to his knowledge, in which the *Imperial* duty has been established where the expectations relied on fell short of a promise or guarantee.

iii) *Hagen v ICI Chemicals & Polymers Ltd* [2002] PLR 1: This case concerned the transfer of employment contracts pursuant to TUPE. The claimants alleged that they were only persuaded to agree to the transfer because of certain promises given and representations made to them by the two defendants. They said that the representations were in fact false and that as a consequence they were misled by the two defendants and had suffered loss. A number of misrepresentations were alleged, the only one made out being one relating to pensions. In the course of his judgment, the Judge (Elias J) accepted the submission on behalf of the employers that, although it is in principle possible for even negligent conduct to constitute a breach of the implied duty of good faith, it would have to be a rare case, coming close to recklessness, before that term could be engaged. He went on to say that the negligent conduct relied on would have to demonstrate a real and unacceptable disregard for the interests of the employee before the implied term could successfully be invoked. It would have to be the kind of conduct that would justify the employee treating it as a repudiatory breach. It will be very difficult in practice to establish breach of the implied term where the conduct relied upon is merely negligent.

iv) *Gibb v Maidstone & Tunbridge Wells NHS Trust* [2010] IRLR 786 (CA): The case is about a compromise agreement put together between a health authority and its chief executive when there was a scandal about superbugs. It turned out that the agreement that the local authority entered into with its chief executive for compensation when she left her post was *ultra vires*, and her claim was based on the fact that she had been assured that it was a properly constituted and binding agreement. I do not propose to go into the facts further. The judge held that the mere entering into of an *ultra vires* agreement in the mistaken belief on both sides that it was valid could not amount to a breach of the implied duty of good faith. However, the Judge held that the representations made on behalf of the health authority to the claimant went beyond mere mistaken or careless conduct and that they had been made recklessly in the sense that they could not have been made with any proper confidence that they were truthful and accurate. Such conduct in a matter of such importance was in the view of the Judge "calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee". There was therefore a breach of the implied term of mutual trust and confidence.

460. The first, second and fourth of those cases are examples of factual scenarios where a breach of the duty of good faith was found to exist in a context where there were particular factors - breach of contract, or a statement known to be wrong, or reckless conduct – justifying the conclusion. The third case emphasises the hurdle faced by a claimant relying on negligent statements. The fourth example also suggests that something beyond negligence or carelessness is necessary in order for there to be a breach of the implied duty, otherwise it would not have been necessary for the Judge to consider, and make findings about, recklessness. To that extent they support Mr Simmonds' approach. But it is important, I consider, to emphasise what the Judge, in the fourth case, saw as reckless – namely a statement made without any proper confidence that it is truthful and accurate.

461. Mr Simmonds also referred to the decision in *Eyett v. University of Nottingham (No. 1)* [1999] 2 All ER 437 at 443-444. Hart J there took the approach which Mr Simmonds now urges on me when considering the application of the *Imperial* duty to require employers to notify members of their entitlements under the pension scheme. In the present case, he submits that I should not allow the RBs to rely on the *Imperial* duty to establish a liability

for statements that would not in another context give rise to any liability. *Eyett*, however, was a wholly different scenario from the present case; I have to say that I gain no assistance from that case in the present context of the exercise by an employer of a discretionary power, being concerned as it was with the possible imposition of an obligation on an employer to do something which the contract of employment did not require.

462. In addressing these competing positions, it is important to note that Mr Simmonds' argument is addressed, essentially, at the question whether statements about the future falling short of commitments can give rise to a breach of the *Imperial* duty. The cases on which he relies have nothing to do with future conduct: they are all about representations of fact or of the consequences of choices. I accept the thrust of Mr Simmonds' submission insofar as it relates to representations of that sort. The making of a merely negligent statement which is then acted on is unlikely in the ordinary course to be such as to destroy or substantially damage the relationship of trust and confidence which lies at the root of the *Imperial* duty. If the negligence does not, of itself, give rise to a cause of action, it should not be possible to have recourse to the *Imperial* duty. In contrast, if the statement is reckless, it will quite likely give rise to a breach of the *Imperial* duty and as such be actionable when it has been acted on. The remedy may be monetary compensation or unravelling the actions taken by the employee/member. The appropriate remedy will be heavily fact-dependent.

463. However, that is not an end of the matter. Suppose that a negligent statement is made by an employer and that a member makes important choices in reliance on it. Suppose later that the employer seeks to make detrimental changes to the Plan; and suppose that, had the negligent statement not been made, the member would have made a different choice. Does the member have any claim against the employer based on a breach of the *Imperial* duty when it comes to the making of the further changes? In principle, I do not see why the member should not have a claim although the issue will be heavily fact-dependent depending, for instance, on the precise nature of the representation, on the time at which the member learned of it, on whether he would in fact have made a different choice if there had not been a misrepresentation and on the scope of the new changes. This, however, has nothing to do with expectations, reasonable or otherwise, about what the employer will do in the future; rather, if there is a breach of the *Imperial* duty, it arises from the consideration (in accordance with my view of the appropriate test applicable in relation to the *Imperial* duty) that no reasonable employer would make the changes proposed in the light of the misrepresentation it had previously made.

464. However, quite apart from that, a misrepresentation of fact or consequences such as that which I have referred to might also carry with it a message about the future, and give rise to an expectation in the members concerned (or rather the objective, reasonable, member) that the employer will, or will not, behave in a particular way in the future in relation to the relevant pension scheme. If it does give rise to any such expectation, that is a consequence, to state the obvious, of what the communication says. It does not make any difference to the message conveyed and received by the communication whether it is correct, negligently wrong or dishonestly or recklessly given. In all of these cases, the same Reasonable Expectations, if any, will be engendered.

465. In all of those cases, a question may arise whether a particular course of action subsequently proposed or taken by the employer in relation to the scheme will give rise to a breach of the *Imperial* duty. The answer to that question must take into account all relevant factors. One of the relevant factors may well be that the misrepresentation relied on was not reckless but merely negligent or perhaps even wholly innocent. If it was wholly innocent, the employer may well be able to argue that its proposed course of action is not one which no reasonable employer would take. It would not, however, be right in my judgement to eliminate, *a priori*, the possibility of a breach of duty in such a case.

466. As to the second of the matters raised above (paragraph 458ii), Mr Simmonds suggests that anybody can tell the difference between something that is a promise or a guarantee, and something that is not, something that is an expression of hope. It is true that that distinction is one which, as a matter of principle, is readily understood. But which side of the line a communication falls may, depending on the facts, be capable of hot disputation among lawyers. The distinction does not, in any case, provide an answer to whether there can be a breach of the *Imperial* duty in the context of the exercise of a discretion. It is not possible to rule out "*a priori*" the possibility of an employer engendering such strong expectations, not amounting to promises or guarantees, among the members about how it will exercise a discretion in the future, that to act contrary to those expectations would

seriously breach the relationship of trust and confidence on which the *Imperial* duty is based.

467. Without trespassing at this stage too much into the facts, Mr Simmonds' position is that the evidence establishes only an expression of intention by IBM and not a commitment, promise or guarantee. It is not open for the recipient of the relevant statement to treat the former as if it were the latter. This is more so where, as he says in the present case, the statement of intention is coupled with an express disavowal of any commitment or guarantee. I do not expect that Mr Tennet would dispute the proposition that a statement of intention, if that is all that is established, cannot be treated as a commitment, promise or guarantee. However, he does take a very different view of what the statements made actually amounted to, saying that they go far beyond a mere expression of present intention and give rise to Reasonable Expectations including one to the effect that future accrual of benefits would not be curtailed for a period which had not expired by the time Project Waltz was implemented. If I am right in the legal test which is to be applied, this means that the RBs need to demonstrate that IBM was acting irrationally or perversely in the sense in which those words were used by Burton J in *Clark v Nomura*.

468. Mr Simmonds notes that it is common ground (which I believe is the case) that the alleged representations – that is to say the words and conduct on the part of IBM relied on by Mr Tennet to establish the Reasonable Expectations on which the breach of the *Imperial* duty is founded – are insufficient to give rise to any liability on the part of IBM as a matter of contract law or as the result of some estoppel or some actionable misrepresentation. It is also common ground that the burden of proof lies on the RBs to establish a breach of the *Imperial* duty. Mr Simmonds then throws down this challenge: Explain, he says to Mr Tennet, why a representation or expectation that is insufficient to give rise to a remedy in contract or by reason of an estoppel or as a misrepresentation is nevertheless capable of being elevated into a substantive right enforceable against the employer merely by reason of the application of the *Imperial* duty. The RBs must explain why this is so where the recipient of the statement is an employee of the maker of the statement when it would not be so in circumstances where any other non-employee recipient of a similar statement would have no enforceable rights.

469. One answer given by Mr Tennet is that it is hardly surprising that an employer's breach of a specific duty to maintain trust and confidence is capable of being actionable in situations in which the employee would not have a remedy for negligent mis-statement or breach of contract. There would be no point in implying the duty if it only applied in situations in which there was already a cause of action. Mr Simmonds' riposte to that answer is to say that it is not an answer at all to the question why statements made to employees should be actionable, where they would not be actionable if made to anyone else, by reason of a duty to maintain trust and confidence which plainly would still have a purpose in many other situations even if it did not extend to statements which were otherwise non-actionable.

470. I do not find that riposte at all satisfactory. It is perfectly clear that the *Imperial* duty applies to the exercise by employers of discretionary powers under a pension scheme. Mr Simmonds attempts to deflect Mr Tennet's argument by saying that the *Imperial* duty is not without application <u>even if</u> statements by an employer can only give rise to a liability on the part of an employer when they are actionable as a matter of general law. But if that is right, it is not easy to see why the same could not be said in relation to any other situation in which the *Imperial* duty might be invoked. It would always be possible to rely, in any particular situation under consideration, on the *Imperial* duty having content in a different context and thus to justify, in that particular situation, the conclusion that the members only have the rights which they have apart from the *Imperial* duty; but taking the argument to its logical extreme, there would be no residual category where the *Imperial* duty but no other obligation would arise.

471. Quite apart from that, the answer to Mr Simmonds' challenge is surely that *Imperial Tobacco* itself demonstrates that, in a pensions context and by analogy with employment law, a new obligation <u>is</u> imposed on an employer in the exercise of discretionary powers. The content of that duty is, if I am right in my conclusions, established by reference to the test of irrationality or perversity. If, in a particular case, the facts which establish irrationality or perversity also establish a remedy grounded in contract or estoppel or misrepresentation, so be it. But that is no reason to impose a requirement that there can be a breach of the new duty in the case of expectations engendered by representations only where there is already a remedy under the general law.

472. Mr Simmonds made a point in his written closing submissions about the way in which different beneficiaries under the Plans should be treated. He submitted that it would be quite wrong to use the *Imperial* duty to allow all employees (and former employees) to benefit in the same way from statements made to all of them, without evidence of what those employees knew and of what they understood from these statements. Drawing an analogy with group estoppel cases, he correctly observes that there must be evidence that is sufficient to establish what information would have been received by the general body of members; and if different classes receive different information, they may have different rights (and are customarily separately represented in court proceedings). I perceived in that submission the suggestion that the subjective understanding of members was relevant to establishing a breach of the *Imperial* duty on a member-by-member basis. But that is not Mr Simmonds' case as will appear in a moment.

473. In contrast, Mr Tennet relies on something which Lord Nicholls said in *Malik*. The employer had submitted that unless the employee's confidence is actually undermined, there is no breach. Lord Nicholls said this:

> "The objective standard just mentioned provides the answer to the liquidator's submission that unless the employee's confidence is actually undermined there is no breach. A breach occurs when the proscribed conduct takes place: here, operating a dishonest and corrupt business. Proof of a subjective loss of confidence in the employer is not an essential element of the breach, although the time when the employee learns of the misconduct and his response to it may affect his remedy".

474. And so Mr Tennet submits that the court's task is to ascertain objectively what expectations members would reasonably have been given by IBM's communications in 2004 and 2006. This submission draws no distinction between two matters. The first matter is whether Reasonable Expectations on which a member may rely are established. The second matter, assuming that some Reasonable Expectations are established, is whether IBM's conduct was inconsistent with those Reasonable Expectations and if so whether there was a breach of the *Imperial* duty. The objective standard referred to by Lord Nicholls is, I consider, clearly relevant to the second matter. Whether the conduct of IBM breached the *Imperial* duty must be judged objectively.

475. However, before a member or any other person can assert a breach of duty by IBM, he has to establish a Reasonable Expectation on which he can rely. I accept that, by analogy with the group estoppel cases, a clear representation can be relied on by the membership as a whole and it is not necessary to produce evidence from each and every member affected that the representation was made to him or her. But in such a case, there needs to be, I consider, strong and clear evidence to establish the estoppel – evidence of a clear representation for instance – in relation to the general body of members. This reflects what Lewison J said in *Trustee Solutions Ltd v Duberry* [2007] 1 All ER 308 at [50(ii)]. It is also the case, I think, that where distinct groups can be identified, this principle can apply to each group separately. Thus, where different representations are made to different groups, the evidence needs to be of a clear representation to the general body of members of that group.

476. There remains one further aspect to mention in relation to this aspect of the case. It is whether it is right to apply an objective approach in ascertaining whether there is a Reasonable Expectation in the first place. For an employer to engender an expectation is not a breach of any duty – at least if the expectation is genuinely held by the employer. The communication giving rise to an expectation about future conduct does not – and is not of itself even likely – to damage trust and confidence. It is the subsequent conduct which disappoints that expectation which might give rise to a breach of the *Imperial* duty. Indeed, the very use of the word "expectation" suggests that there is an actual expectation on the part of a member that IBM will conduct itself in a particular way. Thus, if a particular member did not understand IBM's communications as fettering in any way IBM's conduct in the future, it would not be right to conclude that, as a matter of fact, those communications had engendered any expectation – reasonable or otherwise – at all in that member. But suppose that the communications in fact had an objective meaning different from that which he understood to be their meaning and that a "Reasonable Expectation" would have been engendered in the hypothetical reasonable member who understood that objective meaning. Can the member in question then assert that he is able to rely on that objective meaning so as to be treated as having an expectation which he never in fact had?

477. I have reservations about whether he can do so. However, Mr Simmonds does not take this point. He concedes – indeed it suits part of his case positively to assert – that whether Reasonable Expectations are engendered is to be judged objectively. He expressly accepted in response to a question from me that (1) the members can rely on the objective meaning of the relevant communications even if their subjective understanding of them was different and (2) that the answer is the same whether the communications are received by a single member or the whole membership. That is common ground with Mr Tennet.

478. But, having made that concession, Mr Simmonds goes on to submit that I should only confer benefits on the membership as a whole if I find an unequivocal representation: in the absence of such an unequivocal representation, and in the face of the evidence about various different understandings on the part of members (as was shown by the evidence given by the various member witnesses), there is no basis for finding that every member who stands to benefit read or understood a representation in the way in which the RBs contend it should be read and understood. I do not accept that reasoning. If, objectively, a reasonable member would have understood the communications from IBM in a particular sense, it does not assist either side's case to demonstrate that there are members who understood the communications in a different sense (or did not understand them at all). I do, however, accept that an objective reasonable recipient of the communication will take into account the circumstances in which it was given and assess whether words which have an apparent meaning were actually to be taken as some sort of assurance by IBM that certain actions would or would not be taken in the future.

Approach to communications

479. Mr Tennet makes a number of further submissions about the correct approach which the Court should take to the evidence. First, he says that Reasonable Expectations are "to be ascertained in the light of IBM's communications, not narrowly as a process of construction of those communications". He says that the Reasonable Expectations which members would have derived from communications must be determined by assessing those communications:

i) through the eyes or ears of members;

ii) having regard to the limited level of understanding of pensions terminology and structures reasonably to be expected of members;

iii) having regard to the method of communication and how it might reasonably have been used by members (*eg* a webcast or video is designed primarily to be watched and heard once in real time, not transcribed and analysed; and any written document would usually only be read once, not pored over at length searching for inferences to be deduced);

iv) having regard to the order in which communications were received (so that Q&A documents made available after webcasts or direct e-mails fall to be viewed in the light of the prior webcast or e-mail; and documents received months apart would not be read side-by-side as if sent contemporaneously);

v) having regard to the relative weight which members were reasonably entitled to place on different communications and the relative degree of scrutiny or care which members were reasonably entitled to give different communications; and

vi) in the light of the circumstances existing at the time the communications were made (so that, in the present case, the aim of the Ocean and Soto communications was to persuade members to accept the changes proposed and, in the case of Soto, to do so very urgently; the communications were deliberately designed to reassure members about their future pension pay and to secure their acceptance of pension changes).

480. I accept the general thrust of those submissions although their application on the facts is not straightforward. They amount, perhaps, to no more than a list of some of the factors applicable in the present case when I come to apply the general principle that the meaning of documents and statements must be ascertained in the context in which and the purposes of which they were produced or made. I would question, however, the example he

gives in item iii), particularly in relation to the documents; and I would not place much weight on the order of communications on which he relies in item iv). Moreover, how it was reasonable for a member to assimilate and react to the communications must also be viewed in the context of the importance of the subject matter of the communications and the communications themselves. It is obviously correct that pensions are an important part of remuneration. If it is said, as it is by the RBs, that IBM engendered Reasonable Expectations of such importance that to disappoint those Expectations breaches the *Imperial* duty (thus destroying or significantly undermining the relationship of trust and confidence), I would expect members to have given serious consideration to the communications. Indeed, the evidence is that some members at least did give serious attention to the issue as is shown by the attendance and questioning at roadshows.

481. That is not to say that there is to be imputed to the members the sort of understanding which people fully versed in pensions law and terminology might gain from the communications having read documents carefully and having viewed the Webcast several times. As I said in my judgement in the Rectification Action:

> "ordinary members of the C Plan would not come to the November 1983 Handbook with the eyes of a lawyer, balancing one phrase against another. Such persons would, I suggest, be left with the clear impression that there was an unfettered right to retire from age 60, particularly persons who had attended one of the road-shows and had therefore correctly understood that he or she would have such an unfettered right. It is difficult to think that such a person, coming to the November 1983 Handbook, would detect that its provisions relating to the C Plan meant anything different from that which had previously been presented."

482. Mr Simmonds submits that the reasonable employee will read all of the material provided to him in order to inform himself about a particular event, particularly where he is specifically directed to that material as being relevant to that event. Mr Tennet suggests that this is simply an unrealistic assessment. He says that members cannot be expected to read everything, for instance, as he put it, "to wade through all 236 Project Soto Q&As, or all the UK Forum minutes made available on various websites". He points out that Mr Heath, who presided over the Project Ocean and Project Soto communications, accepted this reality: Mr Heath said in his oral evidence that he would expect members to place more importance on the key announcements, and that he knew that not all members would read the Q&A documents.

483. It is common ground that the reasonable employee will read the documents as a whole, and not cherry-pick or take out of context phrases that suit his argument and ignore those that do not, although Mr Tennet contends that the flavour of the communications taken as a whole is clear and is such as to give rise to Reasonable Expectations. It is IBM which, he says, is guilty of cherry-picking and shutting its eyes to the message which any reasonable reader or listener would take home from the communications. I take account of that in my assessment of the evidence and the arguments based on it, as I will do of a number of other related submissions namely:

i) Mr Simmonds: When faced with a message that seeks to provide comfort to the workforce about the future, whilst making it clear that no promises can be made that no changes will occur in the future, the reasonable employee is capable of grasping that message, rather than understanding it as an unqualified commitment as to the future.

> Mr Tennet: the Main presentations were in effect sales pitches designed to emphasise the security and sustainability of the Plans. Although IBM was not guaranteeing anything, members were entitled to take away the clear message that there would be no changes for some time in the future. It would be for IBM to demonstrate a change in the circumstances of the Plans to justify any future change contrary to the expectations which it had engendered.

ii) Mr Simmonds: If there were any doubt as to the meaning of what he had been told in relation to a particular event, the reasonable employee would ask questions of the appropriate persons in order to clarify his understanding.

> Mr Tennet: The position is entirely the reverse and that it was for IBM to make clear what it was

saying. If members heard and read the communications in a way which IBM did not intend, IBM has only itself to blame.

iii) Mr Simmonds: The reasonable employee understands that the role and duty of the management of a company is to run its business to promote the interests of the company's shareholders, and that management must sometimes make unpopular decisions regarding employment costs.

Mr Tennet: This is right, but the employer does not simply have *carte blanche* to depart from what it has led employees to believe. The profit motive is not, of itself, enough to justify disappointment of Reasonable Expectations.

iv) Mr Simmonds: The reasonable employee understands that management cannot predict the future: they are not clairvoyant and, where no guarantees have been given, their freedom to manage the business in the light of changing circumstances cannot be fettered.

Mr Tennet: There is no dispute about the general proposition. But this does not justify a departure from the previous communications where there has been no change of circumstances. In particular (by which I understand him still to be addressing the case in the context of "no change of circumstances"), it does not justify a departure from Reasonable Expectations engendered by communications concerning sustainability if there were no reasonable grounds for believing that sustainability was being achieved by the Ocean changes.

484. There is force in Mr Tennet's submissions concerning what the reasonable member will read or watch and the attention which he will give the material as a matter of practical reality. I am concerned, however, not with what different actual members might have done: one can speculate (with confidence I think) that some members would have not read or viewed anything, that others would have looked at the key documents with varying degrees of attention and that others would have read all the material assiduously. However, in relation to the issue of Reasonable Expectations, it is what the hypothetical reasonable member would have done which is relevant. That member must, it seems to me, be a person who is concerned to inform himself about the content of communications about pensions and the impact on him for the future. He would listen to (perhaps more than once) the Webcast; he would read written communications devoting enough time and attention to form an understanding of them. He would not simply skim though them saying to himself that he had no time understand them properly. Further, even if he thought that he understood the key documents, he would know that there was ancillary material (such as the Q&As). He would give some attention to that ancillary material and, although he may not be expected to read every word, he would devote enough time them to establish whether particular aspects of importance to him had been dealt with.

485. Part of the context in which the communications are to be assessed includes IBM's Business Conduct Guidelines and its Core Values document and in particular:

i) IBM's express commitment under the Business Conduct Guidelines (which had "the weight of a governing document"). Although these were guidelines for employees, it must be the case that certain requirements were mutual. Thus the obligation "Never to make misrepresentations or dishonest statements to anyone" would apply to communications from IBM to employees just as much as from employees to third parties. And the statement "Honesty based on clear communication is integral to ethical behaviour" ought to permeate the relationship between IBM and its employees.

ii) IBM's Core Values, a "shared set of Values" which "helps guide our decisions, actions, and behaviors and is at the core of our collective aspiration to be recognized as a great company". These Core Values clearly, in my view, apply to the mutual relationship between IBM and its employees. Thus IBM manages by its values; and "IBMers value… Trust and personal responsibility in all relationships". So too IBM itself must value trust and the personal responsibility of its staff one to the other.

486. I have no doubt that the guidance and values apply to IBM itself. I agree with Mr Riley who accepted in cross-examination that "IBM's conduct within the employment relationship should be assessed by reference to the

standards IBM itself set for its employees" and "it would be perverse for IBM to require adherence to such conduct guidelines for its employees but not to adhere to those guidelines itself".

487. I am of the view that these express principles are to be taken into account in assessing whether IBM has been in breach of its *Imperial* duty. Mr Simmonds is rather dismissive of any argument which relies on these principles. At the very least, however, they are surely capable, at the margins, of rendering conduct by IBM a breach of its *Imperial* duty when, absent these principles, there would be no breach of duty; and for my part, I attach more weight to them than that.

488. Mr Tennet submits that IBM knew that there was a perception among members, before each of the Soto and Waltz changes were effected, that the Plans would be kept open to future accrual for the longer term and, as I understand his case, that no detrimental changes would be made in the foreseeable future to IBM's early retirement policies. IBM says that that perception was incorrect and, if there was such a perception, it was not engendered by anything which IBM said in its Ocean and Soto communications.

489. Mr Tennet, in contrast, says that it was incumbent on IBM to correct any misapprehension of which it knew, especially since, on the RBs' case, the misapprehension will have arisen from IBM's own communications to members; an employer cannot excuse itself for giving out confusing or misleading messages by requiring the employees on the receiving end of those communications to make further enquiries.

490. I am not sure that he is correct when putting the matter so generally and widely. But what I do think is correct is that if IBM was to comply with the Guidelines and Values, it would be incumbent on it to correct any widely held (or perhaps even not so widely held) misperceptions of which it knew about IBM's intentions in relation to the Plans before implementing Project Ocean or Project Soto. In that way, the membership would be given the opportunity to make informed decisions in relation to the Plans.

491. As I have already recorded, IBM's position is that the evidence of individual members about what they understood the various communications to mean and their understanding about continued accrual of benefits under the Plans is not of relevance: what the Court should be concerned with is the hypothetical reasonable member. Enlarging on that, Mr Simmonds draws what I think is a useful analogy with survey evidence going to the issue of confusion in trademark cases. The "average consumer" is a legal construct. The approach to survey evidence was considered by the the Court of Appeal (in particular in the judgment of Lewison LJ) in *Marks and Spencer plc v Interflora Inc* [2012] EWCA Civ 1501. His approach is reflected in another appeal between the same parties in *Marks and Spencer plc v Interflora Inc* [2013] EWCA Civ 319. More recently, there has been yet further consideration of survey evidence in the context of passing-off: see *Zee Entertainment Enterprises Ltd v Zeebox Ltd* [2014] EWCA 82. In the first *Interflora* appeal, Lewison LJ quoted from earlier judgments of Morritt LJ and Chadwick LJ in *Bach and Bach Remedies Trade Marks* [2000] RPC 513:

> "……the court is unlikely to be assisted by repetitious evidence from individual consumers, put forward by each party as the embodiment of the average consumer. The task for the court is to inform itself, by evidence, of the matters of which a reasonably well informed and reasonably observant and circumspect consumer of the products would know; and then, treating itself as competent to evaluate the effect which those matters would have on the mind of such a person with that knowledge, ask the question: would he say that the words or word identify, for him, the goods as originating from a particular undertaking?"

492. And so Mr Simmonds submits that, in the context of the *Imperial* duty, I am not greatly assisted in determining the response of the reasonable employee by repetitious evidence of the subjective response of individual members when it comes to assessing the impact of what IBM told its employees.

493. Mr Tennet accepts that such evidence cannot be determinative, but submits it provides helpful insight into the content, prevalence and strength of member expectations. I think this is really only a forensically attractive way of saying that the attributes of the reasonable member should reflect what a number of ordinary (and apparently reasonable) members actually understood. Mr Tennet makes three submissions in support of the relevance and helpfulness of member evidence:

i) First, there was plainly a common, widespread and firm understanding that IBM had made a commitment to underpin the sustainability of the UK DB Plans. I think that Mr Tennet puts his case rather too high in the light of all the evidence. The relevance, I suppose, is that it might be said that only a perverse and irrational Judge could disagree with such a large number of people about the message which could be taken away from the various communications. As to that, I will form my own view and, if it is perverse or irrational, no doubt the Court of Appeal will put me right.

ii) Secondly, evidence of what members actually thought helps to inform the Court's assessment of how the generality of members might reasonably have interpreted the communications they received. The message which I take away from Mr Tennet's communication to me is that my experience and (rusty) specialist expertise ill-equips me to assess what the reasonable member might understand. "Evidence of what members actually thought helps" he says "to recalibrate the Court's interpretation to the level of lay members. And if so many members plainly did have such expectations, how, objectively, could they all be unreasonable?" I am not in sympathy with the view that Judges are "out of touch" with ordinary people, but I understand Mr Tennet's point. Certainly, were I to find that the evidence which the members actually gave is inconsistent with the conclusions which I would otherwise reach about the understanding of the reasonable member, it would cause me to pause for thought. But such evidence is not conclusive and, indeed, it needs to be examined critically to see precisely what the witnesses are saying. My review of the evidence of the RB's witnesses shows a marked lack of consistency about what they understood and why they understood what they did.

iii) Thirdly, evidence of the strength of members' expectations serves to explain and inform why IBM's confounding of those expectations, by reneging on the assurances and commitments given, has destroyed or damaged so seriously the members' trust and confidence in IBM as an employer. That is, perhaps, an attractive forensic submission but I am afraid it cuts no ice with me. Even assuming that the communications from IBM gave rise to Reasonable Expectations, it is for the court to assess whether the *Imperial* duty is thereby breached applying objective criteria. There is little, if any, scope here for the "Judge-is-out-of-touch" argument.

NPPC

494. It is necessary to have some understanding of the US accounting requirements in relation to pensions costs. They are complex and to some extent counter-intuitive, at least to someone versed in the approach to pensions costs in the UK. Both of the accountancy experts have included sections in their reports explaining how the rules work, or are meant to work. For the moment, I set out as brief a description as I can to give a very broad picture (which at almost every detailed level I suspect is not entirely accurate). I have drawn heavily on Mr Robbins' report. That is not to say that I consider Mr E Bradley Wilson's description to be any less accurate, but I have found it difficult to attempt to merge their two descriptions without a very great deal of (unnecessary) work. What I say is intended to be, and I hope is, uncontroversial.

495. The accounting "cost" of a DB plan that is recognised in the accounts in each year is a calculated accounting figure, designed to accrue the cost of employee pensions payable over the approximate service life of employees (*ie* to match the cost to the related service), based on an actuarial estimate of the present value of future payments offset by the amount of expected investment returns from pension plan assets (assuming the plan is funded).

496. Under US GAAP, a company is required at each financial year-end, to undertake a valuation of:

i) The assets of its pension plans called the Market-Related Value of Assets ("**MRVA**"); and

ii) the present actuarial value of pension plan liabilities accrued to date, calculated as a single figure and called the Projected Benefit Obligation ("**PBO**"). The PBO is thus a discounted value of the liabilities to obtain a present value reflecting the fact that the pension payments for which the company's scheme is liable are likely to stretch decades into the future. The PBO is used in a number of situations in the calculation of Net Periodic Pension Cost ("**NPPC**"). It is calculated in a conceptually similar way to the valuation of liabilities under a plan for UK funding purposes: assumptions are made as to the amount which will be paid to members, at what time

and for how long. The assumed benefits are then discounted using an assumed discount rate.

iii) A company is also required to determine the NPPC in respect of its pension plans. This is the annual accounting expense or income that a company must recognise in its Income & Expenditure ("**I&E**") statement otherwise known as the Profit and Loss ("**P&L**") account. In IBM, this went under the description "Consolidated Statement of Earnings".

497. Prior to the Financial Accounting Standard, FAS 158, the accrued or prepaid pension cost that was incorporated into a company's balance sheet was equal to the accumulated difference between past NPPCs and past employer contributions (*ie* total employer contributions paid, rather than the fund value of the plan). A **prepaid pension cost** (a balance sheet asset) arose when the total past plan contributions exceeded the past NPPCs. An **accrued pension cost** (a balance sheet liability) arose when the past NPPCs exceeded the total past plan contributions.

498. There may have been additional amounts that the company was required to reflect on its balance sheet in certain circumstances. These additional amounts did not affect the company's current or future I&E statements.

499. Effective for listed companies as of fiscal years ending after 15 December 2006, FAS 158 requires companies to recognise on the balance sheet the **funded status** of their plans (*ie* the excess or shortfall of the plan's assets over the PBO).

Attribution and smoothing

500. There are two themes of US GAAP pensions accounting that are relevant to the present case: attribution and smoothing.

i) The **attribution** feature of US GAAP means that costs are typically allocated over the entire period of relevant employees' service.

ii) The **smoothing** feature of US GAAP means that significant changes in the assets or liabilities are recognised gradually in certain accounting figures. This feature reduces the volatility of these accounting figures.

Calculation of the NPPC

501. The NPPC is made up of the following principal components:

i) Service Cost;

ii) Interest Cost;

iii) Expected Return on Assets;

iv) Amortisation of Unrecognised Prior Service Costs; and

v) Recognised Actuarial Gains and Losses.

502. The **Service Cost** is the actuarial present value of benefits earned by plan members for their service over the accounting period. This value is calculated based on several assumptions. The most significant assumptions are for the discount rate, salary increases, pension increases after retirement and mortality rates. The discount rate used for the calculation is the corporate bond rate used for the calculation of the PBO.

503. The **Interest Cost** is the increase in the PBO due to the passage of time. The conceptual basis for the figure is that it represents the increase in the actuarial value of the benefits under the plan as a result of the benefits being one year closer to payment. As the payment of liabilities becomes closer, there are fewer remaining years of discounting, resulting in an increase in the present value of the liabilities. The interest cost over a year is calculated by the discount rate at the start of the year multiplied by the PBO. This can be described as the unwinding of the discount in PBO. There are three points to make in relation to PBO:

i) A reduction in pensionable salary where future pensionable salary increases are less than the applicable salary increase assumption will lead to a reduction in the PBO, as well as a reduction in Service Cost. This is because the reduction affects projected salary for active members and therefore the value of past benefits. As we will see, this was one of the effects of Project Soto, since salary increases for the members who remained as part of the Plans were predictably less than the salary increase assumption.

ii) Each year, Service Cost (*ie* costs of accrued benefits) and Interest Cost (*ie* the reduction in the degree of discounting applied to the PBO) are added to the PBO as well as being reported as expenses in the I&E account of the company. Again, as we will see, in Project Waltz, cessation of accrual meant that (notwithstanding that PBO would increase after Project Waltz as a result of addition of Interest Cost) the figure for PBO is less than it would have been had Service Cost continued to be added to the PBO.

iii) The discount rate applied to the calculation of PBO in the present case in respect of the Plans was not gilts based but was based on the actual yield of a portfolio of high quality UK corporate bonds. This means that a portfolio matching PBO movements would need to be comprised of UK corporate bonds. It also means that changes in corporate bond yields can have significant impact on the value of PBO. When this occurs, increases in the value of PBO are added to the figure for cumulative unrecognised actuarial gains or losses (as to which see below).

504. The **Expected Return on Assets** ("EROA") is a credit component within the NPPC. It is the return that a company would expect on its pension plan's assets over the accounting period. This is the product of the company's expected long-term rate of return on assets ("**the EROA assumption**") and the MRVA, thus the higher the EROA assumption and the higher the MRVA, the higher the credit to NPPC. This component of NPPC is not affected by actual asset returns earned over the year. The conceptual basis for the figure is as a projected annual increase in value from the plans' assets; Therefore it acts as a credit figure (*ie* a cost reduction) in the calculation. Mr Simmonds draws attention to the following points with which I agree:

i) The EROA assumption (the multiplier) is a function of the long-term projected yield of the actual assets of the fund. It is based on the actual asset allocation of the fund. This means that, assuming a plan fund invested in return-seeking assets of equal value to the PBO, the figure for EROA (which is based on return-seeking yields) should always be larger than the figure for Interest Cost (which is based on corporate bond yields) assuming of course that the former are actually assumed to produce a higher return than the latter. It also means that a change in asset allocation will change the figure for EROA (and therefore potentially increase NPPC). An alteration in the Trustee's investment policy for the Plans could therefore potentially lead to a reduction in the EROA assumption and in turn to an increase in NPPC and a reduction in corporate earnings. This would be irrespective of any cash contributions paid to the Plan.

ii) The figure for MRVA is a smoothed value of the assets of the Plans' funds. The mechanics of the way in which this figure was calculated by IBM (along with other companies) meant that actual gains or losses are brought into account gradually over a five-year period (and this applies both for the purposes of calculation of EROA and Recognised Actuarial Gains and Losses: as to which see below). So, one of the reasons why IBM in 2007 was able to predict falling pension costs, on the basis of static ("flat") assumptions, was that it could see that past asset gains were due to feed into the calculation of NPPC over the next few years. Equally, it was foreseeable in 2008/2009 that the losses of 2008 would affect NPPC for some years to come.

iii) Where in any given year there is a difference between the EROA of the Plans' funds and the actual return of the funds, the difference is added over a five year period to the unrecognised actuarial gains and losses figure for possible amortisation. So, if the actual value of the Plan fund falls, there will be two effects: the MRVA for the next year will be reduced as a result of some of the actual asset fall being recognised in the MRVA, but also, importantly, the difference between the yield on an EROA and the actual yield would over time be added to the actuarial losses to be amortised.

505. The **Amortisation of Unrecognised Prior Service Costs** is the cost to be recognised in a particular accounting

period in respect of Prior Service Costs. Prior Service Costs (or credits) occur when plan amendments are made which result in an increase (or reduction) in benefits already accrued in respect of service rendered before the plan amendment. In general, FAS 87 permits the cost to be amortised over the future working lifetime of the plan members affected by the amendment. (This is an example of the attribution feature discussed above.) In the case of the Project Soto changes, the benefits were initially amortised for the period after Project Soto, but the cessation of accrual in the Plans as a result of Project Waltz meant that most of the PBO credit had to be recognised in a single year. This is the "curtailment gain" referred to below.

506. **Recognised Actuarial Gains/Losses** are the gains/losses recognised in a particular accounting period. This is an important concept in the context of the volatility of NPPC relevant to the present case. Actuarial gains/losses experienced by a pension plan can fall into two categories:

    i) **Asset gains and losses** arise as a result of differences between the actual return on assets and the expected return on assets.

    ii) **Liability gains and losses** arise as a result of changes in the assumptions used to determine the liability value, and from changes in the value of the liabilities due to actual experience differing to that assumed.

    iii) If changes in assumptions lead to a reduction in the value of liabilities, there would be a liability gain (*ie* a reduction in the PBO) for the year.

    iv) Differences between the assumptions and the plan's actual experience over the year will also lead to gains or losses on the liabilities. For example, if pensioner mortality rates experienced are lower than expected, this would lead to a loss on the liabilities (*ie* an increase in the PBO), as a greater number of pensioners than expected would have survived to continue to receive pensions.

    v) Gains and losses on both assets and liabilities can be significant, depending on market conditions and experience in any particular year.

507. Mr Simmonds adds the following comments with which I agree. The accounts for the Plans show a running tally of unrecognised actuarial losses and gains. The phrase "actuarial gains and losses" is correct but misleading: the tally is not confined to changes in actuarial assumptions but includes what are in practice real world changes (such as falls in the Plans' assets), as measured against the way they have been recognised for the purposes of the calculation. For the purposes of this case, the most significant additions to the tally are: falls and gains in the value of the Plans' funds; increases in PBO due to movements in the corporate bond market (and therefore the applicable discount rate) and any changes to actuarial assumptions (*eg* potential changes in longevity assumptions or similar). Where the running tally exceeds 10% of the greater of PBO or MRVA (known as "the corridor"), the quantum of the tally in excess of the corridor is amortised and recognised in the accounts. The relevant amortisation period is *prima facie* the average future working lifetimes of the active members of the plan.

508. There is an asymmetry between the way in which changes in PBO and asset movements are recognised in the figure to be amortised: changes in PBO (*eg* as a result of movements in corporate bond yields or actuarial assumptions) are added to the figure which is amortised immediately; whereas changes in asset value feed into the figure which is amortised over time. I agree with Mr Simmonds when he says that including this is one of the reasons why even investment in a portfolio which tracked the discount rate for PBO exactly (*ie* a UK corporate bond portfolio) would not eradicate (or even massively reduce) NPPC volatility.

509. Mr E Bradley Wilson separately categorised **Curtailment gains or losses** which are recognised decreases or increases in employee benefits accrued due to closure of the plan to future accrual. A Curtailment gain (or loss) is an occasional component of NPPC, affecting the I&E as a result of a curtailment effected by the company. Both a curtailment and a plan amendment can have the effect of reducing employee benefits for future service. The distinction is that a plan amendment (leading to a Prior Service Credit) arises from a reduction in benefits for future service, while a curtailment (leading to a Curtailment gain or loss) arises from a reduction of number of years of future service. Both a Curtailment gain (or loss) and a Prior service credit arise from some sort of

event often instigated by the company, such as plan closure or a plan amendment, and in this way are distinguished from the regular fluctuations in estimates and assumptions affecting the calculation of PBO, such as the rate of salary increase, or staff turnover, which are dealt with as Actuarial gains and losses.

510. US GAAP permits companies to recognise immediately only a portion of these gains and losses through the NPPC. (This is an example of the smoothing feature discussed above.) Any unrecognised gains or losses are carried forward to future years, and augmented with any new gains or losses that arise, in order to determine the amount to recognise in NPPC in future years. There are various options available for amortising gains and losses. The above components are aggregated and reported as a single net amount, the NPPC, in the I&E statement in the company's financial statements.

511. In any year, to the extent that expected return on assets, any prior service credits and recognised gains exceed service cost, interest cost, any prior service costs and recognised losses, there will be an I&E credit in relation to pensions.

512. Conversely, to the extent that service cost, interest cost, any prior service costs and recognised losses exceed expected return on assets, any prior service credits and recognised gains, there will be an I&E cost in relation to pensions.

Options available under US GAAP

513. Under US GAAP, companies have flexibility in applying the above principles in a number of areas. The three principal areas of flexibility are:

i) the actuarial assumptions used to value the PBO and NPPC components;

ii) the MRVA approach; and

iii) the method used to amortise gains and losses and any prior service costs/credits.

514. It is not necessary to go into any of those at this stage.

515. NPPC has featured large in the present action because, on the RBs' case, IBM's agenda was driven by a need to minimise the figure for NPPC in order to produce a particular level of earnings per share ("**EPS**"). It is that allegation which forms a main plank of the case.

516. There is no difference between the parties' accountancy experts as to how NPPC works. However, the RBs make several references to a comparison between service cost and NPPC. Their proposition is that NPPC might be expected to be at least as much as service cost over a period. I do not accept that proposition. Instead I accept Mr Simmonds' analysis in the light of the expert evidence. It is in essence as follows, although more detail can be found in paragraph 290 of his written closing submissions and the footnote references. He contends that the relationship between serice cost and NPPC depends on the relationship between the expected EROA (deriving from the scheme's asset allocation) and the proportion which service cost bears to the PBO of the scheme.

i) If the EROA assumption is larger than the discount rate, and the PBO is comparable to the Plan assets, the difference between the Expected Return on Assets line and the Interest Cost line in the NPPC calculation will produce a profit.

ii) Whether or not this profit is greater than the Service Cost will depend: (a) on the size of the Service Cost as a percentage of PBO (in the case of the Main Plan between 1% and 1.4%); and (b) the difference between the discount rate (*ie* the yield on AA corporate bonds) and the EROA assumption (*ie* the long-term projected yield of the fund based on its asset allocation).

iii) In practice, the size of this difference will be driven by the prevailing equity risk premium from time to time and the asset allocation of the fund. Mr Clare assesses an appropriate difference between the discount rate

assumption and equity yields as 2.7% for the purposes of Mr Robbins's modelling (this is 7.2% equity yield less 4.5% corporate bond yield: see paragraph 6.48 of Mr Clare's reply report). The appropriate difference between bond yields and equity yields may clearly vary from time to time and the translation of this difference into an EROA assumption for the whole fund will depend on the fund asset allocation. However, although there are a number of variables in the calculation, the simple arithmetic of the process dictates that a well-funded fund which carries a substantial holding of equities will tend to produce a substantial income before deduction of service cost. If the fund is mature, the cost may not make a significant dent in that income (and if the fund is closed, it will make no dent).

517. Mr Simmonds concludes from the above that, in truth, any statement as to whether or not a scheme might be expected to produce an income for NPPC purposes is a statement about the relationship between the scheme asset allocation (*ie* the EROA assumption) and the maturity of the scheme (the quantum of service cost). In this case, as the actuarial experts accept, there was a mismatch between liabilities and asset allocation, which was nevertheless within the spectrum for UK funds. In those circumstances, any statement that "you might expect NPPC to be at least equal to service cost" or "service cost was a bargain" or the various statements of that nature made on behalf of the RBs should properly be viewed as unfounded assertions masquerading as common sense. Whether it is right, as Mr Simmonds suggests, that to the contrary you would 'expect' a mature scheme invested with this mismatch to produce an NPPC profit, I do not need to decide. But what I do conclude is that the arguments raised by the RBs based on the proposition that NPPC cost can be expected to equal or exceed service cost over a period are unsound. The argument that NPPC should only become a problem for Holdings if it were consistently greater than its share of service cost does not address the relationship discussed in the preceding paragraph.

Volatility

518. "Volatility" is a word which has featured a great deal in this litigation. It is, unfortunately, not always clear in what sense it is being used. That is even more so the case in relation to its use from time to time in various contexts – by CHQ and in its communications, by the Trustee and the UK team and in their communications with members. The word itself is not difficult to understand: it means, for present purposes, being likely to change suddenly and unexpectedly or unpredictably. The lack of clarity in the present case comes not from the word itself but from what it is being applied to. There are at least three different relevant aspects to which it has been applied. First, to the value of scheme assets and the amount of scheme liabilities; secondly to the gap between that value and that amount (sometimes referred to as "breadth of variance volatility"); and thirdly to NPPC. The second, the deficit, was a matter of concern to the Trustee. Volatility of that sort could, to some extent at least, be managed by appropriate investment policies and in particular matching (although in the real world, 100% matching is impossible). The third was the matter of greatest concern to CHQ because of the impact NPPC would have on EPS.

519. There is nothing to suggest that the meaning of volatility in any sense was ever explained to members. I can make no assumption at all about what the reasonable member would have understood by volatility, although it seems highly improbable that he would have had any inkling about NPPC volatility, something which, speaking for myself, I had no understanding of before this case began. However, by the time of Project Soto (or at least during the course of it) the members of the Trustee board and of the UK team would have gained an understanding of NPPC volatility and that CHQ's concerns related to NPPC volatility.

520. One finds the use of the word volatility being used in relation to economic forces outside IBM's control in which context the meaning of the word is tolerably clear. But that is not the sense in which volatility (of a type capable of being brought under some sort of control) is being used. As used within CHQ and in the communications between CHQ and the Trustee, volatility was always (there may be exceptions, but if so they are few and far between) used as referring to NPPC volatility. The UK team's paper prepared for the presentation to the Trustee on 8 December 2005 focused on NPPC volatility. Thereafter, my impression of all of the material is that everyone involved in preparing communications was using the word in the sense of NPPC volatility. As I have said, whether the reasonable member reading or hearing the few references to volatility would have appreciated the reference seems to me to be unlikely.

Culture Clash

521. In a later section of this judgment, I will be considering IBM's business case as a justification for Project Waltz and what the RBs have to say about that justification. That business case needs to be set in the context of the history of IBM's business and the culture which it produced. As the history developed, the culture did not remain static. Indeed, in the 1990s it went through a seismic change.

522. I have read and heard some evidence on behalf of IBM about the corporate culture and how it changed. Mr MacDonald gave a general description in his witness statement and also gave more particular evidence about certain aspects. He was not challenged on this aspect of his evidence. I shall say a little about it – although it is, of course, not determinative of any issue in the case – because Mr Simmonds presents it as an answer to a challenge presented to him by Mr Tennet. The challenge was to explain why, if the Reasonable Expectations relied on by the RBs had not been engendered by IBM in the course of Ocean and Soto, there was a widespread and firmly held understanding among the workforce that DB accrual would continue. IBM does not accept that there was such a widespread understanding, but to the extent that there was an understanding at all, he suggests that it arose, not because IBM engendered an expectation in the course of Ocean and Soto, but because some members were clinging to values of a past era.

523. Mr Simmonds explains the old culture and its changes in this way.

524. Until the late 1980s, IBM was pre-eminent in the technology field. IBM accordingly made significant profits and it could afford to provide very well for its employees. That resulted in a culture of paternalism, employment for life and valuable ancillary benefits (as recognised by one of the RBs' witnesses, Mr Johnson). This led to a culture of entitlement, which became associated with the phrase "respect for the individual". Some, IBM would say many, DB members did cling to that culture although Mr Johnson himself did not see himself as one of those, rather he was "in transition" as he put it.

525. By the early 1990s, IBM was (and this is not in dispute) in serious economic trouble: it failed to respond to new forms of competition and by 1993 it was on the verge of insolvency. At that time, the new CEO, Louis V. Gerstner, Jr, began to change IBM's corporate culture: employment costs were reined in, and IBM's corporate values were redefined, with a recognition that increased shareholder value was a key indicator of success. One can see his philosophy set out in his book "Who Says Elephants Can't Dance?" (he at least may have approved of the Waltz of the Pachyderms). One also gets a flavour of the commercial challenge facing IBM from the following details which he gives. The book is not, I appreciate, evidence and I do not rely on it for detail, but only to demonstrate something about his thinking and to show the (unchallenged) scale of the economic hurdles facing IBM in the 1990s.

526. Thus Mr Gerstner explained that IBM lost $5 billion in 1992, and just over $8 billion in 1993, the point at which he became the CEO. Between 1992 and 1994 the number of employees fell from roughly 300,000 to about 220,000. From 1994 onwards there was, on any basis, a substantial turn-around. The share price increased under his stewardship: it stood at $12.72 in 1993, and during the course of the 1990s rose until it stood at $120 by 2001. I think that Mr Simmonds is entitled to rely (as he does) on those figures to illustrate that IBM was in very serious trouble in the early 1990s and to show that there was a substantial turn around in the rest of the 1990s, a proposition with which Mr Johnson agreed.

527. Mr Gerstner also wrote something about the "old" culture – his view of course and not shared by everyone – and in particular what he says about "respect for the individual". I set out below some extracts which Mr Simmonds put to Mr Johnson:

> "The 'old' IBM had very fixed views about compensation; much of it, I suspect, had been derived from the management philosophy of Tom Watson Jr, the man who created the great IBM of the 1960s and 1970s.
>
> Since the company's performance during that time had been so extraordinary, it would be foolish to

say it was not an effective compensation system.

Let me briefly describe the system I discovered when I arrived.

……there was a heavy emphasis on benefits. IBM was a very paternal organization and provided generously for all forms of employee support. Pensions, medical benefits, employee country clubs, a commitment to lifelong employment, outstanding educational opportunities – all were among the best of any United States company…..

Basically it was a family-oriented, protective environment where equality and sharing were valued over performance-driven differentiation. I was well aware of the strong commitment IBM held for its employees long before I joined the company. However, as good as it might have been during IBM's heyday, the old system was collapsing amid the financial crisis that preceded my arrival. Tens of thousands of people had been laid off by my predecessor – an action that shocked the very soul of the IBM culture…..

The old system was not only out of touch with realities of the marketplace, but it was unable to satisfy the paternalistic underpinnings of the historical IBM culture. Consequently, it made fixing the company very difficult and made employees sad and cynical. We needed a whole new approach – and we needed it fast…..

The final change we made was the least strategic but the most controversial: paring back the paternalistic benefits structure. We did not undertake these changes because we thought the highly generous support system was bad per se. Believe me, I would have loved to continue the employee country clubs and the no-cost medical plans. We cut back on these plans because the company could no longer afford the level of benefits. The high profit margins of the 1970s and 1980s were gone forever. We were fighting for our lives. None of our competitors offered anything close to the IBM benefits package. (Even now, after all the changes we made, IBM benefits programs are among the most generous of any United States-based multinational corporation.)….

Also, we changed benefits because the old system was geared to the company's prior commitment to lifelong employment -- for example, the bulk of pension benefits accrued after thirty years of service.

The new IBM was not a place where jobs could be guaranteed for life (nor was the old IBM after it got in trouble). So we had to create benefits programs that were more appropriate to a modern workforce…..

Yet the hardest part of these decisions was neither the technological nor economic transformations required. It was changing the culture – the mindset and instincts of hundreds of thousands of people who had grown up in an undeniably successful company, but one that had for decades been immune to normal competitive and economic forces. The challenge was making that workforce live, compete, and win in the real world. It was like taking a lion raised for all of its life in captivity and suddenly teaching it to survive in the jungle…..

Of course, enlightened companies and leaders know an institution must outlive any one person or any one group of leaders. Watson realised this and he deliberately and systematically institutionalised the values that had made IBM under his tenure a very successful company……

He summarised them in what he termed the Basic Beliefs:

> Excellence in everything we do.
>
> Superior customer service.

Respect for the individual.

There is no arguing with these. They should be the standard tenets of any company in any industry, in any country at any period of history. But what the Beliefs had come to mean - or, at least, the way they were being used – was very different in 1993 than in 1962, when Tom Watson had introduced them.

Perhaps most powerful of all the Beliefs – and most corrupted – was 'respect for the individual'. I am treading on the most sacred ground here, and I do so gingerly to this day, 'respect for the individual' is the rallying cry for the hardcore faithful - for the True Blues, as they call themselves.

But I have to say that, to an outsider, 'respect for the individual' had devolved to mean a couple of things Watson certainly did not have in mind. For one, it helped spawn culture of entitlement, where 'the individual' didn't have to do anything to earn respect – he or she expected rich benefits and lifetime employment simply by virtue of having been hired.

Or that is the way it appeared to me at first. Later I came to feel that the real problem was not that employees felt they were entitled. They had just become accustomed to immunity from things like recessions, price wars, and technology changes…..

In an organisation in which procedures had become untethered from their origins and intent, and where codification had replaced personal responsibility , the first task was to eradicate process itself. I had to send a breath of fresh air through the whole system. So I took a 180-degree turn and insisted there would be few rules, codes, or books of procedures. We started with a Statement of Principles.

'But what about the basic beliefs?' you may ask. 'Couldn't they have been revived and turned into the sorts of principles you are describing?' The answer is, unfortunately, no. The basic beliefs had certainly functioned that way in Watson's day, then for many decades after that. But they had morphed from wonderfully sound principles into something unrecognisable. At best, they were now homilies. We needed something more, something prescriptive.

In September 1993 I wrote out eight principles that I thought ought to be the underpinnings of IBM's new culture and sent them to all IBM employees worldwide in a special mailing. In reading them over now, I am struck by how much of the culture change of the following ten years they describe.

Here are the principles and an abbreviated version of how I described each ...

1. The marketplace is the driving force behind everything we do.

2. At our core, we are a technology company with overriding commitment to quality.

3. Our primary measures of success are customer satisfaction and shareholder value.

This is another way to emphasise that we need to look outside the company. During my first year, many people, especially Wall Street analysts, asked me how they could measure IBM's success going forward - operating margins, revenue growth, something else. The best measure I know is increased shareholder value. And no company is a success, financially or otherwise, without satisfied customers.

4. We operate as an entrepreneurial organisation with a minimum of bureaucracy and a never-ending focus on productivity.

5. We never lose sight of our strategic vision.

> 6. We think and act with a sense of urgency.
>
> 7. Outstanding, dedicated people make it all happen, particularly when they work together as a team.
>
> 8. We are sensitive to the needs of all employees and to the communities in which we operate.
>
> This isn't just a warm statement. We want our people to have the room and the resources to grow. And we want the communities in which we do business to become better because of our presence.

528. That is not how everyone saw it. Thus we find Mr Gavin Wilson (a former member-nominated director of the Trustee) emailing in the following way in June 2012:

> "I blame the whole thing on the egotistical and selfish man who arrived in 1993, Gerstner. Before him, a pension scheme was designed to encourage the employee into a lifetime contract with IBM. With Gerstner, the pendulum swung very strongly away from the employee and towards Gerstner and his small cadre of executives who were prepared to follow his demand that they spend two years' worth of salary to buy IBM shares. Pension schemes became just a cost, and happy retired employees were of no commercial value. Single status went out the window as Gerstner arranged for his lifetime use of IBM's corporate jets. Palmisano largely followed Gerstner's example. Aided by the internet and cheap telecommunications, he could reduce employment in the West, switch to much cheaper employees in the East, and still keep customers in the West happy. Again the matters of lifetime employment and pensions seemed irrelevant."

529. And so, Mr Simmonds explains, IBM remains very tough on managing the bottom line, including employee costs, which is partly a product of the disastrous experience of the early 1990s. Mr MacDonald's unchallenged evidence was that this affected the mind-set of senior IBM executives, many of whom survived the near-death experience of the early 1990s; and even in an era of greater profitability, it still affected that mind-set. Thus, by 2008, IBM was determined that it would be proactive in taking a variety of measures (not simply in relation to retirement) to minimise the impact of the financial crisis and to ensure that IBM as a business remained competitive and could continue to deliver value to its shareholders, including by meeting its commitments under the 2010 EPS Roadmap. In that context, it is not surprising, he suggests, that the long-serving employees who formed the majority of the DB members reacted so strongly to the pension changes; but the strength of their reaction is a response in part to the change in the corporate culture which took place during their employment with IBM.

530. It may not be surprising. But that is not an answer to the RBs' claim. From the extracts from Mr Gerstner's book and from the example – I am sure he is not alone – of Mr Gavin Wilson's email, can be seen the irresolvable clash of cultures. It is not difficult to see that those who share Mr Gavin Wilson's thinking would see the Gerstner approach as destructive of their hopes and aspirations and indeed what, for some of them, had become expectations. But those expectations, led by the culture which Mr Gerstner deprecated in the then new harsh commercial world for IBM, were not necessarily expectations which employees could assert as legal rights, disappointment of which would result, in England, in a breach of the *Imperial* duty. The questions are whether IBM could properly propose and implement Project Waltz and to what extent the new culture can properly be invoked to override any such Reasonable Expectations as can be established.

531. The business justifications asserted by IBM for the Project Waltz changes are important in answering those questions. In addressing them, it is right to say at this point that I agree with Mr Simmonds that the assessment of commercial matters and the making of business decisions is a matter for management. It is not, as he says, for the Court to second-guess the business judgment of management. That other managers might have taken a different course and made different decisions is beside the point.

532. What follows, he says, is that where there is a coherent, rational (in terms of making sense in the context of IBM's business) and a *bona fide* case for the pension changes, the Court should not seek to go behind that case. I do not agree with that. The existence of a coherent, rational and *bona fide* case is, of course, a matter of great significance and, other things being equal, I agree that the Court should not go behind the case, not least because it is ill-equipped to do so. But the argument takes Mr Simmonds too far.

533. Suppose, for instance, that IBM had entered in a binding contract with members to keep the Plans open to DB membership until, say, 2014. Proposals for pension change, even the same proposals as formed Project Waltz itself, could be perfectly coherent, rational and *bona fide* proposals from a commercial perspective. IBM could attempt to persuade the membership to agree to the proposals but it would not be able to impose them save in breach of contract. Just as a proposed course of conduct might be impermissible because it would give rise to a breach of contract, so too a proposed course of conduct might disappoint Reasonable Expectations. And if it did so, then the *Imperial* duty might, as a matter of fact, be breached; one cannot say *a priori* that a coherent, rational and *bona fide* course of conduct precludes the possibility of a breach of the *Imperial* duty.

534. No doubt that conclusion would be challenged by Mr Simmonds: how, he might ask, can a course of conduct be coherent, rational and *bona fide* and yet at the same time amount to a breach of the *Imperial* duty which requires (according the test which I have concluded should apply) irrationality or perversity? The answer to that apparent conundrum is that rationality and *bona fides* are being assessed by different criteria in each case. The business case in favour of a pension change to the detriment of members may rest solely on financial and economic considerations and may, on that basis, be strong and one which an employer, untrammelled by commitments to its workforce, could perfectly properly make: the change would be coherent and rational in that way. In contrast, the test of irrationality and perversity under the *Imperial* duty is focused on a course of conduct which no reasonable employer would pursue. Irrationality, in that sense, may have nothing or little to do with the underlying financial and economic business case.

535. I will come to IBM's business justification for Project Waltz, on the basis that it is relevant, later in the judgment. In addressing it and in reaching my conclusions, I bear the culture clash in mind.

Project Ocean

536. I have referred to the Project Ocean changes in paragraph 110 above; they are set out in Annex B to this judgment. The essential elements were these:

i) an increase (with effect from 6 April 2005) in member contributions in respect of the C Plan (the contributory DB section of the Main Plan) from 4% to 6% and in respect of the I Plan from 4% to 5%;

ii) a corresponding reduction in the rate of future benefit accrual in respect of the N Plan, (the non-contributory DB section of the Main Plan);

iii) an agreement by IBM to make contributions of £200m pa for three years (2005, 2006 and 2007) to reduce the past-service deficit in the Plans; and

iv) the guarantee which eventually appeared in the Funding Agreement which I have already mentioned.

537. I have received lengthy submissions both in opening and in closing about Project Ocean. There is much that is uncontentious. My statements of facts in the following paragraphs are intended to be my findings of fact save where otherwise appears.

538. Mr Simmonds' opening written submissions focused, in his description of Project Ocean, on the financial position of the Plans from a UK perspective. He did not say a great deal in the context of Project Ocean about the position in relation to US GAAP and NPPC (although he had much more to say about them in the context of Project Waltz and to some extent Project Soto). The RBs' skeleton argument focused immediately on this, noting that the effect of the 2002-2005 financial crash in world financial markets resulted in substantial falls in the asset values of the Plans. For purposes of US GAAP accounting, it was not just negative ROA that caused a problem;

more serious was the failure to meet EROA, which was around 10% at the time.

539. The result was that in 2000, 2001 and 2002 the Main Plan incurred actuarial losses (namely a shortfall of actual ROA from EROA) of £488m, £699m and £865m respectively, totalling £2,052m for the duration of the 2000-2002 crash. In 2003, there was the start of a recovery: the Main Plan began to make actuarial gains as ROA well exceeded EROA. These losses for 2000-2002 were, however, smoothed over the coming years, delaying their effects. The funding implications of the 2000-2002 crash was one the factors which led to the Ocean Changes.

540. Thus, it was becoming apparent by mid-2004 that the triennial actuarial valuation of the Plans as at 31 December 2003 would show a significant funding deficit in respect of past accruals (for which, given the balance-of-cost nature of the Plans, IBM would be responsible). In fact, the valuations (which were signed off on 24 December 2004) showed deficits of £900m in the Main Plan and £19m in the I Plan.

541. Further, there was financial pressure from CHQ on the IBM UKI businesses which were seen as underperforming as compared with other parts of the worldwide business. This prompted the UK management team (led, at that time, by Mr Hirst, then the UK general manager) to put together a business recovery plan. As part of the review that this entailed, UK management began, in February 2004, to consider making changes to the design of the UK DB Plans. A "pensions project" team, led by Kevin Waller and also including Mr Wilson, Mr Newman and Mr Heath was set up to consider pension policy changes, including changes required by new Government legislation, increases to employee contributions, a policy for increases in pensions in payment and cost of living adjustments ("**PIP**" and "**COLA**") and questions of long term funding.

542. Given the system of "powers reserved" to IBM Corporation which I described in detail in my judgement in the Rectification Action, CHQ became involved in the formulation of these possible changes at an early stage. The RBs put this rather higher than mere involvement. They say that even though the pensions project was initiated by the UK team, CHQ retained ultimate control over any pensions design changes. It is clear, in my view, that there was more than simple involvement. The "powers reserved" meant that CHQ had to approve rather than merely be consulted. In that sense, the RBs are correct to say that CHQ retained ultimate control; but it is also the case that CHQ did not impose its view in the sense of compelling UK management to take particular action. In practice, this was never an issue because UK management knew where the ultimate power lay and would follow CHQ policy and directions: there was no occasion on which they were faced with implementing something which they considered was wrong, in the sense of being against the interests of the UK companies, although I am bound to say that matters came pretty close to that later on in relation to Project Waltz. The practical recognition of this power structure is reflected in the meeting of the UK Pensions Project Team on 28 June 2004 where it was noted that approval from CHQ *via* Damian Glendinning (Director of treasury operations and pensions strategy in the Corporate Treasury Department at CHQ), and review by Paul Michaud (Program Manager, Global Benefits, CHQ), would be required for any proposals the UK team made, which might take some time.

543. In any case, the evidence shows that there was considerable involvement in Project Ocean on the part of CHQ. Mr Tennet gives the following examples:

i) CHQ had to agree to the Funding Agreement as representing one of the contracting parties IBM WTC. In September 2004 Mr Glendinning flew to the UK, and Mr Greene followed thereafter, to "refine and test the solutions paths we may have with the UK team and the actuary". A senior figure, no less than Mr MacDonald, travelled to the UK to discuss the issues with UK management as he acknowledged in his witness statement. Indeed, it appears that his approval was required before the proposal was put to the Trustee.

ii) Mr Heath explained in his witness statement that CHQ became "closely involved in the formulation of the changes". Mr Stephen Wilson agreed with him. Mr Hirst too confirmed that CHQ approval was required although that, I comment, does not necessarily entail the sort of active involvement in the formulation of the proposal which Mr Tennet seeks to establish.

iii) CHQ took an active role in handling the discussions with the Trustee. For example, Mr Glendinning produced a draft paper to distribute to the Trustee "rather than have someone from IBM UK argue the case".

544. My conclusion is that the influence of CHQ in the eventual Ocean changes was central. Not only could those proposals not have been implemented without CHQ approval, the UK team in practice had to consider changes which they did not favour and were eventually persuaded to adopt them for presentation to the Trustee in the light of (i) the financial and economic information provided by CHQ and (ii) the pressure coming from CHQ (factors of even greater importance in relation to Soto).

545. Before I come to the events rather closer to the adoption of the Project Ocean changes at the end of 2004, there are some earlier documents which have been relied on by the RBs which I should deal with and which Mr Simmonds has addressed in his written closing submissions. They are relevant to establishing precisely what it was that the board of the Trustee, and in particular Mr Lamb, thought they were agreeing to in late 2004, especially in relation to the commitment alleged by the RBs that the Plans would be kept open.

546. The first document is a letter from Mr Lamb to Mr Hirst dated 31 July 2003. Mr Tennet described this letter in his oral opening submissions in this way: "effectively Mr Lamb is seeking reassurances from IBM about its commitment". At this stage however, I consider that it is clear, as Mr Simmonds submits, that Mr Lamb's concern was with the funding of the past service deficit, thus he wrote:

> "Consequently the Trustee received advice from its professional advisers that these numbers should be brought to your attention and that assurances about the Principal Employer's ability and ongoing intent to fund the Plan should be sought."

and

> "I do understand that that funding (except in certain circumstances that are not relevant here) is a matter for the Principal Employer under the Trust Deed and Rules. However, the Trustee would be failing in its duty if it did not bring to your attention the level of anxiety that members may feel when they learn, in due course, of the extent of the deficit."

547. Mr Lamb and Mr Hirst met on 10 September 2003 to discuss the concerns raised in Mr Lamb's letter. Following that meeting, Mr Hirst wrote to give some reassurance:

> "As we discussed in our meeting, the board of the Principal Employer spends considerable time discussing the Plan and has given serious consideration to the issues raised in your letter. I am pleased to be able to confirm that the board has approved that employer contributions totalling £157 million should be made to the Plan in 2004, as recommended by David Eteen, the Plan Actuary, following his latest actuarial review.
>
> However we do not feel it appropriate at this time to make an additional non-regular contribution in excess of that recommended by the Actuary. It remains the current intention of the Principal Employer to continue to support the Plan through the payment of employer contributions in accordance with the provisions of the governing Trust Deed and Rules.
>
> In conclusion, I trust our meeting reassured you that the Principal Employer is committed to meeting its obligations to the Plan and its members."

548. That exchange of correspondence says nothing about any commitment to keep the Plan open to further accrual of benefits. It may well have taken place in a context in which no-one was considering or concerned about the Plan being closed to further accrual. The point is that this exchange of correspondence cannot be read as giving rise to any <u>increased</u> expectation let alone a commitment that the Plan would be kept open: both before and after this exchange, there was simply an assumption that the Plans would continue because no-one had suggested they would not. This is consistent with what the minutes record Mr Lamb as having reported to the TMM on 23 October 2003 where he referred to IBM's intention:

> "From that meeting and the letter dated 13 October 2003 that he had subsequently received from Mr

> Hirst he had been given the very strong impression that IBM intended to continue to fund the UK Pension Plan."

and where he referred to the last paragraph of Mr Hirst's letter quoted above stating his belief that this:

> "indicated implicit support by the IBM Corporation for the UK Pension Plan as, from his previous experience as IBM UK CEO, he assumed that Mr Hirst would have consulted with his colleagues in IBM US before making his statement."

549. Whatever Mr Lamb may have hoped, or even expected, there was, in my view, clearly no commitment given by Mr Hirst that the Plan would remain open for any particular period or at all. The reassurance given by Mr Hirst related to funding, not to any future accrual of benefits. Moreover, Mr Hirst expressly stated that it was IBM's current intention to continue to support the Plan through the payment of contributions. No doubt the Trust Deed and Rules (together with statutory provisions) would have imposed some obligations on IBM from which it could not escape. But that does not lead the conclusion that IBM was obliged to keep the Plan open. I can detect nothing in the correspondence which could reasonably be taken as a commitment to keep the Plan open to accrual of future benefits either at the then current rate of accrual or at any other rate. To the extent that IBM could properly bring about a closure of the Plan to future accrual before this correspondence and the September meeting, it continued to be able to do so; the correspondence and the meeting did not constrain IBM's behaviour in that respect. I ought to note, in any case, that there is nothing to suggest that this correspondence or the contents of the meeting were communicated to members: it cannot therefore have engendered directly any expectation, reasonable or otherwise, in them. That is not to say that it had no impact on the members. The subsequent communications from the Trustee to the members were based on what the Trustee had been told and was capable of giving rise to expectations on the part of the members.

550. The RBs have also relied on an email from Mr Heath to a Mr Glazerman (a C Plan member) dated 21 September 2004. It appears that there had been some press speculation about the future of the C Plan and that IBM was considering winding it up. Some members were concerned that IBM might do just that. Mr Glazerman drew attention to these concerns. Mr Heath's (draft) email in response to this refers to this speculation but does not mention member concerns. Mr Heath stated that IBM did not comment on media rumour and speculation but went on to say that it "may be helpful however to draw your attention to a statement contained in the most recent IBM Pension Members' Report" where Mr Lamb had commented:

> "The Company has confirmed to the Trustee that it remains the Company's current intention to continue to support the Plan through the payment of employer contributions in accordance with the provisions of the governing Trust Deed and Rules. The Trustee has welcomed this positive confirmation from the Company."

551. In his opening submissions, Mr Tennet said that Mr Heath was addressing, in the passage just quoted, the ongoing future of the scheme, not the bailing out of the Plans in the event of a wind up. Mr Simmonds submits that this is a misreading of Mr Hirst's letter because:

i) it made specific reference to the speculation about IBM's winding-up the C Plan: the continuation of support through the payment of contributions is directed at the funding of past service liabilities rather than any commitment to keep the C Plan open to future service;

ii) it strongly echoes Mr Hirst's response in his letter dated 13 October 2003 (referred to above) which related solely to funding; and

iii) in any event, once again it refers to IBM's current intention, not to anything which would or might happen to the Plans in the future.

552. When giving oral evidence, Mr Heath confirmed that he was not stating that there would never be a change: "That did not mean that we would not address issues around the plan, as a company". I accept that that is so: but it has never been the RBs' case, and Mr Lamb has never suggested, that there would never be a change. Indeed,

as Mr Glazerman said in the course of his email exchange with Mr Newman, he did not believe that "anyone is naïve enough to believe that IBM would "never say never" about possible changes to the pension plan". [The sense here is that everyone knew IBM would never say never but a literal reading is to the opposite effect.] There was clearly concern on the part of IBM not to give a commitment that the Plan would not be closed and a reluctance even to give an assurance that there was no current proposal to do so. Perhaps, at that time, IBM could not truthfully have given such an assurance. Closure of the Plan was certainly one of the options which IBM considered when developing the Project Ocean proposals although it was, in the event, rejected. Precisely when it was rejected is not clear. Nonetheless, I agree with Mr Simmonds' submission that this email was not addressing the ongoing future of the Plans: the focus was on ensuring that IBM would stand behind the Plans notwithstanding that substantial deficit which existed. In relation to the future, it was saying no more, at most, than that IBM had no current plans to wind-up the plan so that, without commenting on media reports, the message could be taken home that those reports were inaccurate.

553. The next significant document is an email from Mr Hirst to Mr MacDonald dated 18 October 2004. This e-mail refers to consultation with employees. IBM accepts that the communications to employees were seeking positively to encourage members to accept the Project Ocean Changes, but it is submitted that it is important to see the way in which Mr Hirst explained how the communications process would seek to do this:

> "…by explaining the actions the company is taking to underpin the plan financially and to contribute cash, and link that to the additional contribution we are now asking employees to make to play their part. "

554. I agree with Mr Simmonds that this passage, read in isolation, did not involve any representation or commitment regarding the continuation of future accrual of benefits in the C Plan. It is entirely consistent with IBM's case concerning the Project Ocean changes.

555. In May 2004 IBM Retirement Funds EMEA prepared UK pensions figures, showing actual and projected NPPC for the UK plans. The assumption was that EROA would be 8% and the discount rate was 5.75%. The figures revealed that, owing to the 2000-2002 crash, UK pension costs (including DC costs) were already projected to increase by $84m between 2005 and 2006, and that total UK pensions costs were projected to be $237m in 2006:

	Projected NPPC ($m)	Total projected pension costs ($m)
2004	(3)	63
2005	81	153
2006	158	237
2007	196	283

> [IBM used a standing exchange rate of £1=$1.55 for all of its internal pensions accounting and projects and that is the rate used in the figures later in this judgment unless otherwise specified.]

556. Even though there was already a potential issue over the projected increase in NPPC for 2005 and 2006 and future service costs, UK management's attention was focused on the issue of scheme funding (and the deficit) at this time. In early July 2004 the new Scheme actuary, Watson Wyatt, produced preliminary valuation results for the plans as at 31 December 2003. The preliminary results indicated that there was a Main Plan deficit of £1.2bn on an ongoing basis, which would necessitate annual company contributions of around £244m, in addition to I Plan contributions of around £40-45m, and DC contributions. As set out in the Actuarial Valuation Report which was later produced on 24 December 2004, the funding position had deteriorated since 2000 because:

i) actual investment returns were lower than had been assumed in the 2000 valuation, and the assumed rate of future investment returns was lower;

ii) IBM had taken a contribution holiday, which meant that it had contributed £190m less than the cost of accrual; and

iii) increases in longevity assumptions had added £220m to the deficit.

557. The preliminary valuation was carried out using what have been termed "central basis" assumptions, which in particular set the pre-retirement discount rate at 6.8%, and the post-retirement discount rate at 5.25%. In calculating the post-retirement discount rate, the actuary assumed that retiree members' liabilities would be backed by an asset mix of 10% equities, 10% real estate and 80% bonds, although the actual asset mix of the fund was more heavily weighted towards equities. I do not propose to go into the technical reasons for this or into an examination of the Actuary's paper explaining his methodology.

558. In carrying out the valuation, Watson Wyatt used assumptions that were more prudent than the previous Scheme Actuary, Aon, had used. Watson Wyatt's approach led to the reduction in the EROA assumption to 6.025%, which had the effect of decreasing the discount rate, and hence increasing the valuation of the DB Plans' liabilities. It is not suggested by IBM that Watson Wyatt's approach was unreasonable.

559. At this stage, I say something about asset allocation.

Asset Allocation

560. Mr Lamb exhibited to his second witness statement a table showing the asset allocation policy (and actual allocations) at the year-end for each year from 2000. As at 31 December 2000, when the Main Plan had a surplus of £585m and a funding level of 118% on an ongoing basis, the asset allocation strategy in relation to the DB section of the Main Plan was 80% in equities and other assets (primarily property) and 20% in bonds. The Trustee considered, on the basis of expert advice, that this was an appropriate mix but recognised that, as the Main Plan matured, there would need to be a move towards bonds. The policy of an 80%/20% mix continued in 2001.

561. At a meeting of the Investment Committee held on 2 May 2002, it was decided (following expert advice) that, although there was no need for major action, the asset split ought to be changed – by way of a de-risking strategy whereby a greater proportion of the fund was invested in bonds – in order to reflect the increasing maturity of the Main Plan. In particular, it was decided to implement a 5% move from equities to index-linked bonds by means of a 1% move per quarter for five quarters. After the first 1% movement, however, it was decided (at the meeting of the Investment Committee held on 25 July 2002) to delay the next switch pending further examination of the appropriate ratio in the light of a volatile, declining investment market. The asset allocation policy as at 31 December 2002 was, therefore, a 79%/21% split. In 2003, further consideration was given by the Investment Committee to the appropriate split and it was intended that a full asset/liability modelling (**'ALM'**) study would be carried out in 2004 following the valuation as at 31 December 2003. At the end of 2003, the policy remained a 79%/21% (although the actual split as at 31 December 2003 was 81%/19%).

562. On 8 December 2003, Mr Alexander (of Watson Wyatt) took over as scheme actuary from Mr David Eteen (of AON). The first major task for Mr Alexander, and of Watson Wyatt as the Trustee's new actuarial adviser, was to prepare the formal triennial valuation as at 31 December 2003. It was during the preparation of this valuation that IBM and the Trustee became aware that the Plans were likely to show the substantial deficit which I have referred to and which, in turn, was a primary impetus for the Project Ocean changes, not least because of the effect it was likely to have on IBM's future contributions to the Plans.

563. By July 2004, Watson Wyatt had completed its first ALM study for the Main Plan, which was discussed on 22 July 2004 by both the Investment Committee and the TMM. As at that date, the asset allocation mix was 75%/25%. At about that time, Watson Wyatt had also produced a draft valuation as at 31 December 2003 that, contrary to AON's previous approach to such valuations, was based on (1) the market value of assets and (2) more conservative investment return assumptions. This draft valuation projected a deficit of some £1.2bn which Mr Simmonds describes as "alarming". Given this projected deficit, one of Watson Wyatt's concerns was the restoration of the Plans' solvency, which would require, in particular, significantly increased contributions from

Holdings which, in turn, would require the Trustee to assess the strength of Holdings' covenant.

564. In July 2004 Watson Wyatt produced notes on the effect of various design options and on the effect of cash contributions to the DB Plans, to assist IBM with its consideration of a solution to the problem.

i) Watson Wyatt's note of 8 July 2004 concerned the accounting effect under US GAAP of making additional cash contributions to the Scheme, and in particular the effect on NPPC. It explained that were the deficit of £1.2b to be paid off by a single cash contribution, NPPC would be reduced by £96m pa.

ii) Watson Wyatt's note of 12 July 2004 gave a high level review of a wide range of changes which UK employers were considering, including changes to COLA policy, to the definition of pensionable salary, to normal retirement age, to employee contribution rates, and to accrual rates.

565. Returning to pension costs, and putting matters neutrally, Holdings needed, if it was to reduce pension costs as CHQ clearly wanted, to address two issues namely (i) how to deal with past service deficits and (ii) how to reduce the costs of future service benefits.

566. Mr Simmonds explained IBM's approach to the solution in this way:

i) Although the possibility of closure of the Plans was considered, this was rejected. Instead, UK management decided to recommend to Mr MacDonald the proposal for an increase in member contributions (in respect of the C Plan and the I Plan) and a corresponding reduction in the accrual rate in respect of the (non-contributory) N Plan. Those proposals addressed issue (ii).

ii) Issue (i), the funding deficit, was a different matter. It was of more commercial significance to CHQ than the cost of future accrual because of a concern that the funding deficit would lead to a request by the Trustee for very substantially increased contributions from IBM. UK management addressed this by deciding that the proposals should include the guarantee and significant deficit repair contributions by IBM of £200m pa for three years. The guarantee would enable the scheme actuary to adopt a so-called "best estimate" approach to the actuarial valuation. The provision of the guarantee would also enable the Trustee to set a date on which the target portfolio of the Plans should be achieved – that is to say, a date on which the move from equities to bonds to reflect the increasing maturity of the Plans should be completed – later than the date that would otherwise have been adopted. It was also proposed that any future costs of DB accrual would be shared 50/50 between IBM and the members (excluding any increase in cost that resulted from a change in the average age of active employees).

567. Mr Tennet undertook a rather fuller review of what happened. He explained that the preliminary valuation results were immediately forwarded to Mr Greene, David Hershberg (CHQ Legal) and Mr Glendinning at CHQ on 5 July 2004.

568. Following that, Mr Glendinning described, in an email to Mr Wilson and Mr Newman on 15 July 2004, the discussions he had had with Mr Greene:

i) First, CHQ were giving consideration to an additional cash contribution to the plans, which would provide a "platform Watson Wyatt can use to modify their position".

ii) Secondly, CHQ discussed obtaining a "major concession" from the Trustee that the UK's assets would be invested in two pooling vehicles set up by IBM in Dublin, which would "bring the UK plan more into the overall pensions management system". That did not happen at the time although the Trustee did agree later to invest in IBM's pooled Global Bond Fund.

iii) Thirdly, CHQ considered COLA increases. CHQ knew that restricting COLA increases would be very difficult, but continued to maintain this as a possibility. As Mr Glendinning said:

> "While this will always remain contentious, I think there is a high degree of realism in

the subject here. Naturally, we will not let this deter us from keeping the contention going."

569. An additional cash contribution would necessarily be at the expense of CHQ's share repurchase scheme, since there would be fewer funds available to repurchase shares. Mr Glendinning emailed Mr Wilson and Mr Newman: "I think our approach is based on a reasonable balance between the interests of shareholders and plan members, world wide. As you will see, there is a point at which we make a direct tradeoff bewteen [*sic*] stock repurchases and pensions funding. That is being actively considered.".

570. In its pleading (the Response), Holdings seeks to characterise this email as an example of their general approach of seeking to balance the interests of members and shareholders when setting its preferred investment strategy. But the RBs do not accept that and say:

i) When read in its proper context, it is plain that the reference to a "reasonable balance" in Mr Glendinning's email is merely to the balance between share repurchase and contributions (including, I add, deficit contributions) to the DB Schemes only. It was not a reference to the asset allocation strategy to be pursued by the pension scheme or the assumed EROA that would be credited to IBM in its accounts as a result. I agree.

ii) At this time, and subsequently, CHQ's objective was to persuade the Trustee to continue to pursue IBM's preferred 'equity rich' investment strategy. If successful, such a strategy would maintain the high levels of income from the pension scheme assets which had historically been enjoyed; it benefited IBM by lowering scheme funding obligations, and more importantly, by boosting profits under US GAAP. I consider that the evidence establishes that proposition.

iii) Mr Glendinning's email is concerned with the trade-off (in terms of the effect on IBM's I&E account) between (i) using cash to make contributions to the pension scheme, which would be invested at a high rate of EROA (based on high proportion of return seeking assets) to produce returns credited to the I&E account through NPPC; and (ii) using the same cash to repurchase shares. It had nothing to do with the maintenance of this investment strategy itself. Again, I agree.

571. Mr Glendinning, Mr Greene and Mr Hershberg discussed some time in mid-July 2004 how IBM was to handle the discussions with the Trustee. On 18 July 2004, Mr Glendinning sent to Mr Greene an email suggesting that, "rather than have someone from IBM UK argue the case", it would be a good idea for CHQ to draft a paper to distribute to the Trustee. The email contained a suggested draft which explained that the new actuary's approach represented a "fundamental shift in the planning for, and funding of, pension plans" and that the effect of the actuary's conservative approach reduced EROA from IBM's current assumption of 8% to 6.025%.

572. So what Mr Tennet draws from the above is that, rather than listening to the advice of the new Scheme Actuary, and taking the opportunity to reconsider the true liabilities of the DB Plans, CHQ's approach to the UK plans was to seek to influence the assumptions and investment strategy underlying them, with a view to keeping EROA and discount rates high, and hence NPPC and employer contributions down. I agree that CHQ was, indeed, concerned to keep NPPC and contributions down and, consistently with that, wanted to see what it regarded as more realistic assumptions and a less conservative investment strategy. This was an approach driven by commercial considerations and not, of itself, improper. I do not accept that this approach is to be categorised as a refusal, or even disinclination, to listen to the advice of the Scheme Actuary. Indeed, the advice of the Scheme Actuary was not only listened to but heard. What he said was not welcome. But there was nothing improper about IBM adopting the approach which it then did and to seek to persuade, provided it did so without improper pressure and without making misleading statements or providing false information, the Trustee to act in a particular way.

573. It is, I think, fair to say that these desires of CHQ – to achieve a greater investment in return-seeking assets and to obtain some control over the assumptions to be used for funding purposes – lay behind the idea of a holding company guarantee. It enabled an investment policy to be adopted under which the margins of prudence previously adopted in relation to EROA could be weakened or even eliminated. The result was, in the event, the adoption of the "best estimate basis" in place of the "central basis".

574. The Trustee in turn considered the position. Watson Wyatt's preliminary results were discussed by the TMM on 22 July 2004. I am satisfied that the Trustee's aim was to work with IBM to find a solution to the funding problem and not to provoke IBM into extreme measures. I am sure that Mr Lamb is accurate when he says, as he does in paragraph 1.29 of his second witness statement:

> "…whilst securing the funding of the accrued benefits was our primary concern, the Trustee was also mindful of doing its best to work with the Company to ensure its continuing commitment to the Plans and to maintain a relationship with the Company that would facilitate:
>
> a continuation of the DB plans (accruals for actives);
>
> and a continuation of pension increases for retirees in respect of pre-1997 service"

The Trustee shared IBM's desire to keep the costs of the DB Plans down for IBM so far as proper ("subject to an acceptable level of risk"); it took a long term view to achieving solvency, and was prepared to take more investment risk, on the footing that the DB Plans "were ongoing". As he said in his first witness statement, the Trustee would not have pursued a higher risk investment strategy had it realised that IBM would seek to close the Plans if anticipated returns did not transpire in the short term.

575. It is easy to be wise with hindsight, of course. At that stage, it was the shared assumption of Holdings and the Trustee that the Plans would continue: closure or winding-up was not on the agenda. There is nothing to suggest that Holdings (I shall come to CHQ later) had given any thought to what would happen if their aggressive investment strategy failed to deliver in the short term any more than Mr Lamb had done so. In any case, the Trustee was secured in relation to past service, even if the Plans were closed or wound-up, as a result of the guarantee. I accept, nonetheless, Mr Lamb's evidence about what the Trustee would have done if it had realised that the Plans might be closed if the anticipated returns did not transpire. But I do not take that as evidence that the Trustee actually thought about the point at the time. It was an unspoken assumption that the Plans would not be closed.

576. The investment strategy agreed is not, however, therefore without significance in the context of Reasonable Expectations. The fact that the investment strategy was agreed as a long-term answer to a commercial requirement (I deliberately do not say a solution to a problem) can only strengthen the message heard by the Trustee, such as it was, about sustainability and putting the Plans on a firm footing for the future.

577. Further, although investment strategy was not something which was mentioned in member communications (so that members cannot rely directly on assurances made to them on the topic), it does not follow that it was irrelevant to the message which was given to the members. As will be seen, Mr Lamb communicated the Ocean proposals to the members by a letter dated 9 November 2004. That letter was designed to inform the members about the Trustee's decision in relation to the proposals and why it had decided to support them. The fact that the Trustee supported the proposals would clearly have been a factor to be taken into account by the members in making their decisions and in their approach to the Plans for the future. Indirectly, therefore, communications with the Trustee which gave (if they did give) a message to the Trustee about future benefit accrual are part of the material to be taken into account in deciding whether subsequent actions by IBM UK amounted to a breach of the *Imperial* duty.

578. Test the matter this way. Suppose that Mr Lamb had been given an assurance by Holdings that it would not seek to argue that a failure of the investment strategy in the short term would cause it to act in relation to the Plans otherwise than it would have acted absent such a failure – an assurance too vague to give rise to a binding contract but sufficiently strong to show a very strong commitment on the part of IBM UK. And suppose that the Webcast (as to which see paragraph 613 below) and Mr Lamb's letter had taken precisely the form which they did. Can it be said that the assurance is simply to be ignored because (i) the Trustee itself has no cause of action based on it and (ii) the members were not told about it, so that the assurance could not have engendered any reasonable expectations? The answer to that question is, in my judgement, a resounding "No". To fly in the face of an assurance of that sort is, in my judgement, relevant to the issue of breach of the *Imperial* duty in the same

way as a similar assurance given to the members themselves. The weight to be attached to the assurance in assessing whether there has been an actual breach may not be the same: but that is a different question.

579. Expanding on what Mr Simmonds said about formulation of the proposals and the rejection of any suggestion that the Plans should be closed, I note the following. Mr Waller presented the UK pension project team's proposals for changes to scheme design to Mr Hirst on or about 18 August 2004. Holdings' proposal was to increase employee contribution rates to the C Plan and I Plan and to reduce the accrual rate in the N Plan. The UK team dismissed the option of restricting pensionable earnings on the basis that it would not have a uniform effect on all members. Further, although it was actively considered, closing the plans to future accrual was not recommended by the team for a number of reasons. One reason, as Mr Simmonds himself acknowledged, was that such a course would be controversial amongst employees and detrimental to IBM from an employee-relations perspective.

580. Mr Waller's paper expressly relied upon Watson Wyatt's note of 12 July 2004 to show that the cost of accrual had increased. That paper calculated the increase in the costs of accrual explaining that the reasons for the increase included allowance for more members to retire early. Further, there is nothing to suggest that COLA increases had been treated any differently from the past in ascertaining the contribution rate. Accordingly, Mr Tennet argues that the proposal to increase employee contribution rates, namely because the costs of accrual had increased, implicitly assumed that IBM would maintain its COLA and early retirement terms and practice. That must be correct; and it is certainly the case that everyone was proceeding on the basis that the Plans would not close and would provide further benefit accrual at the current rates. But that cannot be taken as a commitment that things would not change.

581. From late August 2004, CHQ engaged Towers Perrin to assist the UK pension project, ahead of the Trustee meeting which had been set for 21 October 2004 at which it was intended by IBM that the proposals to increase contribution rates would be discussed. Towers Perrin, it must be emphasised, were retained by IBM; they were not advising the Trustee. Although they were asked to consider a whole range of redesign options, they were not instructed to provide advice "as if" they were the Scheme actuary. It had been Mr Glendinning's suggestion that they should provide "as if" advice, but Towers Perrin had said that this "would force them to be more conservative than is useful for our purpose", as Diane Gherson (Vice-President, Compensation and Benefits) told Mr MacDonald in an email dated 1 October 2004. Mr Tennet is right, I consider, to identify CHQ's aim as being to find a way to encourage Watson Wyatt and the Trustee to adopt a stance which was less conservative than the Scheme Actuary would ordinarily recommend.

582. I have already considered the genesis of the guarantee. As Mr Simmonds explained, the guarantee had the two-fold advantage of enabling the scheme actuary to adopt the less conservative "best estimate" approach to the actuarial valuation and to postpone the date for completion of the move from equities to bonds. It would also, as Mr Tennet correctly noted, have a significant effect on company contributions by (i) encouraging the Trustee to adopt a more risky investment strategy and (ii) the removal of the margin for prudence in the assumptions used; but those two results came with an increased risk to IBM which carried the ultimate funding obligation (*via* IBM WTC), if matters did not turn out as hoped for.

583. I should mention at this stage a complaint which was made to the Pensions Ombudsman by certain members of the Plans. The complaint was that Holdings had failed to share the surplus in the Plans with members by awarding benefit increases, instead preferring to use the surplus to fund its own liabilities for contributions in relation to the DC Plans. In its submissions to the Pensions Ombudsman, Holdings had rejected the proposition that there was any link between surplus and its policy in relation to pension increases, pointing out that benefit increases had been awarded in the past even when there was an actuarial deficit and arguing that the decision to meet DC contributions out of surplus did not reduce pension costs but dealt merely with the question of cash flow.

584. The UK Pension Project Team was alive to these submissions. They considered the submissions at a meeting on 2 September 2005 concluding that to fund the current deficit by stopping increases to benefits would create a link between funding and increases, invalidating the argument which had been presented to the Pensions

Ombudsman.

585. Holdings was therefore faced with a presentational problem in relation to the new proposals to increase contributions as part of the solution to the past service deficit. At the start of October 2004, CHQ, which was itself aware of the submissions made to the Pensions Ombudsman, began to consider how the increase in contribution rates might be presented to members. Mr Michaud noted the problem in a draft note to Mr MacDonald at the end of September 2004.

586. Ms Gherson, too, noted the problem in an email dated 1 October 2004 to Mr MacDonald. She wrote: "Unfortunately, the idea of connecting funding status to employee contributions turns out to be problematic because of the many years when IBM had a funding holiday while employees made contributions". That is entirely consistent, and indeed confirms, the proposition that CHQ's concerns were about the funding deficit in the UK Plans and how this would impact on IBM Corporation's I&E. Ms Gherson's conclusion was that:

> "…we are back to the controversial (in the UK) idea of moving the C plan to market competitiveness. The problem thus far has been the less-than-satisfactory work on competitive benchmarking – we will be sure to have a bullet-proof chart for your use next week".

587. On 27 September 2004, Mr Lamb met Mr Hirst and Mr Wilson to discuss the guarantee and future company contributions. There is no note of that meeting. It was followed by a letter to which I turn in the next paragraph of this judgment. Shortly after that, work began on producing a first draft of the guarantee. It is interesting to note (I say interesting because it shows who really called the shots) that CHQ was at this stage keeping open the possibility of ignoring the recommendations of the Scheme Actuary on contribution rates even if adopted by the Trustee. Towers Perrin had already indicated to Ms Gherson that if they had had to produce a valuation for the Trustee, it would be more conservative than the indications which they had previously given to CHQ; but they felt that IBM was entitled to base its funding decision on its own interests and the independent advice which it had received (*ie* from Towers Perrin).

588. Mr Lamb followed up that meeting and the provisional agreement with a letter dated 4 October 2004 to Mr Hirst. This explained that Watson Wyatt had agreed to use the "best estimate" valuation basis, rather than the "central" basis, if a guarantee were provided, thus reducing company contributions from £289m pa to £200m pa. Mr Lamb also noted that "if an agreement along these lines can be reached the Trustee will be better placed to try to accommodate Company wishes on investment policy and structure", the reference to structure being, in context, a reference to the proposed changes to the contribution rates.

589. In that letter, Mr Lamb explained that he wanted to:

> "assist the Company to find a Plan funding approach that best protects the pension rights of the membership, ensures the ongoing funding of the Plan, and is perceived as being affordable by the Company"

and added that:

> "The Central Basis Valuations results in contributions of £289m per annum for the DB Plans….. However, if the IBM Corporation was to give its commitment to ensuring that ongoing contributions will be met then I think we can find an acceptable way forward."

590. It is clear from those passages that it had not occurred to Mr Lamb that the benefit structure of the Plans might change, and so the explicit discussion concerned the funding of the Plans and did not expressly address ongoing benefits. But a discussion of funding only makes sense if those involved understand precisely what it is the funding relates to. In that respect, there can be no doubt that one element of the funding discussion related to the deficit in respect of past service. Past service benefits were a given: at least in relation to Project Ocean there was no suggestion that the final salary link might be broken.

591. But the position in relation to the future is less clear. It is apparent, in my view, that Mr Lamb was making the

assumption that benefits accrual would continue unchanged. It is hardly likely that Mr Lamb would have used the language he did if it had occurred to him that the Plans might be closed in the short term (whatever that may mean) particularly given the use of the words "ongoing contribution" and "commitment to ensuring that ongoing contributions will be met". He cannot, in my view, be read as speaking only of the contributions needed to fund the past service deficit or, in my view, of contributions to some hitherto unmentioned reduced accrual rate. I think Mr Hirst must have appreciated that that was the basis on which Mr Lamb was proceeding. Indeed, Holdings itself had no intention at that stage to reduce benefits, even if it had been discussed within CHQ as a possibility.

592. Moreover, a feature I will address later, the contribution figure actually agreed for the years 2005, 2006 and 2007 included an amount in respect of benefit accrual during those years, a fact which the Trustee would have been well aware of. That is consistent with the second paragraph just quoted from Mr Lamb's letter. In that paragraph, his reference to "ongoing contributions" must be read as contributions to reflect precisely the same obligation as the £289 million was required to meet: that is to say a contribution which included an amount in respect of the relevant year's future benefit accrual.

593. But none of this means that Mr Lamb thought that his proposal would give rise to a guarantee that benefit accrual under the Plans would continue unchanged indefinitely or even for a fixed period come what may. To be fair to him and to the RBs, that is not their case. But it is an aspect of this litigation to which a considerable amount of time and energy has been devoted (in relation to Soto as well as Ocean I must add). I need to deal with it in some length because the results of that time and energy inform the debate about what message Holdings and IBM Corporation/CHQ actually did give to members.

594. The context of the letters passing between Mr Lamb and Mr Hirst was a funding problem for IBM UK. The funding rate which the Scheme Actuary would be recommending was more than CHQ wanted Holdings to pay, or perhaps which it could afford, to pay. Had Holdings been willing and able to pay, however, there would have been no need for a funding agreement with the Trustee. Nor would there have been any question of a binding commitment that future accrual would remain unchanged (although, of course, any changes to the Plans in the future would have to be effected within the constraints of the Trust Deed and Rules). Whatever may have been Mr Lamb's assumption, I do not consider that it was implicit in Mr Lamb's proposal that IBM would guarantee not seek to change the accrual rate in the future either at all or for some defined period. The proposal, insofar as it can be ascertained from the letter and the attachments (which I come to in a moment), was to replace one funding proposal (namely the recommendation of the Scheme Actuary) in relation to the deficit and an assumed future accrual rate with another funding proposal (namely that proposed by Mr Lamb as a satisfactory middle ground between the extremes of the Scheme Actuary's recommendation and CHQ's wishes). Each proposal was based on the same (assumed) future accrual rate. There is nothing in Mr Lamb's proposal to give rise to a commitment by IBM that the sort of changes for the future which could have been made had the Scheme Actuary's recommendations been adopted would not be made.

595. In any case, Mr Lamb's letter was only the start of a process. The guarantee which was eventually agreed was, presumably, seen by everyone concerned, including Mr Lamb, as the commitment referred to in his letter. It is really by reference to that guarantee and the various statements made about it that the RBs must make their case. Mr Lamb's letter is part of the background, but was in reality overtaken by events.

596. Mr Lamb's letter attached two letters to him from the Scheme Actuary which "set out two options for such an IBM Corporation Commitment" (that is to say the commitment "to ensuring that ongoing contributions will be met"). The first letter was informed by the discussion which Mr Lamb had previously held with Mr Hirst. The second included an option which had not been discussed but which Mr Lamb thought might be attractive.

597. The first letter was described by the Scheme Actuary as an outline of what the Trustees should seek if it was to accept a lower level of contribution than those set out under the "Central Basis" valuation results. The Trustee was to be guaranteed that the agreed funding and statutory payment obligations would be met by IBM Corporation if Holdings could not meet them. Those agreed funding obligations were the regular contributions required from Holdings as agreed at each triennial valuation. The guarantee would be for an indefinite period but

would terminate if (i) there was no funding shortfall and the solvency position was satisfactory in the event of winding-up or (ii) any funding or solvency shortfall is "demonstrably able to be met from the resources of [Holdings]". On this basis, the Scheme Actuary was of the view that the Trustee could accept funding at a level calculated on a "best estimate" basis.

598. It is apparent from that letter that the Scheme Actuary's concern about adopting the "best estimate" basis was essentially that Holdings would not be able to meet its obligations. With a guarantee from IBM Corporation, that risk was covered to his satisfaction. Consistently with that, the guarantee would come to an end if either (i) there was no funding shortfall and the solvency position on winding up were satisfactory or (ii) Holdings' own financial position improved to the extent that it could clearly meet any funding or solvency shortfall. I do not consider it is possible to spell out of that letter a requirement, or even understanding, on the part of the Scheme Actuary, that benefit accrual should continue at its current rate. It is entirely consistent with the Scheme Actuary's advice that benefit accrual could be reduced. The impact of such a change might be to reduce the required funding rate under the "best estimate" basis (although the element attributable to the past service deficit would not reduce): members would be fully protected by the guarantee which, under this proposal, was to be for an indefinite period (unless it terminated as a result of one of the two conditions specified – in which case members would be fully secured quite apart from the guarantee).

599. Mr Lamb himself was well aware of the sensitive position he and the Trustee were in. His view at the time, as he put it in his second witness statement, was that there was no obvious benefit in insisting on a valuation taking place on such a prudent basis that it would produce a deficit which Holdings might have difficulties financing. And so he considered the best solution was to put in place a guarantee if one could be obtained which would then stand behind the liabilities of the Plans. The balance he perceived was that, although it was necessary to achieve higher company contributions, the Trustee:

> "would not want to take a stance which would put the Company off continuing to sponsor the schemes. In particular, it would not want to damage the UK sponsor's covenant such that IBM US looked to close the schemes or scale back on the benefits that were being provided to members or scale back operations in the UK".

600. I accept this evidence about his and the Trustee's views. Mr Lamb wanted to produce a solution acceptable to IBM which did not provoke IBM Corporation (or indeed Holdings itself) into closing the Plans or scaling back benefits although I shall note that the fear of closure did not derive from any threat made by IBM. Indeed IBM was not considering closure at that time. But that is very different from seeking an assurance (albeit one not contractually binding or one giving rise to an estoppel or actionable misrepresentation) about the future, whatever Mr Lamb's and Holdings' assumptions and intentions might have been.

601. The effect of these proposals was to reduce the amount which needed to be contributed from that originally recommended by the Scheme Actuary. CHQ had previously been contemplating the making of a significant cash injection but the amount could now be reduced.

602. IBM's choices are nicely reflected in an email to Mr MacDonald from Mr Greene dated 9 October 2004 where Mr Greene noted that any additional cash could be used either to make further contributions and reduce the investment risk in the plans, or to boost EPS. This email shows, I think, that Mr Greene was certainly not contemplating closure of the Plans. He wrote:

> "At the 200M level [the proposed annual contribution] we are still likely to have a deficit at the end of the next three years requiring further funding going forward after that. In addition we know that should we be fortunate enough to end up over funded we can shift assets to bonds to reduce risk, something we should do over time anyway as the plan is very mature. My conclusion is to hold at the 200M mark. The UK can fund that level with some adjustments to its financial model, the total WW company is in outstanding financial shape with strong cash balance and strong cash flows expected going forward which put us in a good position to get some of these deficits behind us in an orderly manner. Also for every dollar we put into the plan we get an increase in our pension

earnings at 8%, about the equivalent at the EPS line of what we get by using the same dollar to buy back stock, so we are not hurt with investors except for the impact on cash flow."

603. IBM's full package of proposals, including both the guarantee and the changes in respect of future accrual, was set out in an attachment to a letter from Mr Hirst to Mr Lamb dated 15 October 2004, replying to the latter's letter of 4 October 2004. It is important to record what Mr Hirst did and did not say in that letter. First, he referred to the 4 October letter referring to Mr Lamb's indication that the Scheme Actuary would agree to recommend a contribution of £200m pa for the next three years if IBM Corporation was able to provide an acceptable commitment to support the plans. Mr Hirst then stated that there had been extensive consultation within IBM and was able to confirm that "we are willing to agree in principle to such an arrangement in a form which I believe should be acceptable to the Trustee and the Scheme Actuary". He attached a summary of the principles which would be passed to the lawyers to produce an agreed document for signature. What he did not do was go any further than that and in particular he did not say anything about the ongoing accrual rate in the Plans. It seems to me, therefore, that the position at that stage was that Mr Lamb and Mr Hirst had discussed certain proposals; that those proposals had been considered within IBM; and that the proposal on the table for acceptance by the Trustee ("….should be acceptable to the Trustee and the Scheme Actuary") was that contained in the attachment. Mr Lamb could breathe a sigh of relief but he would not, in my view, have been entitled to perceive the arrangements as amounting to any sort of assurance about future benefit accrual other, perhaps, than an implicit assurance that IBM had no current plans to reduce benefits. Nonetheless, he continued to believe – and nothing was said by Mr Hirst or anyone else to disabuse him of the belief – that the basis of their earlier communications and the messages to be taken from them had not in any way altered.

604. The proposals were then presented to the Trustee by Mr Heath on behalf of Holdings at the TMM held on 21 October 2004. On the guarantee, the Scheme Actuary (who was present) explained its function and that it would allow him to remove the margin of prudence in the valuation assumptions. I interpose here to note that nothing can be inferred from the existence of the margin of prudence about future accrual. That margin was included at the rate actually adopted to reflect the assumed accrual rate. But if the accrual rate reduced or if the Plans were closed, that margin would be reduced (as an absolute number but remaining at the same percentage perhaps) or, on closure, cease to be payable. Accordingly, what the Scheme Actuary said about the margin is not relevant, in my view, to the issue of commitment to the Plans.

605. According to the minutes, Mr Lamb explained that there was "an implied linkage" between the guarantee and the investment strategy "as the Trustee might be better disposed towards certain investment strategies with the Guarantee in place than it would without one." Mr Greene added that "from the Corporation's point of view there was a desire to see improved investment returns and it was hoped that the Guarantee would enable the Trustee to achieve this through its bond strategy and long term approach to its equity strategy". The Trustee resolved that Mr Lamb would work with Nabarro to negotiate with IBM WTC on the final wording of the Guarantee.

606. On the increase in contribution rates, the TMM was provided with a proposal paper which set out IBM's stated reasons for making the proposals, namely a significant increase in the cost of future accrual as the result of improving life expectancy, lower inflation and lower real rates of investment return. The stated aim, as recorded in the paper, was to strike a "fair balance between the rights and expectations of pension plan members and affordability on the part of the company." Mr Heath emphasised to the Trustee that employees were only "being asked to take a share of additional costs for future service and were not being asked to contribute towards either the deficit or their accrued rights." Mr Lamb explained "the increased contributions levels would have the effect of making it a safer environment for all members."

607. The proposals to change the contribution rates were approved by the Trustee with the support of 5 board members, with 1 member against, 2 abstentions, and 4 members unable to vote because they were conflicted.

608. The Trustee resolved to agree to the proposals in principle, but this was subject to employee consultation and expressly on "the assumption that there are no plans for other major changes to the trustee deed & rules or changes to pension practice". Mr Greene and Mr Heath were present at this meeting. They clearly must have understood the assumption that was being made. Holdings and CHQ must have known the basis of the

acceptance by the Trustee of the proposal.

609. I do not think that is disputed by Mr Simmonds. But he submits that at that time, there were no such plans. I accept that submission to the extent that there were no positive plans under consideration at the time; and, as I understand it, the RBs do not contend otherwise. However, that is not to say that the possibility of future changes was something which IBM had rejected. Indeed, further changes were considered by CHQ about 9 months later. There is some evidence to suggest that IBM already had the possibility under consideration (although it had not formulated any proposals) but in the end Mr Tennet did not rely on this as indicating any breach of the *Imperial* duty or any other duty.

610. I note, in this context, that when granting approval on 8 October 2004 to Mr Heath to proceed with the Project Ocean proposals, Mr MacDonald explained to Mr Heath that:

> "It might be useful to have a statement about the UK Team's commitment to the ongoing review of the affordability of the plans in light of business conditions and a recognition that future plan changes could be needed if business conditions deteriorate. Also, we spoke about communications to employees and the need to be clear about this point as these changes are introduced. Obviously this does not need to go into the document [a reference I think to what became the Funding Agreement]".

That caution from Mr MacDonald did not, unfortunately, find its way into the eventual communications with members. I am not aware of any response to the point by Mr Heath. There is nothing to suggest that this cautionary note was conveyed to Mr Lamb who might have been prompted by it to consider its impact on the Trustee's agreement to the investment strategy which it adopted.

611. Mr Tennet placed reliance on what is recorded at page 7 of the minutes of this meeting. He suggested that it demonstrates that there was already confusion amongst the members of the Trustee board as to what the guarantee meant in practice. The relevant passage is as follows:

> "Dr. Marks again stated that, in his opinion, the Guarantee was not necessary as the Trustee already had a guarantee under UK legislation. Mrs. Kirkwood suggested that Dr. Marks had overlooked the fact that the Guarantee would provide the Trustee with a deal that would keep the Plan open for future accruals which was something they did not have previously. Dr. Marks said that he thought that the Guarantee did not take away the Company's power to wind up the Plan."

612. Mr Simmonds regards this as a forensic point of no relevance to the issue. I agree, for the reasons which he gives as follows:

i) Mrs Kirkwood was immediately corrected by Dr Marks, who said that he thought that the guarantee did not take away IBM's power to wind up the Plan, a view from which no one demurred;

ii) there is no suggestion that any other member of the Trustee board was of a similar view. Mr Lamb, Mr Newman and Mr Bridges (who were all present at the meeting) all accept that no guarantee was given by IBM that the Plan would remain open; and

iii) this is not evidence that the members as a whole were misled into thinking that the guarantee had the effect suggested by Mrs Kirkwood: indeed, had any member read this minute, such an impression would have been dispelled immediately by Dr Marks's correction.

Communication with Members

613. The proposals were announced by a combination of (i) a letter from Mr Lamb on behalf of the Trustee sent on 9 November 2004 and (ii) a webcast presented by Mr Heath to all IBM UK employees on the same day ("**the Webcast**").

The Webcast

614. The Webcast is an important communication. The RBs rely on it strongly as a representation about IBM's future conduct in relation to the Plans. IBM contends that there is nothing in it which is inconsistent with what was said and done in its subsequent conduct in formulating and implementing Project Waltz. IBM contends that none of the statements made in the Webcast or in any of the subsequent roadshows carried out by Mr Heath and his colleague, Mr Waller, at various IBM sites across the UK when properly understood in context amounted to a guarantee or commitment that DB accrual would remain open, or that other changes to the Plans' benefits structure would not be made, for any particular period.

615. It is appropriate for me again to note that, as was made clear in the written opening submissions on behalf of the RBs, it is not, and never has been, their case that IBM guaranteed to members so as to give rise to a legally binding obligation that the Plans would never be closed in the future. The RBs says that that is not the issue. The issue, they say, goes to the reasonable expectations which IBM engendered about whether it would be necessary to revisit the issue of closure or further changes over a long-term time horizon. While not giving an absolute guarantee, it is said that IBM certainly engendered a reasonable expectation that it would not be making further changes to, or closing, the UK DB Plans for the long term.

616. I set out for convenience the whole of the text of the Webcast in Annex D to this judgment. I have added paragraph numbers thus: **[**x**]** for ease of reference. I refer to the numbered paragraphs of that text as "Webcast [x]". On the RBs' own evidence, the member witnesses' subjective understandings (given such relevance as is due to them in accordance with the discussion I have already conducted) stemmed, in many cases, from the Webcast; and Holdings' conduct in 2006 was relied on as confirming the expectations which had already been engendered in 2004 in relation to Ocean by the Webcast in particular. Accordingly, Mr Simmonds submits that, if the RBs are unable to establish Reasonable Expectations based on the Webcast, then "their whole good-faith case is holed below the waterline".

617. Although the Webcast is an important document, it does not stand alone even in relation to Project Ocean. It followed on from the agreement of the Trustee to the proposals, as a communication exercise in order to obtain the assent (rather than formal consent which was not required) of the members. In addition, there was the important communication from Mr Lamb to the members already addressed; he wrote as he did knowing that the Trustee had agreed to the proposals only on the assumption that there were no further major changes planned to the rules of the DB plans or changes to pension practice.

618. As a preliminary point, it is to be noted that the Webcast refers throughout to IBM. It is clear that this is a reference to Holdings (although it perhaps includes IBM UKL but nothing turns on that) and not to IBM Corporation or CHQ. Where IBM Corporation or some other corporate entity (*eg* IBM WTC) is referred to, it is expressly identified: see Webcast [41] and [42].

619. Mr Heath told the Court that the Webcast was the "primary method of communication" to members, alongside the Project Ocean Roadshows (materials from which Mr Tennet points out have never been disclosed to the RBs). He also points out that neither the email announcing the Webcast nor the Webcast itself made any mention of any other materials on the changes (*eg* Q&A documents). But I attach little significance to that. There is no reason to think that people who knew about the Webcast did not also know about the existence of the Q&As and, in any event, members were given the opportunity to attend roadshows which were referred to in Webcast [50].

620. I accept, as Mr Tennet submits, that the Webcast was a communication to be listened to and not, as its primary method of assimilation, read. Mr Heath's announcement email did not include a transcript but instead just a link to the audio webcast. He could not remember if a transcript was ever made available. Whether it was or not, I do not consider that the hypothetical reasonable member can be expected to have obtained and read a transcript. But I also agree with Mr Simmonds when he says that the reasonable member would have been aware of the following:

i) from the 2003 members' report, that Holdings' position was that it remains its current intention to continue to support the Plan through the payment of employer contributions in accordance with the provisions of the governing Trust Deed and Rules;

ii) from the explanatory literature issued to members, that IBM reserved the right to change the Plans, subject to their governing provisions. The literature to which Mr Simmonds refers comprises of (i) the employee handbook (ii) the C Plan Handbook and (iii) the I Plan Handbook, each of which contained provisions expressly drawing attention to the fact that IBM reserved the right to amend or terminate the relevant Plan subject to the Trust Deed and Rules.

621. It was not possible to listen to the Webcast in the way which it was possible to read a document. With a paper document at least the reader can flick backwards and forwards. But he/she could not do that with the Webcast: the most he/she could do was listen to it more than once. It has not been possible for me to listen to the Webcast. It has not proved possible to locate a copy. I must therefore do the best I can to take from the transcript the flavour of the Webcast itself.

622. Mr Tennet is critical of some parts of Mr Simmonds' cross-examination of the member witnesses in relation to the Webcast. He says that aspect of that exercise was artificial, with the witness being asked to accept the meaning of one part of the Webcast by reference to another part when there was not in practice the opportunity when simply listening to the Webcast to make the sort of detailed comparison that the cross-examination entailed. Quite reasonably, members instead focused on the overall message, and did not pick through the language as if they were lawyers construing a commercial contract, looking for nuance and inconsistencies. Those are, in principle, perfectly fair submissions. I take account of the point in assessing what the reasonable member would take from the Webcast. I have read and re-read the transcript of the Webcast (it might be said that the re-reading is unfortunate for, in doing so, I have put myself in a very different position from the reasonable member) and been addressed about it. It might have been better if I had been asked to read and record my impressions before being treated to the detailed analysis. I have done my best to imagine what the hearer of the Webcast would have taken away from it and to take account of the fact that the impact of the written text, read and re-read and subjected to analysis, may be different. It is nonetheless inevitable that I must carry out just the sort of close textual analysis that Mr Tennet says is not the correct approach: I need to do so to deal with Mr Simmonds' submissions as well as to see whether Mr Tennet's case might succeed even on this close analysis.

623. Mr Simmonds put it to the member witnesses (or at least to some of them) that the objective of the proposals was to secure the sustainability of the Plans. That was the aim of the package taken as a whole. I think that all of the witnesses agreed with that, although they had an idea of what "sustainability" entailed somewhat different from Mr Simmonds' idea. It was, however, common ground that some sort of bargain was struck between Holdings and the members, using the word bargain in a very loose sense. Thus Holdings would take certain actions (increase its contributions, take responsibility for the past service deficit, provide a guarantee (*via* IBM WTC) under which it would take responsibility for contributions including deficit contributions until 2014); members would pay increased contributions (or, in the case of the N Plan, members could instead suffer a reduced accrual rate) and any change in the cost of future benefits would be shared equally between Holdings and the members (an aspect which became known as "the Evergreen Agreement").

624. Holdings' case is that since, as is common ground, there is nothing express in the Webcast about future accrual (and certainly no unequivocal express statement or representation that the Plans would remain open to future DB accrual) and since no express commitment is to be found anywhere else (whether in documents or statements on behalf of Holdings), the most that can be derived from the Webcast (and indeed from any other communications) is that Holdings had no present intention to change future benefit accrual.

625. As to that, I accept that Mr Heath and Mr Hirst honestly believed at the time that there were no further plans to cease DB accrual or to make the other changes which were later proposed as part of Project Waltz, as to which the RBs do not contend otherwise. Mr Simmonds recognises that Mr Heath accepted that he approached the communications process with a view to 'selling' the package of measures to employees; this does not, he says,

detract from the facts that (1) he made no representation as to future accrual and (2) he believed that the package could be sold both positively and honestly, and that the package had solved the pension 'problem' which so far as UK management was concerned was a funding problem for the past and a cost (and to that extent funding) problem for the future.

626. That, on Holdings's case, is enough to dispose of the claim for breach of the *Imperial* duty insofar as reliance is placed on the Webcast: the Court need not engage at all in any further analysis of the Webcast itself. Unfortunately, I do not think that I can resolve the case that easily. This is for three main reasons. First of all, if the Webcast did give rise to Reasonable Expectations notwithstanding that there was no guarantee of future accrual or a guarantee that there would be no detrimental changes, a course of action disappointing those Expectations is in principle capable of giving rise to a breach of the *Imperial* duty; just as I have rejected Mr Simmonds' submissions that a negligent statement can never give rise to a breach of the *Imperial* duty (see paragraphs 458*ff* above), I also reject the suggestion that even a non-negligent but incorrect statement can never do so. Secondly, I do not consider that Holdings is able to shelter behind the good faith of Mr Heath (and other UK executives) in the attribution of knowledge to Holdings: it may be that what CHQ knew is to be attributed to Holdings: see paragraphs 999*ff* below where I consider this point in the context of the Project Waltz changes. And thirdly, the Webcast may have given rise to rather stronger expectations about past service benefits (possibly including early retirement benefits based on the current policy and pension practice) than about future accruals. I therefore move on to consider the Webcast.

627. Mr Simmonds accepts that it is implicit in the Webcast that Holdings did not have a present intention, which it had not revealed, to effect further adverse changes to benefits or member contributions in the near future. But he says that, as a matter of fact, Holdings did not have such an intention so that I do not need to be concerned with the consequences of that implicit feature being contrary to Holdings' actual intention. I will need to address in due course what Holdings knew and intended in contrast with what any individuals knew.

628. Mr Tennet accepts that the Funding Agreement did not, by itself, constitute a promise that DB accrual would continue (either at all or at any particular rate) in the future. He accepts that Holdings is not precluded from taking steps to close the fund to further accrual as the result of an estoppel or actionable representation. And he accepts, as he must, that Mr Heath did not state expressly that DB accrual would continue in the future or that there would be no further changes to the Plans.

629. Mr Tennet contends, however, that the Webcast gave a number of assurances as to what the bargain which I have just described would achieve; and that these assurances and commitments are enough to give rise to Reasonable Expectations, the disappointment of which were capable of giving rise to a breach of the *Imperial* duty (and which in fact did give rise to such a breach). In that context, he submits that the Webcast "repeatedly states Holdings' "commitment" to the UK DB Plans including their "sustainability" for ongoing accrual".

630. As to that last point, the Webcast in fact uses the word "commitment" twice. Although Mr Tennet's statement is literally correct, the expectation (legitimate perhaps) of the reasonable reader and hearer (me) of his submissions would be to expect to find many more references. Be that as it may, the two references are found in Webcast [43] and [49]. The first refers to Holdings' "continuing commitment to the Plans and their members" being demonstrated by the guarantee. The second refers to Holdings' "commitment to underpin the sustainability of the defined benefit plans in the UK" being demonstrated by "this series of initiatives", that is to say the change to employee contributions, the significant cash contributions Holdings was to make (largely directed at making good the deficit) and the guarantee.

631. As to "sustainability", this word is used three times (in Webcast [10], [14] and [49]).

    i) In Webcast [10], the proposals are identified as the action which Holdings is taking "with the intention of securing the sustainability of our defined benefit pension schemes". This first use of the word comes after a very general introduction and in the context of explaining only an intention. The reasonable listener to the Webcast would not, in my view, at that stage take any particular message from the use of the word "sustainable" other than a perception that the proposals were about making the DB Plans affordable and secure.

ii) In Webcast [14] reference is made to an additional expense (*ie* the impact of increased longevity referred to in Webcast [13]) as having a "key impact on the sustainability for defined benefits pensions schemes". This is a general statement about pension schemes in general (including State schemes) and not a narrow statement about the Plans. The word "sustainability" is being used here in a more specific or nuanced way than in Webcast [10]. The message it is conveying is that pension provision has become more expensive and that this has a key impact on the ability of employers and the State to continue to make provision at this level. It is not a statement which has anything to do with security for past service benefits. The main focus of this part of the Webcast is on future provision. That is made clear by Webcast [11] and [12] which demonstrate that Mr Heath is talking in this part of the Webcast (down to Webcast [34]) about provision in respect of future service. He is explaining how the Plans will continue in a way which is sustainable. For the C Plan and the I Plan, this would be achieved by increased member contributions. The N Plan would remain non-contributory, but the members' share of the cost would be reflected by a reduction in the future accrual rate. And, as Webcast [33] explains, a periodic review of member contributions would be carried out every three years, with an intention that any change in cost of future should be shared "as appropriate, **up or down**, based on the results of future actuarial valuations". This last arrangement has been referred to as the "Evergreen Agreement".

iii) It is true that, at the end of Webcast [12], Mr Heath contextualises that which he is about to say. His statement in Webcast [13] that "As people live longer the cost of providing pension benefits increases significantly" applies to past service benefits as well as to future service benefits (although actuarial assumptions relevant to funding include longevity assumptions); but that, in my view, does not detract from the conclusion that "sustainability" in Webcast [14] is referring to the provision of benefits by reference to future service and not to the cost of provision of past service benefits.

iv) The third reference to "sustainability" is found in Webcast [49]. This comes in the final section starting at Webcast [45] where Mr Heath recaps what he had said overall. At Webcast [48], he sums up the effect of the proposals as putting the Plans "on a firm footing for the future" and, at Webcast [49], as demonstrating Holdings' "commitment to underpin the sustainability" (the third and final reference in the Webcast to "sustainability of the Plans"). Reading Webcast [48] and [49] together, the message is that both the past and the future have been addressed. A "firm footing" could relate to the past and the future – the deficit problem is answered and the future cost is shared. And in context, "sustainability" – following on from a "firm footing" – could be seen as addressed to both the past and the future in the same way as in Webcast [10].

632. It is worth noting Mr Heath's description at Webcast [9] of Holdings as a "strong and responsible company" and his belief that the proposals "offer a positive, measured response to a number of fundamental changes which are impacting employers across the UK".

633. At Webcast [41] Mr Heath starts his explanation of how it was proposed "to further enhance the security of the plans", a reference back, no doubt, to the "further measures to underpin the security of the plans" referred to in Webcast [2]. The explanation relates to the guarantee and nothing else. The detail of the guarantee was not given, nor were its terms (let alone a draft) available. All the members were told was that Holdings had agreed in principle to guarantee company contributions to the fund. I see no reason why anyone would have taken this to be a guarantee only of the deficit contributions; and the eventual guarantee in the Funding Agreement was not in fact limited in that way.

634. Mr Simmonds relies on an answer given by Mr Heath in answer to a question from me whether or not he expected that Holdings might not later turn around and seek to reduce the benefits (thereby reducing the size of the deficit) the response was:

> "I would purposely never offer a total guarantee for the future in a business like Holdings because it's a business where things change, and the financial environment around it changes. I would never offer myself as a hostage to fortune by guaranteeing something which I could never be sure of. So was I expecting a further change two years down the line? At the stage, no, I wasn't."

635. And so it is said that Mr Heath's purpose was to reassure people that Holdings was recognising its

responsibilities so far as concerns the funding gap relating to past service liabilities. Holdings submits that Mr Heath's answer summarises what a reasonable employee would have taken from the references in the Webcast to the guarantee.

636. For my part, I do not consider that the references to the guarantee indicate that it is to apply only in respect of the past service deficit and the contributions referable to that deficit. It is true that it follows on immediately from the section of the Webcast dealing with past service, but earlier in the Webcast (see Webcast [17] and [18]) reference is made to a sharing of the increased cost (so that Holdings will bear a share) and to the fact that Holdings will continue to bear the lion's share of the contributions. That is the conclusion which I reached after having taken the opportunity to read, several times, the hard copy of the Webcast. It is also the impression which I think I would have taken from listening to the Webcast on a single or number of occasions (had it been possible to do so) without the benefit of a hard copy. My assessment is that the overwhelming overall impression is that the reasonable listener to the Webcast would understand that the guarantee would relate to all contributions payable by Holdings to the Plans. I reject Mr Simmonds' submission that the guarantee as described in the Webcast (in contrast with how it actually appeared in the Funding Agreement) was restricted to the same territory as the increased employer contributions referred to in Webcast [39] which is what I understand him to submit.

637. Mr Simmonds suggests that it is not clear how any member would have gleaned from the Webcast an understanding that the guarantee covered future service. To my mind, it is the natural reading, at least of the transcript of the Webcast, that the guarantee would relate to all contributions falling due during the course of the guarantee (until 2014 by which time Holdings hoped the deficit would have been eliminated). But it does not necessarily follow that any particular level of further benefit accrual (or any accrual at all) is guaranteed: all that is guaranteed is the payment of such contributions as actually fall due in accordance with whatever accrual rate is in force from time to time. I agree with Mr Simmonds that there was no guarantee of any particular rate of future accrual. However, the RBs do not assert, as I have said, that the Webcast amounted to a promise or legally binding guarantee. Their case, rather, is that a departure from the "commitment" displayed by the Webcast resulted, in all the circumstances, in a breach of the *Imperial* duty which is something very different.

638. Past service benefits are mentioned in Webcast [12] and addressed more fully separately in Webcast [34]*ff*. As to those benefits, the clear message is that Holdings is taking responsibility for the deficit: see Webcast [12] and [34] in particular. In saying what he did in those paragraphs, there is no reason to think that Mr Heath (or Holdings) had failed to recognise that the actual benefits in respect of past service included the final salary link and nothing to suggest that he considered that existing pension practice (*eg* early retirement policy) was to be left out of account when ascertaining the past service liabilities.

639. At Webcast [47], Mr Heath adds that other alternative proposals had been considered including changes to retirement age and more widespread changes in benefits design. He does not say, although it is the case, that closure of the Plans to future accrual had also been considered. These alternatives were not adopted because, at least in Mr Heath's view, the proposals actually put forward represented the right initiatives which "balance the need to ask you to take a share of increased future costs with long term security". The balance he is identifying in that statement is, it seems to me, the balance in what it is that the members and Holdings each bring to the overall package: members pay increased contributions (or in the N Plan receive less benefits) whilst Holdings makes its cash injection and procures the guarantee (thus increasing the security of benefit).

640. As to the references to putting the Plans "on a firm footing for the future" and to the "commitment" in Webcast [48] and [49], Mr Simmonds suggests that they are a perfectly accurate description of what Holdings was proposing to do and the objective, which he has identified, of the package, especially given that Mr Heath had identified the large deficit as the principal threat. But that, in my view, is to diminish inappropriately the message which was also being conveyed in relation to future service by those same paragraphs. Thus Webcast [48] refers to "the changes we are proposing to make" which can only be a reference to increased contributions in the C and I Plans and the reduced accrual rate in the N Plan. And the "commitment" in Webcast [49] is a commitment to sustainability which must include looking at the Plans as ongoing Plans. The natural assumption would be that the Plans would continue to provide further benefits: Holdings could not have intended, and a

reasonable member would certainly not have understood, the Webcast to be contemplating sustainability as drawing a distinction simply between an unsustainable scheme (which would have to be put into winding-up) and a sustainable scheme (which could continue as a closed scheme with no further accrual). Such a sophisticated distinction is not one which I would expect the reasonable member – even as rational and intelligent as the Holdings workforce – not skilled in arcane matters of pensions law and practice to understand from listening to the Webcast.

641. Part of the message in Webcast [47] to [49] may, in reality, have been the most important part of the Webcast: members were being told that the Plans were not being closed at that time. The evidence shows that there had been real concern among members that the Plans might be terminated. There had been press speculation to that effect. And there was, on the evidence, a palpable sense of relief when the Webcast was released that the Plans were not to be closed. It does not follow from that message, however, that the members were entitled to think that closure would be off the agenda for the long term.

642. This approach is not inconsistent with Mr Heath's own evidence in cross-examination where he said this:

> "I would certainly accept that at the time it was not Holdings's intent to close the schemes and that was not on the agenda, and we wanted to reassure people that that was not on the agenda at the time. I was asked in subsequent roadshows specifically the question around: is there a guarantee around the future? I offered the response: no, there is never a guarantee in anything. But – but – we are – our intention is to put these schemes on a more sustainable footing."

643. Mr Simmonds submits that Mr Heath's answer accurately summarises not only the intention of Holdings at the time but also what a reasonable employee would have taken from the Webcast. I do not disagree to this extent: the Webcast was not giving a guarantee about future accrual either indefinitely or for any particular period and a reasonable member would not have understood that it was doing so. But, as I have explained, that is not the RBs' case.

644. Mr Simmonds goes as far as to suggest that a reasonable member might not even have drawn the inference from the Webcast that Holdings hoped to keep DB accrual going given these factors: (i) that there is no clear reference to keeping open DB accrual for the future (ii) that the guarantee itself is described by Mr Heath solely in terms of funding and (iii) that benefits under both the Main Plan and the I Plan were variable for future service. So, he says, a commitment to fund did not necessarily presuppose any particular level of benefits for future service. It is, however, clear that the proposals were proceeding on the basis that the Plans would continue unaltered: or to put it simply another way (as is Holdings' own case) no further changes to the Plans were being considered by Holdings. This is the only conclusion consistent with the basis on which the Trustee agreed to the proposals and with Mr Heath's own observation that he was not expecting "a further change 2 years down the line". I regard that (inevitable) conclusion as consistent only with the further conclusion that Holdings hoped that there would be no further changes in the foreseeable future. I accordingly reject the suggestion identified at the beginning of this paragraph.

645. There is more substance in Mr Simmonds' argument that a guarantee of future funding does not imply a guarantee of future accrual. Rather, there is simply a guarantee of contributions in relation to whatever benefits actually accrue. On this approach, the existence of the guarantee from IBM WTC does not constrain Holdings in making changes to the Plans: those changes stand or fall on their own merits.

646. I agree that a close analysis of the transcript of the Webcast shows that the guarantee is concerned only to secure the payment by Holdings of its contributions under the Trust Deed and Rules and the cash contribution. I do not consider that the terms of the guarantee, as explained in the Webcast, have anything to say about a commitment to keep the DB plans open to further accrual or to preserve the pension practices then current. But that is not to say that references to the guarantee are irrelevant to further accrual and pensions practice. The presence of the guarantee, in contrast with its terms, is a demonstration of Holdings' commitment to the Plans (I actually wonder whether Mr Heath intended to refer to IBM Corporation's commitment when he referred to IBM's commitment). To the extent that the references to commitment and sustainability give rise to Reasonable Expectations, those

are reinforced by the presence of the guarantee; but the presence of the guarantee is not, in my view, by itself enough to give rise to any Reasonable Expectation about future accrual or continuation of current pension practice.

647. Mr Tennet suggests that the reasonable member would not appreciate that the guarantee of "company contributions to the fund" (see Webcast [41] and [42]) up to 2014, did not necessarily mean that accrual would actually continue. The understandable expectation, he says, was that if contributions in respect of future accrual to 2014 were guaranteed, there would be no reason to stop accrual. He suggests (although I do not know the evidential basis for this, but shall assume for the moment that it is correct) that many (although not all) members did not differentiate between different IBM entities and assumed that IBM as a global business would stand and fall together. Many never expected that Holdings would ever be permitted by CHQ to become insolvent. The value of a funding guarantee would not necessarily have been apparent to them. It was therefore perfectly reasonable for members to think that the guarantee did something beyond merely providing security for Holdings existing funding obligations in the event that it was unable to pay.

648. I do not agree with that line of argument. First, I do not agree that the reasonable member would have considered that there would be no reason to stop accrual if the guarantee was in place. The reasonable member may not be an expert in the law of guarantees, but he might well have known – I have not been addressed with argument either way on this point – that a principal debtor will usually remain responsible for indemnifying his guarantor; thus Holdings would end up with an inter-company obligation if IBM WTC were called on under its guarantee. Even Mr Tennet does not appear to suggest that the reasonable member (in contrast with many although not all members) saw IBM globally as a business which would stand or fall together. It is hard to think that that was the view of UK management who were acutely aware of the internal competition for investment from Armonk. And even if it was reasonable for some members to think that the guarantee did more than simply guarantee Holdings' contribution obligation, Mr Tennet's argument does not establish that the reasonable member would have thought this way. Nor does the argument lead to the conclusion that the "something beyond" went all the way to an expectation that the Plans would remain open until 2014.

649. I conclude therefore that however one approaches the Webcast, the references to the guarantee, standing alone, do not justify the Reasonable Expectations on which the members rely in relation to future service accrual. I should add this: It does not follow from this conclusion that, when one comes to consider whether Project Waltz gave rise to a breach of the *Imperial* duty, responsibility for the deficit is irrelevant: any business justification for the changes will have to explain why the particular changes were ones which were appropriate. The statements concerning responsibility for the deficit in the Webcast and elsewhere are factors then to be taken into account in answering the question whether any reasonable employer would act in the way that Holdings acted.

650. My conclusion is not affected by Mr Heath's statement in Webcast [42] and [43] that the guarantee is "excellent news" for members. I do not consider that the description of the guarantee as excellent news gives any support to the establishment the alleged Reasonable Expectations. The guarantee clearly <u>was</u> excellent news for anyone who was concerned about Holdings ability to meet its funding commitment. As to Mr Tennet's argument about that being a fanciful concern, see paragraph 705 below. Mr Heath was also entitled to see it as excellent news (although he did not articulate this reason) because without it the Trustee might well have proceeded with its switch to bonds which might (Mr Lamb feared as much) provoke IBM into closing the Plans or even winding them up.

651. As to "sustainability", Mr Tennet must be right to say that this means that the DB Plans would be sustainable in their current form. I consider that to be the only sensible interpretation of the word "sustainable" in context. Mr Heath agreed that he intended to demonstrate the company's intention "to continue to support the plan in its current form", saying that "There was no doubt that at that time we believed that…what we were doing was securing the sustainability of the plan for the longer-term". Indeed, it was precisely to ensure the sustainability of that which existed already that the proposals were put forward.

652. Mr Tennet identifies two implications to be taken from the Webcast: the first is that, following adoption of the

proposals, Holdings saw the DB Plans as sustainable for the foreseeable future. The consequence of that would then be that the members had a Reasonable Expectation that benefit accrual would continue for the foreseeable future. The second implication is that, in making these assurances as to sustainability and statements of commitment, Holdings implied that it had reasonable grounds to believe that the assurances were true.

653. Before addressing those two implications, I make this observation. If it were established that either Holdings did not believe, or is to be treated as not believing that the DB Plans were sustainable (*eg* it was reckless as to whether that was true or not) that cannot have any impact in relation to the Reasonable Expectations engendered by the Webcast. A Reasonable Expectation, as I have coined that expression for the purposes of this judgment, is an expectation as to future conduct. An expectation that someone is telling the truth is of a different type. An incorrect statement may give rise to a remedy, for instance based on misrepresentation or estoppel, but that is because it is incorrect and was acted upon, not because the recipient believed it was true. An incorrect statement, for instance one made dishonestly or recklessly, may give rise to a breach of the *Imperial* duty but that is not because it gives rise to a Reasonable Expectation.

654. In the present case, it is not alleged that the statement as to sustainability was itself a breach of Holdings' *Imperial* duty. If it had been, and if a breach were established, the consequences of such a breach in terms of any remedy to be granted today are terrible to contemplate. For the reasons just given, those statements are not, in my view, relevant to Reasonable Expectations. The accuracy of the statements about sustainability and putting the Plans on a firm footing do not, therefore, have the importance which Mr Tennet attaches to them.

655. I nonetheless need to say more about Mr Tennet's two implications: in relation to the first implication, I have, unfortunately, no clear idea what Mr Tennet means by the words "foreseeable future". If, as I consider it does, sustainability refers to sustainability of the Plans in their current form, the Webcast cannot reasonably be read as looking further ahead than, at longest, the period to 2014. There is some merit in taking that period because, according to the Webcast, it was anticipated that the deficit would, at the contribution rates then proposed, be eliminated by 2014 which would suggest that Holdings at least had some material to suggest that the Plans would remain viable with their current structure until then.

656. But that is to read a lot into both those words ("sustainability" and "commitment") and into the whole phrases ("on a firm footing for the future" and "commitment to underpin the sustainability") as they would be read by the reasonable member rather than by advocates and Judge in the courtroom. At most, in my view, a member would be able to take away from the Webcast the message that Holdings considered that continued accrual at the current rate would be affordable by Holdings in accordance with current cost projections and in the light of its own current financial circumstances. I use the word affordable rather than sustainable deliberately. From Holdings' perspective, once the members' contributions were increased, there would be no difference between sustainability and affordability by Holdings of its obligations.

657. If I am correct in my conclusion that the duration of the guarantee does not provide a useful indicator of the period of the foreseeable future, the Webcast contains, expressly, nothing to tell us how long that period lasts.

658. Some help can be found in Mr Tennet's own submissions that it is to be implied that Holdings had reasonable grounds to believe that the assurances as to sustainability which it gave were true. One of his submissions is that the members were entitled to think that IBM had taken reasonable steps to understand the present circumstances of the UK DB Plans and what might happen in the future and had reasonably assessed the possibility, and possible consequences, of unfavourable market performance in the future: see paragraphs 661*ff* below. The reasonable steps, assuming the submission to be correct, are essentially obtaining financial information and advice and turning those into projections. There is a limit about the distance into the future for which it is reasonable to expect projections to be made. Even if Holdings is to be taken as making an implied commitment into the future, I do not think that the implication can reasonably be expected to last longer than the period during which reasonable projections can be made.

659. As to that, I consider a much shorter horizon than 2014 to be appropriate. To suggest that Holdings could in 2005 have confidence about the costs of the Plans or indeed its own financial circumstances until 2014 is, in my

view, unreasonable. Indeed, I have serious doubts that it would be reasonable to take the foreseeable future in relation to "sustainability" beyond the due date of the next actuarial valuation of the Plans. The reasonable member might not have been able to understand the Webcast at that, perhaps technical, level. But he would be capable of understanding that any commitment which Holdings was giving was limited to the horizons which financial prediction made reasonable. I might add, in this context by way of aside, that, even if the subjective understanding of the members were relevant, I would attach no weight in this context to the evidence about the palpable relief felt by members when the Webcast was released as support for the Reasonable Expectations asserted. The relief manifested was that the Plans were not to be wound up: there had been rumour that this was to happen. The Webcast demonstrated – perfectly accurately as it turned out – that the Plans were not being wound up and that a solution to the problem (*ie* of immediate wind-up) had been avoided. For how long it had been avoided was another question.

660. As to the second implication which Mr Tennet seeks to draw, it is certainly the case that Mr Heath must be taken as believing the truth of what he said. What is more, Holdings itself cannot be heard to say – and does not say – that what Mr Heath said was unauthorised and not to be taken as a statement by Holdings. Further, although Mr Heath did not speak on behalf of CHQ, what he did say was known to and approved by CHQ. I make no judgment about what, as a matter of either law or morality, CHQ ought to have said if they knew that Mr Heath's remarks about sustainability and commitment were not thought by CHQ to be accurate. But what I do say is that, if CHQ did not think them to be accurate and remained silent, I do not think that Holdings can be in any better position insofar as breach of the *Imperial* duty is concerned than if Holdings itself had thought them to be inaccurate.

661. On the basis of that second implication, Mr Tennet submits that members could reasonably expect that:

i) Holdings had taken reasonable steps to understand the present circumstances of the UK DB Plans and what might happen in the future and had reasonably assessed the possibility, and possible consequences, of unfavourable market performance in the future; and

ii) Holdings was prepared to tolerate the consequences of such unfavourable market performance if it occurred and to stand by the UK DB Plans.

662. Without such an implication, he suggests that the assurances and statements of commitment would be of little value. Consistently with that submission, it is pointed out that Mr Heath confirmed that Holdings own intention was to explain that the UK DB Plans would be sustainable even if things changed. The RBs' written closing relies on this part of what he said, "we believed that what we were putting in place again was a proposal which would give greater sustainability, notwithstanding other things might happen". The RBs' written closing does not, however, include the next part of his answer: "In the circumstances at the time". That is an important part of the answer: it makes clear that Mr Heath saw the proposals as providing the necessary stability in the circumstances at the time. Significant changes in financial and economic conditions would not, therefore, preclude a subsequent change in the terms of the Plans. It is also important to note that the part of his answer which was quoted did not suggest that Holdings was making a statement about absolute sustainability. The aim, he said, was to give greater sustainability, that is to say as compared with the situation prior to the amendments.

663. If one asks whether the proposals produced greater sustainability making that comparison, it is clear to me that the answer is that they did so. So far as concerns past service benefits, the capital injection coupled with the IBM WTC guarantee was clearly an improvement (subject to the next paragraph of this judgment); so far as the future was concerned, the increased member contributions and the terms of the Evergreen Agreement (*ie* the agreement to share any increased cost between Holdings and members) self-evidently made future benefits more affordable from Holdings' perspective and, again, the guarantee gave an added element of comfort. In any case, Mr Heath was alive to the possibility of termination of further accrual at that time and that acceptance of the proposals would avoid the risk of immediate termination. I do not, therefore, consider that Mr Heath's answer assists the RBs' case and I do not agree with the submission that, without such implications, the assurances and statements of commitment would be of little value, although they would certainly, I accept, be of less value.

664. I do, however, accept that the reasonable member was entitled to think that Holdings had made an assessment of the current circumstances of the DB Plans. I consider also that the reasonable member was also entitled to think that the representations about sustainability and IBM's commitment would hold good in the light of (i) the investment policy to be adopted as Holdings understood it would be and (ii) the actuarial valuation assumptions to be adopted as Holdings understood them. Although the members did not know the details of either of (i) or (ii), Holdings certainly did and, indeed, the bargain with the Trustee was that the shift to bonds should be slowed down and that actuarial valuations should no longer be on the "central basis" but on the less conservative "best estimate basis".

665. I do not accept, assuming that I have understood it correctly, Mr Tennet's further submission, namely that "it is to be implied that Holdings was prepared to tolerate the consequences of such unfavourable market performance if it occurred and to stand by the DB Plans". I understand this to mean that even if markets moved adversely, the reasonable member could expect that benefits would remain unchanged so that pension practice would continue and the DB Plans would remain open to future accrual at the current rate.

666. The submission which I have recorded – it is how it is put in the RBs' written closing submissions – is an extreme one. In fact, even Mr Tennet accepts that a really serious, unexpected and unpredictable change in financial and economic circumstances which put the very existence of Holdings at risk might justify changes to the DB Plans even in the short term. But suppose that the Trustee had been allowed to continue with its planned shift to bonds. The funds would still have remained invested significantly in equities and other return-seeking assets. I do not consider that the reasonable member could understand the statements in the Webcast about sustainability and commitment as creating an expectation that, even if the value of the funds fell significantly, the DB Plans would continue unchanged whether in relation to future service benefits or in relation to pension practice.

667. I do not consider that conclusion should be any different even though part of the bargain between Holdings and the Trustee resulted in a slowing down in the rate of shift into bonds and a change to the "best estimate basis". The resulting investment spread, although different from that which the Trustee would otherwise have adopted, was within the range of reasonable and responsible investments given the existence of the guarantee (and perhaps even without it). There is no justifiable criticism of the Trustee for having adopted the policy which it did given the existence of the guarantee.

668. At the other end of the spectrum, I do consider, for what it is worth, that in the short term the members could reasonably expect that no further changes would be made in the absence of a significant change in financial and economic circumstances. For instance, the members would justifiably be shocked if, the day after the Ocean changes had been implemented, Holdings had announced that it was reviewing the level of future benefit accrual and its early retirement policy. They would be justified in feeling shocked because the Webcast certainly gives the impression that there is a problem to be addressed and that the initiatives which it explains provide at least some fix to that problem. If Holdings had embarked on a review of DB Pension provision very soon after the implementation of the Ocean changes, this would require an explanation, otherwise its good faith in presenting the changes may be brought into question. It is not as though the Webcast had said: here is a problem which requires immediate treatment; here is an immediate fix to that problem; but it cannot be seen as a final solution and we will be embarking on a review of the DB Plans in the near future. Quite the reverse: it stated that the DB Plans were sustainable and that Holdings was committed to underpinning their security.

669. There is another indicator of the duration of Holdings' commitment to keep the DB Plans open. The £200m pa contribution was assessed by Watson Wyatt as a single figure including a deficit contribution and a future service contribution. The latter element was assessed on the basis of the current benefit structure. In my judgement, the reasonable member would understand that this annual contribution would be made for 3 years (see Webcast [39]) and that the DB Plans would therefore remain open for at least that period.

670. But this is all hypothetical: relevant changes were not in fact made within the short term. [The Project Soto proposals were made within the 3 year period but these are not challenged by the RBs]. The Project Waltz proposals did not start to be formulated until 2008. That, in my view, is far beyond the short-term horizon within

which it is obvious that further changes would not, absent a significant change of circumstance, be made.

671. The next stage of the RBs' argument is this. It is said that, by these assurances and statements of commitment, Holdings implied that it would not change its mind and renege on its commitment in future without good reason. Mr Tennet relies on two factors which I have already mentioned:

i) The alleged assurances and statement of commitment cannot be read as confined to the very moment when Holdings made them.

ii) The assurances and commitments related to long-term issues (pensions) and would be worthless if Holdings could renege on them in the short term without compelling reasons.

672. As to the first of those factors, I do not dissent from the proposition that the impact, such as it is, of the Webcast is not restricted to that very moment, and that is reflected in what I have said in the preceding two paragraphs.

673. As to the second of those factors again I have accepted that, in the short-term, the members could reasonably expect that no further changes would be made in the absence of a significant change in financial and economic circumstances. However, I disagree with the submission insofar as it relates to a period beyond which reasonable projections could be made, for reasons already given. Further, the assurances and expressions of commitment are not worthless even if Holdings could, other than in the short term, change its mind and act contrary to them. As well as the factors identified at paragraph 671 above, there are these additional factors. First, they gave the members comfort that the DB Plans were not about to be wound up or closed to further accrual. Secondly, they could be taken as an indication that there were no current plans (or even discussions on foot) to take such action. That would be so, it seems to me, even if Mr Heath had added, at the end of the Webcast, that although Holdings had no current intention to close the DB Plans or make any changes to accrual or pension practice, it reserved its right to do so: the addition of those words would not bring about an internal inconsistency.

674. Next it is said that the Webcast made clear that Holdings was taking sole responsibility for any past service deficit and explained the steps which would be taken to deal with it, over the period of the next three actuarial valuations. In contrast, there was to be an immediate increase in contributions to reflect increased costs due to factors such as increased longevity and any further increase in the costs of future service would be shared. It is not possible, subject to one qualification, to quarrel with either of those propositions. The acceptance of responsibility for past service benefits can be seen in Webcast [12], [18], [34]; and this is emphasised by the action Holdings was taking to deal with the deficit as set out in Webcast [39] (the £200m pa cash injection), [40] (later cash contributions to be based on subsequent valuations), and [42] (the guarantee until 2014).

675. The qualification is this. Mr Heath referred to Holdings' "responsibilities"; he was also referring to the deficit as disclosed by actuarial valuations. He said nothing about the basis on which past service liabilities were to be ascertained. There are two related points to make here:

i) The first is that, were future service accrual to cease, the final salary link would be broken (as everyone perceived the position at the time).

ii) The second is that, if it were possible for Holdings to revise a pension policy (for instance in relation to early retirement) prior to the Webcast and the Ocean changes, Mr Heath did not say anything expressly in the Webcast to the effect that Holdings would not revise those policies in the future.

676. It might therefore be said that the "responsibility" to which Mr Heath was referring was for the deficit in respect of past service which would ultimately depend on the benefits which had to be provided in accordance with the provisions of the DB Plans and pension practice from time to time. On that approach, there is nothing in the argument that responsibility for the past included a commitment to future accrual on the basis that that is how the final salary link would be preserved. And nothing in the argument, either, that responsibility for the deficit in relation to past service benefit included a commitment not to change pension practice.

677. In that last context, I draw attention to what I have already said in paragraph 638 above. What I said there was

there was no reason to think that Mr Heath was not aware of the final salary link or pension practice when it came to calculating the deficit. It does not follow from that that Mr Heath considered that pension practice could not be changed consistently with what he said in the Webcast.

678. Mr Tennet nonetheless submits that the statements about past service benefits have two consequences. I paraphrase his two submissions to express them in the language of the expectations which the statements would engender in the reasonable employee.

679. The first submission is that the reasonable member would have the expectation, arising out of Holdings taking responsibility for any deficit, that it would not change benefits applicable to past service in order to reduce the UK DB Plans' liabilities and thereby the very deficit for which it was taking responsibility. Cutting benefits to reduce any deficit would hardly be taking responsibility for it. Included in the benefits which are thus protected would be what Mr Tennet refers to as the "automatic entitlement" to early retirement under Holdings' longstanding practices or the linkage of emerging pension to final salary.

Automatic entitlement to an early retirement pension

680. I need to disgress for a moment to consider this "automatic entitlement". There can be no doubt, in my view, that there was a widely held view that there was a right to early retirement. The RBs' opening submissions presented a number of factors leading to the conclusion that by 2009, at the time of Project Waltz, there was a cultural expectation of such a right resulting from a practice established over many, many years. The material does indeed show, I consider, that that expectation existed well before that and certainly before the time of the Ocean changes.

681. The first thing to note is that the evidence shows that, in practice, early retirement was commonplace. The actuarial valuation reports up to 1997 show the average retirement age within the Main Plan during the 1980s and 1990s. It was never above 60.42, was once as low as 54.47 and was more often than not in the range 55 to 59.

682. The cultural expectation of early retirement was reinforced by the separation packages and enhanced early retirement terms under which members routinely left IBM UK, permitting early retirement from age 50 (even from deferment) without any requirement for consent or, from age 53, known as the Career Transition Programme, the Skills Rebalancing Offers and the Individual Separation Plan programmes. Holdings itself recognised, in its answers to questions presented at the Pensions Consultation Committee ("**PCC**") meeting on 12 August 2009, that historically most people retired in their late 50s and that retirement at NRA (63) was under 10%. There is no reason to think that that was not a long-standing situation.

683. The DB members' benefit statements reflected this culture. The statements contained tables showing the pension available at each year from age 50 (later, 55) onwards, on the basis of the ERDF prescribed by the applicable plan rules as applicable on retirement from active service. Before 1997, the statements did not contain anything to suggest that such early retirement was at Holdings' discretion. After 1997, the statement continued to set out the amounts available at each age from 50 (or in due course 55).

684. On 13 July 2009, IBM presented some charts as part of the UKI Transformation summarising Holdings' early retirement practice and procedures in operation prior to the 2009 Project Waltz proposals. One slide described the essentially administrative process for obtaining approval from relevant line managers. It was noted (in bold typeface):

> **"1. Only criteria used today is that the employee is 50 or more and that is [sic] has both 1st and 2nd Line approval.**
>
> **2. In last 5/6 years, never seen a refusal but possible deferrements [sic] in dates.**
>
> **Current policy, where approved the employee can leave IBM with a reduced pension in**

accordance with the early retirement factors that apply to the Pension Plan to which they belong."

685. Mr Riley stated in his email dated 31 July 2010 to Mr Murphy that retirement at 57 was "obviously ingrained in the mindset of our people". And he had stated at the final PCC meeting on 8 September 2009 that early retirement had become an automatic entitlement. As to UK management's approach to recording this in the minutes, see paragraph 1299 below. In his oral testimony, Mr Riley accepted that a member receiving benefit statements in the form sent out by IBM's Pension Trust department would have thought that the pension shown at age 55, 56, 57 *etc* was what they had earned to date as a pension and that this was so notwithstanding the small print on a different page about early retirement being "at the discretion of the Company". He was taken to a typical statement for 2008 but his answer could not have been any different had he been shown the corresponding statement for 2004. He accepted that the proposed change in the early retirement policy amounted, in practice, to a retrospective cut in pensions earned based on the benefit statements.

686. Although the material which I have just addressed post-dates the Webcast by a few years, I have no reason to think that the culture at the time of the Webcast was any different and every reason to think that it was the same.

687. Whether or not the members had an enforceable entitlement based on contract or estoppel at the date of the Webcast to benefits based on the then current early retirement policy is not an issue which has been raised. But what is clear, I think, is that even in 2004 there was a widely-held perception on the part of members that they would be able to retire before NRD if they wished to do so and that in practice, even if consent was formally required, it would ordinarily not be refused; that was a perception engendered by Holdings which knew that the perception was widely held. It was a Reasonable Expectation. Action by Holdings contrary to that Reasonable Expectation is at least capable of engaging the *Imperial* duty. The Expectation was, however, the result of a policy and a practice. Policy and practice can obviously be changed for the future in respect of future service. Whether it can be changed in respect of past service is a different question. I do not think that it could be said that the expectation in respect of past service can never be changed without a breach of the *Imperial* duty. For instance, it would be surprising if Holdings was unable to revise its policy and practice on early retirement in relation to a 35-year-old man with 4 years' pensionable service in the DB Plans. In contrast, it could well give rise to a breach of the *Imperial* duty to change the practice with only a month's warning in relation to a 58-year-old man with 20 years' pensionable service in the DB Plans.

Communication with members (continued)

688. After that digression, I return to Mr Tennet's submission about the reasonable member's expectation that Holdings would not change benefits applicable to past service in order to reduce the DB Plans' liabilities. I am concerned here, in reality, only with the change to early retirement policy. So far as benefits which are laid down in the Trust Deed and Rules (in contrast with a discretionary benefit such as an early retirement pension), there is no need to invoke expectations at all. What can and cannot be done is laid down by the Plans' amendment powers under which accrued rights are protected to the extent set out in the fetters which I have discussed in relation to Issues 1 to 3. So far as the final salary link is concerned, nothing now turns on that in the light of my decision on Issues 1 and 2 (although an issue remains, in the context of Project Waltz, about the validity of the 2009 Non-Pensionability Agreements).

689. So far as early retirement practice is concerned, I have concluded in my digression into "automatic entitlement" first that the reasonable member had a Reasonable Expectation that the pension policy and practice would apply to him if he wished so far as concerned his past service benefits at least but secondly that it is not necessarily the case that a change in policy and practice would amount to a breach of the *Imperial* duty. A reasonable member hearing the Webcast would, I have no doubt, see confirmation and reinforcement of that Reasonable Expectation. In particular, although he may have appreciated before the Webcast that policy and practice might change, he would, in my judgement, take from the Webcast the message that the deficit attributable to all the benefits (in respect of past service) provided by the DB Plans <u>including those arising under the early retirement policy and practice</u> was guaranteed up to the first quarter of 2014. It follows, in my judgement, that the reasonable member would have had an expectation that the benefits to which that guarantee relates would continue to be provided. I

should add two caveats. First, the reasonable member could not have expected that the Trustee's powers were restricted by the Webcast. Thus, if the Trustee brought about a winding-up of the DB Plans, the expectation would no longer have any scope for application. Secondly, it may be that Holdings' own power to bring about a winding-up of the DB Plans remained unaffected. I do not need to decide whether that is so since the Plans have not been put into winding-up.

690. Reasonable Expectations are, however, no more than expectations. To disappoint those expectations does not necessarily lead to a breach of the *Imperial* duty, even in a matter as important to an employee as pensions. Thus, even in the context of the early retirement policy and practice, a significant change in financial and economic circumstances might be such as to justify a departure from the Reasonable Expectation without the *Imperial* duty being engaged or, if engaged, being breached. Whether the *Imperial* duty was engaged by the Project Waltz changes and, if it was, whether there was a breach of the *Imperial* duty are matters to which I come to in the context of my discussion of those changes.

691. In reaching these conclusions, I do not overlook Mr Tennet's submission (the second submission referred to at paragraph 678 above) that members could reasonably expect that benefit changes in the future would not be justified on the basis that the past service deficit had increased. As a starting point, that may be right, and the onus will be on Holdings to demonstrate why a departure from the Reasonable Expectation would not give rise to a breach of duty. But it is not possible to rule out, *a priori*, an increase in the past service deficit as a sufficient demonstration of that result. That, as I have said, will need to be assessed in the light of all the circumstances, including the extent to which Holdings can be said to be responsible for any increase in the deficit.

692. These conclusions are not, I think, in any way inconsistent on the evidence which Mr Heath gave and which Mr Tennet says supports his argument. Mr Heath said that his expectation was that Holdings, having taken responsibility for any deficit,

> "would not…make changes which impacted past service benefits. So that any changes – I would never have ruled out IBM closing the scheme for the future, moving everyone to DC etc. etc. but I would have expected the Company to honour anything accrued to date."

693. The question he was asked related to past service benefits and his answer was given in relation to past service benefits. I do not think that it was anywhere made clear, if indeed this was the questioner's (Mr Tennet) intention, that past service benefits included the "automatic entitlement" to early retirement benefits alleged or that Mr Heath understood the question that way. Even if Mr Heath did understand it that way, I do not consider that his answer was directed at a situation where a significant, unforeseen, change in financial and economic circumstances might otherwise justify a departure from the reasonable member's Reasonable Expectation. In any event, what Mr Heath would have expected is not the issue: the issue is what the reasonable member hearing the Webcast would have understood.

694. I do not consider that the conclusions are affected, either, by the awareness on the part of the reasonable member (see paragraph 620 above) of the contents of the 2003 members' report and the explanatory literature issued to members. The members' report tells the reader nothing relevant to the proposed changes; quite clearly, the Webcast and other communications supersede anything said in that report. The explanatory material does refer to Holdings' power to amend the Trust Deed and Rules, but the hearer of the Webcast was not reminded of that and is entitled to take the message about the future of the DB Plans from the Webcast. In any case, so far as early retirement policy and practice is concerned, Holdings must, in relying on the reference to the Trust Deed and Rules, take the rough with the smooth; if a change to policy and practice is to be seen as an amendment within the scope of the reservation in the explanatory material, it should be seen as subject to the same fetters as an actual amendment, in which case the practice and policy could not be changed <u>even in the face of</u> a significant change of financial and economic circumstances.

695. A separate, but related issue is this. Mr Tennet submits that Holdings' acceptance of responsibility for any deficit also necessarily meant that the reasonable member could expect that Holdings was doing more than taking

responsibility for the funding of any deficit: it was also taking responsibility for any increase in the accounting cost of the UK DB Plans (*ie* NPPC) consequent on an increase in the deficit (to the extent that they even contemplated the possibility of a difference between the two). Accounting and funding were in effect two sides of the same coin; it would be artificial to suggest that Holdings accepted responsibility for funding, but not for the effects of the DB Plans on its I&E account. I do not agree with that submission. The Webcast said nothing about accounting aspects or the consequences of a continuing, perhaps increasing, deficit. Everything in the Webcast was, as I read the transcript, directed at English concepts and consequences. In my view, NPPC does not come into the picture in relation to expectations at all. Rather, it comes into play as one factor in the assessment of whether a change in benefits (*eg* the change in pension policy and practice) gives rise to a breach of the *Imperial* duty. The issue may turn on whether producing a particular NPPC result is a justification for the change. Applying the test which I have identified, the question is whether achieving that result by making the relevant change is something which no reasonable employer would do.

696. In the above discussion, I have carried out a close textual analysis of the Webcast. I have also attempted to interpret the various statements in it as the reasonable member might interpret them. I need now to carry out a reality check by standing back to consider the Webcast as a whole through the ears of the reasonable member hearing it on one or two occasions. The conclusions which I reach are, inevitably, impressionistic. But my conclusion is the same as that which I have already reached. I can assure the parties that this is not a "he would say that wouldn't he" assessment. I have given this the most anxious consideration. My assessment is that the central message in relation to past service is that nothing is changing or will change without justification at least prior to 2014: I do not need to say anything about changes after that. The central message in relation to future service is that benefits will continue to accrue. But the reasonable member could not properly hear a message that Holdings had committed itself (albeit in a way not amounting to a legal promise) to future accrual until 2014 although I consider that the reasonable member, reflecting on what he had heard, would be justified in reaching the conclusion that benefits would continue to accrue for at least 3 years. I do not propose to say where the cut-off date for the continuing commitment is, at least at this stage.

697. Further, I do not consider that the reasonable member would form an expectation that further accrual would continue for any particular period (except perhaps in the very short term) regardless of changes in financial and economic circumstances (falling short of the changes which even Mr Tennet accepts would justify a change in future accrual). His expectation would be qualified by an acceptance that such changes in financial and economic circumstances could justify a change. Whether one categorises that situation as one where the extent of the Reasonable Expectation is circumscribed by the qualification or as one where a disappointment of that Expectation has no consequence does not matter much, if at all.

698. Moving on from the contents of the Webcast and its impact, it is, however, convenient to record at this point that CHQ saw the communications sent to members and approved of them. Thus Ms Gherson was sent the Webcast on 16 November 2004. Her response to David Heath was:

> "I am very impressed. The message is simple, and delivered clearly and in a positive and reassuring way. I wish you continued good luck in your face-to-face meetings with employees".

699. Mr Lamb's letter to members dated 9 November 2004 explained the proposals. He made some of the points which Mr Heath had made in the Webcast. Mr Lamb identified the large deficit (£900m) which had been determined by the Scheme actuary as at the end of 2003. He noted that the deficit was large both in absolute terms and in terms of the resources of the employer. As to that he said:

> "I am therefore pleased to tell you that the Trustee has reached agreement in principle with the IBM Corporation that will guarantee company contributions to the fund. The principles of the guarantee are agreed: the legal documentation is being prepared….
>
> …… the guarantee will be for the period up to the end of the first quarter of 2014. This period covers the next three Valuation Reports and roughly coincides with the period in which, if the future experience of the Plan is in line with assumptions, company contributions are expected to extinguish

the deficit.

> The guarantee is excellent news for members. It enhances the security of members' benefits and demonstrates the ongoing commitment of IBM to the plan and its members. It has been agreed in principle that company contributions to the defined benefit sections of the plan will be £181 million in each of the next three years. This compares to £121 million this year…. "

700. The figure of £181 m represents the C Plan's share of the £200 m referred to in the Webcast as the Q&As later explained. Although the letter does not expressly state this, the £181 m for each of the three years 2005, 2006 and 2007 covers the cost, as then estimated, of future service benefits for that year and the contribution towards the deficit. A member reading this carefully would see that this "compares to £121 million this year" and would know that during "this year" accrual was at the current rate (to state the obvious) and would have no reason for thinking that the three subsequent years would be treated any differently and every reason for thinking that they would be treated the same.

701. The letter also included the following passage:

> "It is not the role of the Trustee to determine IBM's future remuneration policies nor to negotiate on behalf of employees. The Trustee should primarily have concern to protect the accrued rights of members. The Scheme Actuary has advised the Trustee that members [*sic*] accrued rights are unaffected by IBM's proposals."

702. Mr Simmonds observes that the latter advice was correct. I agree since these proposals did not break the final salary link. Mr Simmonds also adds that the description of the Trustee's role, which was to protect accrued rights rather than to be concerned with future accruals, was entirely consistent with the approach adopted by Mr Lamb throughout the discussions relating to the Project Ocean Changes. Although what Mr Lamb said reflected how he saw the Trustee's role, that is not to say that his letter did not go further: it clearly did. The question is what message his letter sent over and above protecting accrued interests.

703. Mr Tennet has focused some attention on Mr Lamb's statement that "the deficit is large in absolute terms and large in relation to the resources of the plan sponsor" remarking that IBM has relied on those words as evidence of a fuller explanation to members as to why a guarantee only of funding would be such "excellent news" for members; namely that there was in fact some prospect of IBM UK not being able to meet the deficit. In my judgement, the reasonable reader of Mr Lamb's letter would not have taken the guarantee as relating to anything other than funding. Whether IBM's later invocation of the guarantee as being part of what made the Plans sustainable is another matter. But in the context of Mr Lamb's letter, it is reading far too much into it to treat it as a commitment that future accrual will continue.

704. What is one to derive from Mr Lamb's statement that the guarantee was good news for members? One reason for it being good news was that it allayed any fears there might be about Holdings being unable to meet its commitments.

705. The RBs, however, say that it was fanciful to think that IBM Corporation would allow Holdings to enter into an insolvency process and that in practice Holdings would meet its contribution liability. There was no need, therefore, for a purely financial guarantee, so that the guarantee must have carried with it an implication that there would be future accrual at the current rate. One difficulty with that argument is that the major financial problem with the Plans related to the past service deficit. If, as is the RBs' case, Holdings would not have been allowed to default then the past service hole would have been plugged without a guarantee. Why then, I ask, would not exactly the same occur if Holdings had agreed to commit itself to future accrual without a guarantee? Surely, in practice, IBM Corporation would be expected to stand behind Holdings as much in the latter situation as in the former. The reality, it seems to me, is that the guarantee was put in place because this was a requirement of the Scheme Actuary if he was to advise the Trustee to agree to IBM's proposed contribution rate. The guarantee gave legal effect to what the RBs say would have happened in any case. But it was a real benefit to them, as Mr Lamb communicated. And he was able to communicate that message because he knew that the guarantee was essential to IBM's funding commitment and that without the guarantee, there was a fear that IBM

would take unpalatable action, even closing the scheme altogether or placing it into winding-up. In other words, the real benefit was precisely to ensure that the Plans did continue albeit without a commitment that they would do so for any particular period.

706. There is one further point to make in relation to Mr Lamb's letter. In it, he explained the main reasons for the deficit. The first and second reasons given were (i) returns on plan assets were lower than assumed; and (ii) the assumptions about future investment returns in the 2003 valuation were overall lower than assumed in the 2000 valuation. The third reason was the assumption made for life expectancy which had "a significant effect" on the financial position of the Plans. Mr Tennet relies on the first two reasons and submits that, since those were the present causes of the deficit, members could expect that if further asset falls or changes in asset assumptions increased the past service deficit in future, IBM would continue to meet its responsibilities for any such increase in the deficit. This is the same submission as made in relation to the Webcast; I have dealt with it already.

707. As part of the consultation exercise, IBM produced a Q&A document dated 8 December 2004. Whether or not it received as much attention as the Webcast (Mr Tennet submits it did not) it was part of the communication exercise and cannot simply be sidelined. I have explained what I consider the hypothetical reasonable member would have done with this material above. To some extent, it simply repeated the essence of what Mr Heath had said in the Webcast including the following:

> "The company believes that the proposals put forward enhances the security of members' benefits and demonstrates IBM's continuing commitment to the Plans and their members"
>
> "Employees are not being asked to contribute towards any shortfall. The increase in employee contributions only relates to benefits earned for future service. Furthermore, the company has committed to funding any future shortfall due to the results of closing the plan to new members"
>
> "With the very substantial cash injection of £200m for each of the next three years, the guarantee and the changes The Company is proposing to make, IBM's defined benefit pensions plans will be on a firm footing for the future and demonstrates IBM's commitment to underpin the sustainability of the defined benefit plans in the UK"
>
> "The company believes that the proposals put forward enhances the security of members' benefits and demonstrates IBM's continuing commitment to the plans their members… The company is stepping up to its responsibilities by guaranteeing a cash injection to ensure the security and sustainability of the…Plans"

708. The Q&A document explained the difference between the figure of £181m pa referred to in Mr Lamb's letter and the figure of £200m pa referred to in the Webcast (as to this see paragraph 700 above).

709. The Q&A document also contained an albeit limited explanation of the guarantee. It raised and answered a number of questions including the following:

> "**11.1 What does the IBM corporate guarantee refer to?**
>
> The guarantee relates to two things. Firstly, the IBM World Trade Corporation guarantees to meet future payments as advised by the Scheme Actuary, in the event that [Holdings] is unable to do so. Secondly, it guarantees that, in the event the funding at subsequent triennial valuations does not improve to the level expected, the Trustee will receive additional funding, spread over the remaining period of the guarantee
>
> **11.2 The corporate guarantee is £600M - how is the rest of the £900+ deficit going to be made up and over what period of time?**
>
> As David Heath outlined in his announcement, "The guarantee will be for the period up to the end of first quarter 2014. This period covers the next three Valuation Reports and roughly coincides with

the period over which the actuarially-assumed investment returns and company contributions are expected to eliminate the deficits".

£200 million represents the aggregate contribution to both the IBM Pension Plan (the C, N and Data Sciences Sections) and the IT Solutions Pension Plan. As set out in Jim Lamb's announcement to members, the Company contribution to the IBM Pension Plan for the three years, 2005, 2006 and 2007, amounts to £181 million per year, covering the cost of future service benefits for that year and the contribution towards the deficit.

11.3. Requesting clarification of statement on "guarantee"

Firstly, there is a guarantee basis for determining the amount of company contribution for the future. As part of that guarantee, the company will contribute £181 million into the [Main Plan] (covering the C Plan, the N Plan and the Data Sciences Section) and an estimated £19 million into [the I Plan] for each of the 3 years 2005, 2006 and 2007. It is these two figures that make up the £200 million set out in David Heath's announcement.

The guarantee covers the period of the next three triennial valuations, during which it is anticipated that the actuarially assumed investment returns and company contributions will eliminate the deficit.

Secondly, it guarantees that, in the event IBM UK is unable to make those payments IBM World Trade Corporation will ensure that the payments are made.

11.4. Requesting confirmation of planned 2004-2014 future funding over and above the 3x £200m to make up £900m deficit

As outlined above, for the 3 years, 2005, 2006 and 2007, the company will contribute £181 million to the [Main Plan] (C Plan,N Plan and the Data Sciences sections) and an estimated £19 million to the [I Plan], covering both the cost of future service benefits for each of those years and a contribution towards the deficit. As at 31 December 2006 further valuations will be undertaken (and as at 31/12/2009 and 31/12/2012) to ensure that the funding position is on track to meet the deficits in the timeframe agreed, with appropriate schedules of contributions being put in place following each valuation on the agreed funding basis."

710. The Q&As confirm, if confirmation is needed, that the guarantee referred to in the Webcast and Mr Lamb's letter to be given by IBM WTC is precisely that, a financial or funding guarantee. I do not consider that it provides a commitment in relation to future service.

711. However, what the Q&As make clear is that the £200 million contribution (split between the Main Plan and the I Plan) for each of the years 2005, 2006 and 2007, is a contribution in respect of not only the deficit but also in respect of future accrual. This contribution is a commitment by Holdings. It is true that it falls within the scope of the guarantee but that is not relevant to the critical point which I draw attention to, namely that the funding commitment relates to future service accrual for those three years.

712. Mr Tennet relies on the statement in section 11.1 set out above. He acknowledges that to a pensions lawyer, that explanation indicates that the guarantee was merely a funding guarantee. However, he says, it would be perfectly reasonable to assume that, as "future funding payments" covered funding for any future accrual, such future accrual would in fact occur. Again, this is a point made in relation to the Webcast and I have, again, already dealt with it. Taking section 11.1 in isolation, I would reject Mr Tennet's submission for the same reason as I have rejected it in relation to the Webcast and Mr Lamb's letter. But the point is now made in a different context, a context where the very same document contains the explanation in sections 11.2 and 11.4 stating clearly that the contribution promised by Holdings, and guaranteed by IBM WTC, includes the cost of future service benefits. In context, there can be no doubt that the future service benefits are those accruing under the then current provisions of the Plans.

713. Accordingly, even if the Q&As do not give rise to a promise or legally enforceable guarantee of future accrual at current rates, I have no doubt that a reader of the Q&As would be entitled to take them as an assurance or commitment that future accrual would continue at the current rate for the years 2005, 2006 and 2007. Accordingly, whatever the Webcast and Mr Lamb's letter may be taken to say in the absence of the Q&As – and that is the context in which I have so far addressed them – the overall impact of the three documents taken together – Webcast, Mr Lamb's letter and Q&As – is that members have a Reasonable Expectation of continued accrual at current rates for 2005, 2006 and 2007. It is not open, in my view, for IBM to take any point that members would read and rely on the Webcast and Mr Lamb's letter, but pay scant attention to the Q&As; indeed, that is not Mr Simmonds' submission.

714. But equally, I consider that the members are not able to sideline the Q&As. They can take advantage of the Q&As in their favour but they are also to be taken as having a general understanding of the Q&As and in particular of the explanation of the guarantee. I do not detect in the Q&As any support for the view that there is an assurance or commitment of any sort concerning benefit accrual after 2007. It might be said that the fact that the Q&As clearly contemplate further accrual up to 2007 is an indicator that nothing is to change thereafter. If it said that accrual is assured after 2007, the immediate question is, for how long? There is no reason to select 2014. 2014 is relevant to the period of the guarantee but not to the period of a commitment to further accrual on the basis that nothing is to change. The logic of the argument is that accrual is to continue unchanged indefinitely absent a serious change of circumstances: but that is a conclusion which cannot be right. In any case, the contrary argument is that a clear commitment to continued accrual until 2007 is an indication of precisely the opposite result: an express – or at least necessarily implicit – conclusion that accrual is to continue through to 2007 can be said to be an indication that, after that time, there is to be no commitment and that there is certainly no guarantee or assurance.

715. My conclusion, subject to paragraph 717 below, is that the reasonable member is not entitled to read the Webcast, Mr Lamb's letter and the Q&A's taken together as giving an assurance or commitment that benefit accrual will continue after 2007 at the current rate. This goes further than my conclusion in relation to the Webcast. Even in relation to that, my inclination was to say that the reasonable member would have not seen a commitment to continue accrual after 2007, although he/she (and indeed Holdings) might have hoped that it would. If it did then the Evergreen Agreement would take effect. But I do not see the Evergreen Agreement as inconsistent with termination of future accrual. That inclination is confirmed by Mr Lamb's letter and the Q&A's which make no reference to the Evergreen Agreement.

716. I do not consider that the contents of sections 17.4 and 17.5 of the Q&As which have been relied on affect my conclusions. Those sections repeat previous comments about commitment and sustainability but do not, in my judgement, take the debate further.

717. There is one caveat which I must express to these conclusions. Unbeknownst to the members who read Mr Lamb's letter, the Trustee had approved the Ocean changes only on the express assumption (known to Holdings by the time of the member consultation) that there were no plans for other major changes to the Trust Deed and Rules or to pension practice. The reasonable member's expectation from the Webcast and reading Mr Heath's letter cannot, therefore, have been seen as influenced by the Trustee's assumption. But this factor is one to be brought into account in assessing whether Project Waltz gives rise to a breach of the *Imperial* duty.

718. The next documents to be considered are the 2004 Members' Reports for the Main Plan and the I Plan, published in July 2005. Both of these contained further information about the guarantee. Mr Lamb's letter of November 2004 was reproduced.

719. IBM relies on those Reports as reinforcing the message which it submits the previous documents gave. I agree that the Reports reinforce the previous message, although as already explained, the message which I consider those documents gave is not quite the same as that for which either Mr Simmonds or Mr Tennet contends.

720. A brief summary of the key features of the Funding Agreement was reproduced in those reports from the Plans valuation reports under the heading "Key Features of the Funding Agreement contained in the 2003 Valuation

Report". After that, there followed an outline of the termination provisions. That outline uses some fairly dense and technical language. The relevant passage is set out in the RBs' closing submissions: this was done, it is said, merely to show the difficulty members would have faced in understanding what it meant.

721. Whatever difficulty there may have been in understanding that outline, I agree with Mr Simmonds that the reasonable members interested in the nature and content of the guarantee (which our hypothetical reasonable member would have been) would have read the section of the Report under the heading I have just mentioned. His submission is that it provided a clear and accurate summary of the principal terms of the Funding Agreement (this section of the Report does not actually use the word "guarantee" at all although the previous section, replicating the November letter, did of course do so). A fair reading of this summary in full would, he suggests, have informed the reasonable member of the following:

    i) the Funding Agreement was all about the provision of financial support for the Plans until 31 March 2014;

    ii) contributions payable by the IBM UK employers in accordance with the funding plan would be underwritten by IBM WTC; and

    iii) the funding position of the Plans would be underpinned in certain circumstances, with the purpose of addressing deficiencies in the Plans.

722. Mr Simmonds states, correctly, that the Report describes the circumstances in which the Funding Agreement would be terminated prior to 31 March 2014, including where the Plans were no longer in deficit on a prescribed basis, or where the UK employers had sufficient financial resources to meet any funding shortfall on a prescribed basis. It is clear to me, notwithstanding Mr Tennet's submissions, that the outline could not be read by the reasonable member as supporting the idea that the Funding Agreement (or the guarantee which formed part of it) was a guarantee of future benefit accrual or, indeed, that the Funding Agreement was concerned with future accrual at all.

723. Both sides are correct in thinking that the Report is consistent with their positions. In that sense, if the previous documents showed that the RBs are correct or that IBM is correct, then the Reports would underline the correct position. Equally, the Reports are entirely consistent with the approach which I have concluded is actually correct in relation to the earlier documents. In the end, I do not think that the Reports assist.

724. It is fair to say, as Mr Simmonds does, that there was no significant opposition to the proposals amongst the membership during the course of the consultation process. However, as a result of the consultation, one amendment was accepted by Holdings. That amendment (which was notified to the Trustee at a TMM held on 9 December 2004) was to give N Plan members a one-off chance to elect to make contributions of 2% in respect of the increased cost of future accruals and, in return, to continue to accrue benefits at the existing rates, rather than have reduced accrual for future service. Subject to that amendment, IBM decided that it wished to proceed with the proposals. They were approved by the Trustee at the TMM held on 9 December 2004 just referred to and were implemented with effect from 6 April 2005. At that same meeting, the Trustee approved the wording of the relevant documentation effecting the changes and including in particular the Funding Agreement which contained the guarantee.

725. Mr Tennet submitted in his written opening submissions that IBM was undoubtedly aware that members were left with the impression that the plans would stay open in future for the long term. Thus he refers to Mr Newman's report to Mr Heath on 9 November 2004:

> "There is almost euphoria amongst people that I've bumped into this morning. There's an almost tangible air of "relief" and they are really appreciative of the open, honest, factual no-nonsense way in which this series of announcement has been constructed and announced. The 1 or 2% increase is clearly less important to people than the (implied) message that the Plans are not being closed, nothing else really nasty is going to happen.....and the funding/guarantee is a bonus on top."

726. I do not consider that one can take from this the message that members thought the Plans would remain open for

the long term. The fact is that there was, as I have said, a concern at the time, and there had been press speculation, that IBM was actually considering closing the Plans. The Webcast and Mr Lamb's letter made clear that that was not going to happen. The members were able, like Mr Lamb had been, to breathe a sigh of relief. But they were not entitled on the basis of what they had been told to conclude that the issue would not be revisited. They were not entitled to think that the Plans would remain open for the long term and not even, in my view, in the medium term. members may well have hoped that what they were told would turn out to be a long-term solution and that the Plans would remain open for the foreseeable future. And they may well have felt disappointed (many certainly were) and even angry when the Project Waltz proposals were presented. They may well have felt equally disappointed and angry if the Ocean proposals had never seen the light of day and Project Waltz had been the first change. The issue is not whether they were disappointed and angry; nor, indeed, is it whether they believed, rather than merely hoped, that the Plans would remain open, although that is a pre-requisite to their claim. The issue is whether Reasonable Expectations were engendered by the communications from Holdings on the basis of which they were entitled to form such a belief.

727. At this stage, I wish to refer to one point on which Mr Tennet relies and to flag one general point raised by Mr Simmonds. Mr Tennet relies on what Mr Heath told me, as Mr Tennet puts it, that he had received "a lot of feedback" from many members over a long period of time after the Webcast, and that he was well aware, even at the time of the 2005 Ocean changes, that a number of members (even if not, in his opinion, the majority of members) were under the impression that IBM had guaranteed that future benefit accrual would continue unchanged. That is a slightly tendentious way of putting it. The exchange went like this:

> "Q. From those discussions which subsequently occurred, is it your understanding that many members did assume that what you were telling them in this telecast was that the ongoing status of the plans was being guaranteed until 2014?
>
> A. I don't believe that was the majority view of the members. Certainly in the feedback I have had, and I did have from a wide range of members, I think the majority of members understood what the guarantee was about; that the guarantee was about the funding of the plan, not the future of the plans. However, there were some people who had interpreted it in a different way, absolutely."

728. And in relation to what members thought the formal guarantee referred to in the Webcast meant, there was this exchange:

> "Q. …… You accept that at least some members took away the impression that the scheme was guaranteed not to close before 2014?
>
> A. I think some members may have taken the impression. I don't believe that was the majority of members. And when those members, the smaller number of members, came to me and asked me, I explained what the guarantee was actually about."

729. That is not a very strong base, I venture to suggest, from which to assert that IBM knew that "many members" were under a misapprehension, let alone that the hypothetical reasonable member would have held such a belief. Nonetheless, Mr Tennet goes on to observe that when Mr Heath was asked at the Project Ocean and Soto roadshows whether the guarantee provided such an absolute promise, he always put members right. Again, it is worth setting out the exchange:

> "Q. You don't say that you are guaranteeing the plans will never close in future, but you do talk here of a commitment to underpin sustainability. Would you accept that your announcement could have been reasonably interpreted by members to mean that if they agree to pay the increased contributions, which they are not obliged to pay, then IBM was committed to the sustainability of the plans in the UK?
>
> A. I would certainly accept that at the time it was not IBM's intent to close the schemes and that was not on the agenda, and we wanted to reassure people that that was not on the agenda at the time. I was asked in subsequent roadshows specifically the question around: is there a guarantee around the

future? I offered the response: no, there is never a guarantee in anything. But -- but -- we are -- our intention is to put these schemes on a more sustainable footing. Absolutely."

730. Mr Heath did not, there at least, answer the question about how the Webcast could reasonably have been interpreted. That, in any case, is a matter for me. Mr Tennet refers to Mr Heath's answer, however, as showing support for his submission that Holdings knew that many members were under a misapprehension. I do not understand why it does so. The fact that a member asks a specific question does not mean that he had misunderstood the message which Mr Heath was intending the Webcast to convey. The questioner might have been unclear about the message and to have been simply seeking clarification, thus demonstrating at most ambiguity in the Webcast. Or he might have understood the message as being that which Mr Heath intended and to have been seeking confirmation that he could not expect a guarantee about future accrual. This is all speculation. My only point is that Mr Heath's answer lends scant support to the proposition that many members were under a misapprehension. I do not accept Mr Tennet's submission that the very fact that Mr Heath was having to put members "right" indicates that there was a commonly held misapprehension or that IBM knew that such a misapprehension was commonly held, or that IBM's communications, sent to all members, were not sufficiently clear in this regard. But even if that is wrong, the question is what the reasonable member appreciated. It is not possible, in my judgement, to erect an entire edifice, designed to support an assertion of breach of the *Imperial* duty, on a foundation of an allegedly unclear communication particularly where this particular piece of evidence relied on is that it was not a majority of members who were under a misapprehension. It is no doubt almost certainly the case, as Mr Tennet says, that not everyone attended the roadshows. But I fail to see where that gets him: the most he could say is that some of (the minority) of members who were under the alleged misapprehension were not disabused of it, a foundation which would not support the smallest of garden sheds.

731. The general point which Mr Simmonds makes (although it is jumping ahead a bit) is this. If and insofar as the members had gained the impression that there would be no further changes to benefit structures for a particular period, it is clear that the announcement of the Project Soto changes ought to have led them to question that impression or, at the very least, to reflect on the fact that IBM did not share that impression as to what had been agreed or committed to by it in 2004. He says that the possibility of future changes was then clearly communicated. Having flagged the point, I park it for now.

732. Just to complete the narrative of the Ocean proposals, after completion of the employee consultation, the Trustee resolved, at a TMM meeting on 9 December 2004, to implement the changes, and approved the wording of the necessary Deeds. At the same meeting, the Trustee then considered the investment strategy in the light of the guarantee, with the assistance of the Scheme investment adviser Mr Pardoe. The minutes record that Mr Pardoe explained that the investment risk within the Main Plan was high, relative to the current liability profile and the size of IBM UK, and also record that:

> "without the existence of the Guarantee Watson Wyatt would be recommending a significant and accelerated switch to bonds. However, he stated that with the Guarantee a slower pace of change may be acceptable (e.g. an initial 10% switch followed by 2% per annum)……"

733. Mr Wilson was also well aware of the investment risk, and explained that the:

> "Principal Employer would also wish to see appropriate actions taken to resolve the mismatch which currently existed and was of the opinion that the issue should be closely monitored throughout the ten year period of the Guarantee."

734. The Trustee ultimately resolved to move 10% from equities to bonds over the next 3 years. As Mr Lamb explained and I accept, that decision was on the basis of the Trustee's understanding that it "had reached a bargain with IBM that would secure the sustainability of the DB pension schemes".

735. The Funding Agreement was executed on the same day as the TMM, 9 December 2004. I have already set out its essential provisions: see paragraph 111 above. Accordingly, the Funding Agreement had achieved CHQ's twin objectives of removing the margins for prudence in the funding assumptions and of persuading the Trustee to

adopt only a slow move to bonds.

736. It is to be noted that the Funding Agreement does not refer expressly to a commitment to make contributions of £181m/19m to the Plans over each of the years 2005, 2006 and 2007. Those figures arise out of the actuary's advice that, if the guarantee were provided, he would be able to recommend contributions at that level. Nonetheless, it was clearly, in my view, both Holdings' and the Trustee's understanding that contributions would be made at that level for those years and that, indeed, is what the Funding Agreement in fact would achieve if the Plans' benefit structures remained unchanged. Both the Webcast and Mr Lamb's letter of 9 November 2004 communicated to the members (as already noted) a guarantee that payments at that level would be made for each of those three years.

Project Soto

737. I have described the Project Soto changes in paragraph 112-115 above; they are to be found at Annex C to this judgment. The changes need to be considered in the context of the Trustee's investment policy which, in turn, reflected Holdings' strategy as a result of the adoption of the Ocean changes. It will be recalled that the Trustee had wanted to switch gradually from what it saw as overexposure to equities, particularly UK equities, into bonds (of which there were, of course, a variety of types including index linked bonds, UK fixed interest bonds and global bonds). Consideration was given to the type of bonds best suited to the Plan at an Investment Committee meeting on 17 February 2005. It is worth noting a couple of matters which were identified in a paper prepared by Watson Wyatt for that meeting. That paper identified the "overwhelming amount of risk" as originating from the equity holdings so that changes made within the bond portfolio would have a minimal impact on risk. But since a switch to bonds was anticipated (albeit at a slower pace than contemplated before the adoption of the Ocean proposals) the issue of how the bonds were structured would become more significant. The paper reminded the Trustee that the "Duration of the bond portfolio is, generally speaking, just as important a source of risk, ie a mismatch to the characteristics of the liabilities, as the proportion of inflation sensitive bonds held."

738. IBM operated a Global Bond Fund (**"GBF"**). As appears from the minutes of the Investment Committee meeting on 17 February 2005, of the £150m received from Holdings in December 2004, £114m had been invested in the GBF. A further £200m, representing the proceeds of other investments which were being realised, was due to be invested in it. The result would be that the Plans would hold 25% of the GBF.

739. The subject of the bond allocation was raised again at the Investment Committee meeting on 20 October 2005. Watson Wyatt advised that the "duration of the bond assets in the Fund…is significantly lower than the duration of the liabilities". The duration of the total bond portfolio was about 8 years, whereas the duration of the liabilities was around 16 years: if interest rates were to fall by 1%, the Plans' liabilities would increase by around 16%, whereas the value of the bonds (which were under 30% of the total assets) would rise only by around 8%. In other words, there was not a matching of assets and liabilities. CHQ were, I have no doubt, aware of this issue. Watson Wyatt also advised that a significant proportion of the liabilities were inflation linked, meaning that, since much of the income from the bond portfolio was fixed, the Plans were exposed not only to interest rate changes (via the mismatch in duration), but also to inflation rate changes.

740. Mr Tennet submits that the obvious solution to the interest rate exposure identified was to switch into longer bonds. However, the Trustee by then had no control over the duration of that part of its bond allocation invested in the GBF so long as it remained invested in that fund. And, as Mr Martin Jack (Director, IBM Retirement Funds, EMEA) told the Trustee at the 20 October 2005 meeting: "the purpose of the GBF is not intended to match liabilities but is to maximize alpha." As Mr Tennet correctly observes: "In other words, IBM did not view the GBF as designed to match the Plans' liabilities, but instead it viewed it as an opportunity to seek outperformance".

741. The strategy which Mr Tennet suggests may be one way of dealing with the mismatch. But it could only ever be part of the strategy. In any case, the appropriate investment policy for a scheme depends on a number of factors of which matching is only one. Moreover, it is accepted that the Trustee's actual investment policy was within

the range of reasonable policies given the guarantee in the Funding Agreement, quite apart from which, exact matching can never be achieved.

742. The Trustee's view was that no immediate action was required: as Mr Lamb observed, "the guarantee has given the Trustee a period of time in which to put in place a structure to achieve better liability matching." According to Mr Tennet, it is plain from that that the Trustee's approach was entirely founded upon its assumption that if the risk did not pay off IBM would not withdraw its support of the DB Plans by ceasing future accrual. That goes too far: I agree with what he says but only with the omission of the words "by ceasing future accrual". The benefit of the guarantee was not dependent in any way upon future benefit accrual. It was not even dependent on the Plans staying out of wind-up and continuing as closed schemes since the Funding Agreement provided protection in that event.

743. The Soto changes also need to be considered in the context of the actual and projected NPPC figures which were of importance to IBM Corporation (and CHQ) in meeting its targets for EPS. The RBs' written opening (which I do not think is challenged in this respect) contains a table (at paragraph 184) which shows that UK NPPC pension costs (including DC costs) were projected (in May 2004) to increase by $84m between 2005 and 2006 and that total UK costs were projected to be $237m in 2006. That paragraph attributes the cause to the 2000-2002 crash, as to which I do not have the material to form a judgment but which seems entirely plausible.

744. Further projections by CHQ in early January 2005 were that 2005 NPPC would reach $110m. By 17 January 2005, Watson Wyatt had advised that NPPC for 2005 was likely to be $193m. The reasons for this increase were (1) a change in assumptions resulting in an increase in the PBO (projected benefit obligation) and (2) a shortening of the amortisation period over which earlier market losses could be spread.

745. It was this increase which, according to the RBs, was the trigger for the Project Soto changes. IBM has a different perspective, suggesting that the underlying causes of Project Soto were twofold. First, it was a reaction to the impact of the working into the NPPC figures of the bursting of the 'dot com' bubble in 2002 and 2003. Secondly, it was a reaction to the fall in bond yields experienced in 2005. On either view, however, it was the increase in the NPPC figure which was the catalyst for the change.

746. From CHQ's perspective, the objectives of Project Soto were threefold:

i) the reduction in 2006 NPPC, the importance of that reduction being to assist IBM Corporation in meeting its EPS targets (as was also the case in relation to Project Waltz);

ii) the reduction in NPPC on a longer-term basis; and

iii) the reduction in volatility of retirement benefit costs. That, in essence, is volatility in the gap between the amount of the liabilities and the value of the assets.

747. It was not suggested at the time, and I do not believe it is suggested now, that operational performance of the business within the UK was a driver of the Soto proposals. There is no evidence to suggest that such performance was any sort of catalyst. Nonetheless, operational performance became a factor which CHQ used to push the proposals forward (or as the RBs might prefer to put it, to force the proposals on the UK team).

748. There is no doubt that the impetus for the Project Soto changes came from CHQ rather than the UK management. In March 2005, Mr Koppl gave a presentation (his paper "Retirement Related Expense – February Forecast") to Mr Loughridge, IBM's global CFO, that forecast a substantial increase in IBM's projected global NPPC. The presentation included a slide entitled "2006 Retirement Related Expenses Risk/Roadmap". The presentation gave a worldwide forecast of NPPC costs for the non-US DB plans; these costs were projected to increase/decrease from $252m in 2004 and $793m in 2005 to $1,044m, $1,121m and $954m in the years 2006 to 2008 respectively. One slide showed that the NPPC increase was worldwide and not unique to the UK. After 2007, the cumulative loss is shown as decreasing. It would appear that the effects of the 2002-02 world financial problems would have worked their way through the NPPC figure. The increases in NPPC had been described in internal CHQ material as the "perfect storm" in the sense that it was the result of the combination of market falls

(reducing ROA) and falls in bond yields (reducing the discount rate). As Mr Tennet points out, this did highlight the mismatch of investments with the way that liabilities were valued for the purposes of US GAAP.

749. Mr Tennet also makes reference to the fact of CHQ's awareness of the potential problems with DB schemes at this time. As it was put by Mary Barton in an email to Mr Koppl dated 31 October 2005:

> "the pension levels are rooted in a past when IBM faced little competition for its products and services. Today's intensely competitive marketplace, on the other hand, requires that we deliver products and services at competitive rates. When we shoulder benefit cost burdens that few of our competitors experience, it hurts our ability to price competitively…
>
> The problem is most acute right now in a handful of countries (Canada, Germany, Japan, Netherlands, U.K., U.S. and Switzerland). In each of these countries, in late 2005, IBM is identifying solutions to help curb the rising pension costs that are threatening the vitality of the business."

750. It was in response to these projected cost increases that Project Soto was initiated. Its purpose was to analyse for each relevant country (including the UK) the potential benefit redesign options that might be available and the financial, HR and legal implications of those options. Work on Project Soto began with a meeting at CHQ on 14 July 2005 attended by, among others, Mr Koppl, Mr David Hershberg (CHQ Legal) and Mr Eric Alderman (whose role I do not know). Some slides were shown during the course of the meeting. Slide 1 stated that "Retirement Related Expense is Far Too Volatile" and that the aim was to "Define a strategy to reduce volatility" with a view (stated in Slide 8) to "Implementing changes by Jan 2007". Various alternatives were flagged at this stage, including "Improve asset – liability matching" and "Freeze DB, replace with DC". The charts expressly noted, however, that even if all active employees moved to DC worldwide this would have only a slow and relatively small effect on PBO volatility.

751. Now, it might be said that CHQ had no business opening up a review of the UK DB Plans in the light of what had been communicated to members at the time of the Ocean changes. I would not agree with that because CHQ was, quite reasonably, investigating all options in the light of the circumstances (in a rapidly changing environment) in March 2005. The review included consideration of the legal implications; there could be no suggestion at that stage that CHQ was set on a course of action even if it might be of doubtful legal validity.

752. Slide 8 also shows that the proposals would be devised by CHQ and then IBM would work with country management to implement them. Objective advice based on external legal expertise was to be obtained. The process, which would involve consideration of the HR and legal position, is fully recorded in a paper prepared at the end of July 2005 by Towers Perrin who were engaged by CHQ to undertake analysis of the options.

753. Work was done on a further presentation by Mr Koppl (given on 12 August 2005) in which cessation of DB accrual was one of the options for consideration, as was reducing or eliminating early retirement "subsidies". CHQ had been heavily involved in the Ocean project less than a year before and yet there was no mention of the selling points which had been made of sustainability, security or the firm footing on which the Plans had allegedly been placed. Nor was there any mention of the "automatic entitlement" to early retirement which many members reasonably believed they had (which belief Holdings certainly knew about and which is difficult to imagine CHQ did not know about). The aim was stated as simply being "to reduce 2006 expense"; reference to volatility had disappeared. Perhaps Mr Koppl did not know what had been said to employees in the UK. Nor was any of this mentioned in Towers Perrin's paper "Initial Findings" dated 16 August 2008.

754. Before local teams were informed about Soto, CHQ carried out further analysis, and considered how it was going to present the Soto initiative to local management.

755. I ought at this stage to mention some of the communications leading up to the first meeting with local UK management.

756. On 17 August 2005, Ms Karen Salinaro sent an email to Mr MacDonald. She explained that she had spoken to

Mr Michael Burkhardt (HR leader for Northeast Europe), Mr Joe Severi (VP Human Resources, South West Europe) and Mark Slocum (CFO South West Europe) about CHQ's intentions in Europe. She said that she had "played the in-country card" explaining that the countries with the biggest NPPC increases (including the UK) would "need to focus on what they can within country to offset the problem". In other words, each country was expected to produce a contribution to the solution of the NPPC problem faced by IBM Corporation as a result of US GAAP and its implications for NPPC. In practice, CHQ was leading the agenda and, as will be seen, calling the tune.

757. Mr Koppl gave his "Work Plan" presentation on 18 August 2005 which showed among other things that CHQ still had work to do on its analysis of the savings from freezing future accrual and other design options. The cessation of accrual was thus an option which had not, at this stage, been ruled out.

758. On 1 September 2005, Towers Perrin produced their draft work in progress report in support of the design discussion. For each plan, the covering email explained that they had assessed, among other things, the possible employee relations implications. The column which had appeared in a previous version quantifying the size of the potential saving had been removed since it had been agreed (presumably with CHQ) that "this information will not be shared, at this stage, with the local IBM teams". Towers Perrin identified one problem: cessation of DB accrual "Might be viewed as a breach of trust by employees".

759. Further, Towers Perrin were working on the assumption (since shown by my decision on the Rectification Action to be incorrect) that there was no right to retirement with an unreduced pension from age 60. Nothing was said, so far as I can see, about changing early retirement policy and practice although it must have been implicit in the option to restrict post-60 early retirement subsidies.

760. The possibility of avoiding the perception of breach of trust would not have been helped if the UK Team had known of an email sent on 30 August 2005 by Ms Salinaro to Mr Koppl commenting on a briefing paper prepared by him for Mr Greene:

> "….Randy communicated to these countries and IOT leads that unless they make significant changes to the retirement plan to reduce I&E impact, there will be no SIP/PB/equity funding made available to them. It is their problem and the corporation and other countries without pension issues will not subsidize their largesse. They can choose between spending the money on their active employees/execs in cash/equity or on the retirement plan. Given that in most cases not all of the employees are in the offending plan, we expect that changing the plan will be more attractive than no SIP/PB/equity"

761. As I understand, Mr MacDonald had communicated the message in the first sentence just quoted. But the remainder of the passage is Ms Salinaro's explanation to Mr Koppl of CHQ's thinking which the UK Team would not have known about. On that basis, Mr Tennet submits with some force that this was a:

> "pretty extraordinary summation of the position in the UK given the actual causes in the increases in NPPC and the long history of profiting from the UK DB Plans. The threat to withdraw any salary increase programme funding (effectively freezing salaries in countries with DB pension schemes until cuts were made), was not consistent with a consensual and collaborative approach by CHQ towards in-country management."

762. One might add that it does not seem consistent either with the still recent communications in the context of Ocean including not only "commitment" and "sustainability" but also an apparent undertaking to make contributions for 2005, 2006 and 2007 in respect of future service (as already explained).

763. Coming to communication with the UK team, on 31 August 2005, Ms Salinaro emailed Mr Burkardt, Mr Severi and Mr Slocum with an outline of the next steps for Project Soto. She asked that her email be forwarded to the key people in the UK who would be working on the project. The email set out a tight timeline (a "very rapid process" as she described it), which envisaged approvals, including the approval of the Trustee, would be obtained in the week of 28 November 2005 so that the proposals would be ready for implementation by the end

of the year. CHQ would retain oversight of the project. The email had began with the statement – perhaps even a warning: "Now that we have all heard the same message about our need to focus on the 2006 and longer-term I&E impact associated with pensions, we wanted to outline the process that we are envisioning". The first "we" was no doubt a reference to "you", the recipients and the second "we" a reference to CHQ. The stated objective at the end of the email was that "The UK, Germany, Netherlands and Switzerland businesses must be able to cover the increase in their year-to-year workforce costs": not much room for local management decision-making there, one might observe.

764. Following that, the UK team was informed of the Soto project, Mr Heath being forwarded that email on 7 September 2005. There can be no doubt that the UK team's initial reaction was one of great concern especially, as Mr Heath describes and I accept, because these changes came so soon after the Ocean changes. Mr Wilson himself shared that concern as he explained and I accept. He had been sent an email on 31 August 2005 by Mr Jack with his preliminary thoughts and containing NPPC projections and an analysis of the effect of certain changes in the design of pension provision.

765. It was intended that the meetings with local management, the so-called 'kick-off' sessions, in the several countries would take place in mid-September 2005. The first kick-off session for the UK was booked for 13 September 2005 at Bedfont Lakes. The proposed attendees included the UK team (which included Mr Heath, Mr Wilson, Mr Murphy (UK HR) and Mr Waller), Mr Hirst, Mr Burkhardt, members of the CHQ team, Mr Iain Stark (Europe HR) and Towers Perrin. That meeting did actually take place at that time and place. Mr Koppl was there as part of the CHQ team.

766. Before that meeting, an interim conference call was planned for 9 September 2005 to take place between the UK team, personnel from CHQ, Mr Stark, Towers Perrin and Jones Day (IBM's US lawyers). Prior to that call, Mr Stark had forwarded to the UK team a one-page summary of possible design options from Towers Perrin, which listed some options and the possible US GAAP (*ie* NPPC) effect of them. Mr Stark did not send, and nor did the UK end receive, Towers Perrin's full report. Mr Heath's response (to Mr Wilson, Ms Middleton (a member of the UK legal team) and Mr Hirst) was: "I think we have already looked at most of these but ought to include our view of doability in our pitch for Tuesday [13.09.05] on any we have not already considered".

767. The UK team was not happy and continued to express concern about cessation of DB accrual. Thus on the same day, 9 September 2005, and before the call took place, Mr Waller sent CHQ the UK team's initial "UKI Soto Initiatives" charts, which broadly corresponded to the list of options in Towers Perrin's one-page slide to which I have just referred. The slides reminded CHQ of the actions that had been taken during Ocean. In particular, one slide emphasised that closing the plans to future accrual or compulsory transfer to DC ″Would be viewed as breach of trust. Contrary to message delivered end 2004/early 2005" and that "Benefit reduction not consistent with earlier message".

768. These matters were raised in the UK Workshop on 13 September 2005. When cessation of DB accrual was raised, Mr Heath said that he was worried about the employee relations impact and it would be a "basic breach of trust given l.y.″ which I take to mean "last year" and to be a reference to the Ocean changes.

769. It is not without significance that Ms Salinaro's note records two items. The first, at the beginning of the note, is this:

> "– Key issue is message just delivered a few months ago. What did we say:
>
> Argument needs to be pure economics not FAS economics [a reference to US Financial Accounting Standards]"

770. The second item appears later in the note:

> "Needs solid reasons other than US GAAP
>
> ... Need to build"

771. This is confirmation, if it is needed, that CHQ's starting point was the delivery of NPPC savings; and that was necessary in order to maintain EPS. The real reason for the changes was driven by that consideration and the Soto proposals were a solution to that problem of maintaining EPS and, possibly, a desire to get rid of DB Plans as a matter of policy. The search was then for a justification for the changes which could then be presented as reasons for the changes.

772. The upshot of the meeting was that the possibility of cessation of DB accrual was not abandoned notwithstanding the UK team's concerns and its presentation; and it was agreed that both voluntary and compulsory changes from DB to DC for future benefit accrual would be analysed. It was also agreed that consideration would be given to future COLA.

773. Following the launch of Soto, with its objective to reduce the year-on-year increase in NPPC for 2006, Mr Wilson started work on establishing what that year on year increase was. He started with an estimate of $199m. Following a meeting with Watson Wyatt on 15 September 2005, he was able, in an email sent to Mr Hirst on 16 September 2005, to refer to a much lower figure of $83m. He identified the reduction as arising from the result of recent restructuring, a lower salary plan in 2005, longer average service life, lower future salary increases, better asset returns in 2005 than anticipated and the introduction of the Flex benefits system (which brought tax savings of around $9m pa). Watson Wyatt's own figure was $92m, the reduction to $83m resulting from the last of the items which I have just listed.

774. The figure of $82m is found in IBM's paper dated 23 September 2005 – "Project Soto – Redesign of Pension Plans" (as to which see paragraph 776 below).

775. Mr Tennet says that one might have expected IBM to see this as good news. But Mr Stark had a different take on Mr Wilson's email in his response to Ms Salinaro on 17 September 2005: "You were right when you said that setting a # could distract focus… we have a unique opportunity now to address the costs of pensions – both the level and the volatility – to solve this for the long term once and for all…..". Further, at this time, there was a communication, for the first time to anyone in the UK, that the Soto target was not simply the year-on-year increase for 2006 but a different objective, the long-term overall cost of the Plan: see Mr DeAngelo's email to Mr Wilson on 19 September 2005.

776. The paper "Project Soto – Redesign of Pension Plan" to which I have just referred is marked as "Prepared for IBM Attorney". The slides describe an "Extremely aggressive timeline" and stated that [we] "Must take into consideration country-specific challenges but we must recognise cost decreases for I&E purposes by beginning of 2006", no doubt in order to meet NPPC targets. The slides also state that a communication plan to members would be developed. It would convey a key message that the changes would "Allow continued necessary investment in other compensation programs, salary, variable pay". One might think that the message here was to be that changes to the Plans would be followed by more money being made available for pay increases, something which did not happen.

777. Slide 31 of the draft presentation for Mr MacDonald and Mr Loughridge made the UK's concern about the "Business impact of forced employee change" clear: "Any forced change viewed as breach of trust (company "tricked" individuals to sign up to agreement earlier)…Betrayal – poor understanding of economic case". That slide, however, did not make it into the final deck for the meeting.

778. At this stage of the development of the proposals (mid-September 2005), CHQ was not entirely happy with the approach of UK management which it did not regard as sufficiently enthusiastic about the proposals. CHQ therefore wanted to keep control of the Project Soto Pension Briefing presentation: as Ms Salinaro put it, it was better if CHQ were controlling the document so that it could be directed appropriately. By 25 September 2005, Mr Greene and Ms Salinaro were discussing whether to express their "concerns about UK management" to other managers. There was frustration on the part of Ms Salinaro, expressed in her email to Mr MacDonald dated 28 September 2005, that "the UK team does not seem to feel the same sense of urgency" [the comparator country has been redacted from the trial bundle] and in her email of the same date to Mr Burkhardt where she complained that:

> "the problem I see is the lack of buy-in by local team that there is a problem. Doing "whatever the corp. will ask him to do" is not an attitude that will enable successful execution in a difficult environment… It is clear to me that they feel dragged along unwillingly."

779. Mr MacDonald distanced himself from Ms Salinaro when giving evidence. Perhaps her thinking is not to be attributed to CHQ in all its starkness. But it is the case that, at this stage, she at least was not just considering cessation of DB accrual: unknown to the UK team, Ms Salinaro and Towers Perrin had also been considering winding up the plan. This was less than one year after Ocean, and demonstrated some insouciance with regard to the concerns about breach of trust of which she must have known.

780. During the late summer and autumn of 2005, various discussions were held. In particular, two review sessions, involving Mr Loughridge and Mr MacDonald, were scheduled for 28 September and 25 October 2005.

781. The first of these sessions was attended by 25 people from CHQ, the UK, NE IOT, and Towers Perrin. The UK management's recommendation was that further work be done on two of the identified options, namely (1) voluntary transition to DC with compulsory capping of pensionable DB pay growth and (2) voluntary transition to DC. There was also a third option, reduction in discretionary COLA.

782. Although the UK management did not close its mind to compulsory cessation of DB accrual, it subsequently concluded that it would be the wrong thing to do, certainly from a commercial perspective. For that reason, it recommended the two voluntary transition options. It also recommended that further work be done on COLA: the UK management's then recommendation was to restrict such adjustments in respect of pre-April 1997 service to 50% of UK RPI (subject to a cap of 5%). In an email dated 7 October 2005 following that meeting to Mr Castellanos, VP CHQ HR, concerned in large part with the time by which the proposed changes could be implemented, Mr Heath again explained the difficulties that the Ocean changes had created, but that he thought the UK's proposal was achievable:

> "Our view is that the package of measures we have put on the table are sellable to a broad cross section of our population. There will undoubtedly be a perception amongst a sizeable number of DB Plan members that we have breached the trust they placed in us when we "sold" the previous deal to them last year."

By this time, UK management's proposal was for (1) voluntary transition of DB members to an enhanced DC scheme, with a cash incentive to those who moved (2) restricted pensionable earnings growth of the DB members who remained and (3) a reduced but guaranteed COLA of 50% of RPI, coupled with C Plan enhancements.

783. Ms Salinaro then asked Mr Heath a number of questions about the proposals. His response made it clear that the UK team thought that the proposals would address what they were told were CHQ's two key aims of NPPC reduction, and NPPC volatility reduction:

> "We have developed the package of measures in order to address the two key issues that the corporation has asked that we focus upon, 1. $92M cost saving for the next year 2. Reduction in long term volatility of pension plans."

and

> "The particular proposal is designed to reduce volatility rather than reduce cost and it is that basis that we have used for designing the DC option"

784. According to IBM's written opening submissions, none of these options would have achieved savings sufficient to offset the estimated increase in NPPC of $92m. Accordingly, the UK management was asked to continue its work in order to identify other options that would save $92m, to consider alternatives that would reduce long- and short-term cost and volatility, and to consider an acceleration of the timetable for implementation. The RBs'

written opening submissions contend that the effect of such changes would have been to reduce NPPC by $100m for a full year, and up to $88.5m for 2006, depending on when the changes were implemented, and thus it would have been enough to meet IBM's $92m requirement.

785. It is the case, however, that Watson Wyatt's projections dated 21 October 2005 sent by the UK team to CHQ showed that the current proposals would make substantial reductions in a full year NPPC, that NPPC would be far less than IBM's service cost in 2008 and that NPPC would turn negative in 2010. There is some reason to think therefore the UK team thought that the concerns about NPPC were being met.

786. However, unknown to the UK team, CHQ had been considering other options. Ms Salinaro and Towers Perrin had even been considering winding up the plan with serious consequences for members in many ways including their loss of COLA and early retirement entitlements. Towers Perrin prepared presentations *"Project Soto – Creative Strategies*" for 23 and 25 September 2005 identifying those two serious disadvantages and noting the substantial reduction in benefits (and thus cost, I would add) in the event of winding-up.

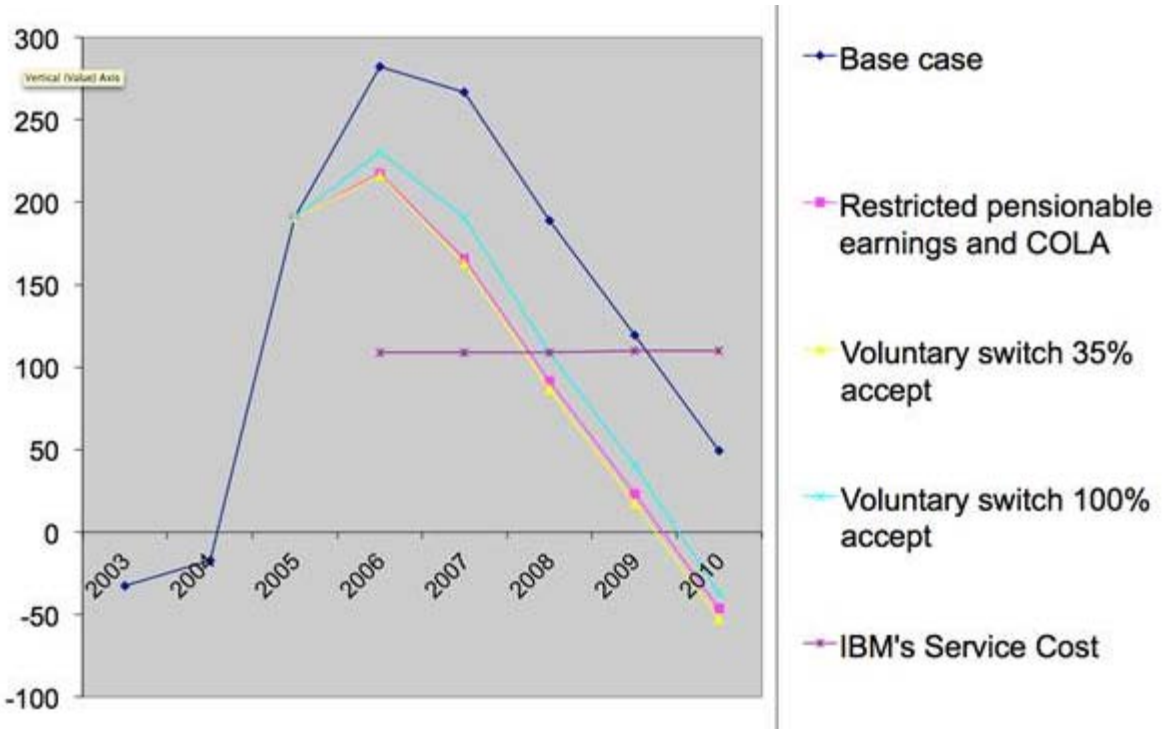
787. Significantly, Mr Potgieter of Towers Perrin wrote to Ms Salinaro and Mr Koppl on 27 September 2005. The relevant part of his email and her reply are set out at paragraphs 970*ff* below.

788. In those emails we see an acknowledgment from IBM's own advisers that the Soto proposals would not solve the future volatility problems. The type of volatility being mentioned here was volatility which has an impact of IBM's P&L account, that is to say NPPC volatility. It is also recognition that such volatility was related to the past. Mr Koppl agreed with that, adding that the service cost only added about 1% each year to the liabilities. His evidence was that NPPC volatility was the result of the large size of the pension funds and the large amount of the PBO. And yet we have Mr Heath saying that the proposals following on from the first review session were seen as reducing volatility and thus meeting one of CHQ's objectives. I am sure that he genuinely did perceive the proposals as having that result, but perhaps he was focusing less on past service benefits and more on reducing any further volatility arising from yet more defined benefits accruing in the future.

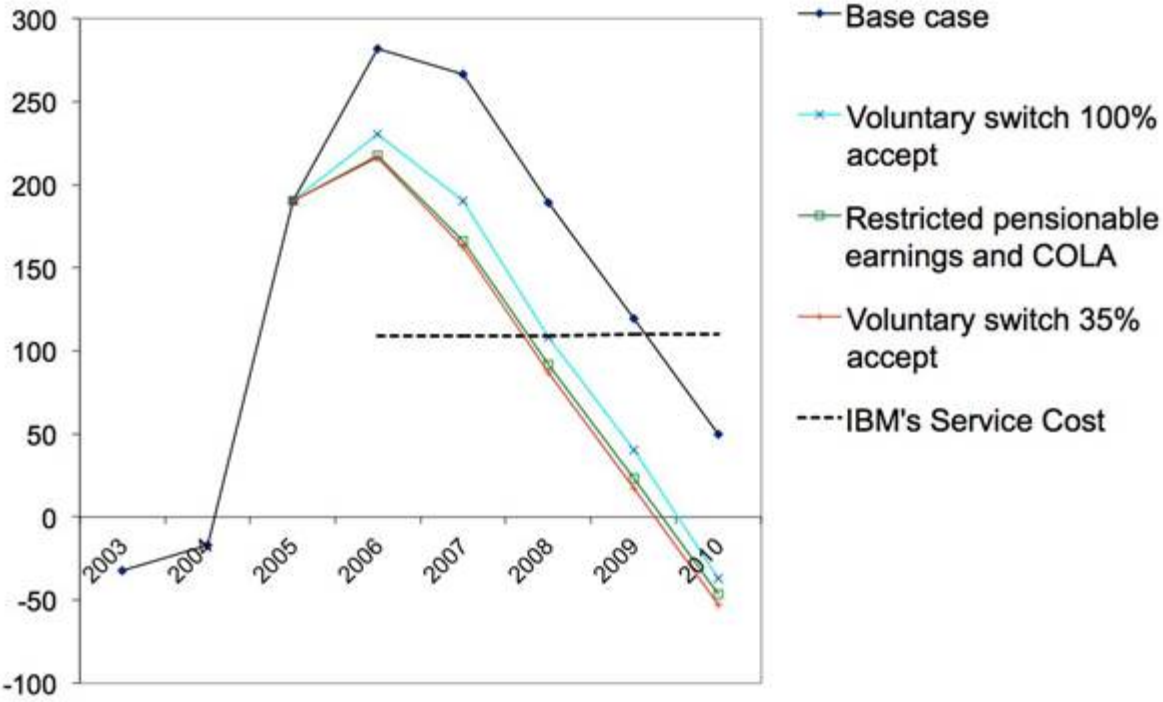
789. There is some further email correspondence which throws some light on IBM's approach. On 16 October 2005, Mr Stark (Europe HR) raised a concern that DB transfer to DC would expose IBM to funding costs, since the DB contribution schedule would remain in place. Mr Wilson's response was to agree that "shifting people to DC will incur additional cash funding costs over the next 2 years" but warned that if cash funding was a concern the whole proposal would have to be rethought. He explained that he thought cash funding was not a concern:

> "so far I have heard exactly the opposite…namely that the priority is 1. 2006 I&E; 2. Longer term volatility; and that the Corporation is willing to use many options including CASH to solve these two."

790. Ms Salinaro considered that "real long-term savings" were the "first priority" and that "volatility is next and that we have some amount of flexibility to use cash to help us get to the optimal solution". I am unclear how this expression of view fits with her response to Towers Perrin (see paragraph 971 below) that volatility was not really addressed by the proposals. As to savings, Watson Wyatt produced some projections which followed shortly on 21 October 2005. I have found the tables very difficult to follow. But the position was, happily for me, summarised in IBM's own graph produced shortly afterwards, using very similar figures. The graph shows NPPC falling from 2006, and turning negative in 2010. That chart is reproduced here, with a line showing IBM's Service Cost after the changes if 35% of DB members decided to move to DC:



(For the reader viewing this in black and white the following chart explains the colouring)



791. The second review session took place on 25 October 2005. The recommendation of the UK team was to incentivise members to transfer voluntarily from DB to DC accrual by providing enhanced DC terms (in the form of increased employer contributions) and by reducing the attractiveness of DB (by restricting pensionable earnings increases).

792. In more detail the proposals were:

i) A COLA increases guarantee would be offered to the Trustee, fixing COLA increases at 50% of UK price inflation, up to inflation of 5% pa. The stated outcome would be a cost reduction.

ii) Pensionable salary increases would be restricted to the lower of UK price inflation or 5% pa for purposes of DB accrual. This change would be implemented through a rule change (and a new section in the I Plan). The stated outcome would be a cost reduction. Mr Simmonds now submits it would also improve volatility.

iii) DB members could voluntarily move to enhanced DC accrual, which would benefit from enhanced contribution rates. There would be no restriction on pensionable salary increases. Accrued benefits were to "retain current Final Pensionable Earning (not restricted) and early retirement terms". The stated outcome would be "Reduced Volatility". A risk was identified: "higher cash (2006/07)". That risk was stated in the slides for the 14 November 2005 meeting as: "higher cash as Main plan funding fixed to 2007 (2006: $9m, 2007: $18m)".

iv) The M Plan would be improved so as to increase the employer contribution rate for under 35s from 6% to 8%, and to double the existing earnings cap.

793. It was estimated that there would be a 35% take up of the incentivised switch. This would give rise to total cost savings on a full-year basis of $96m but, because the changes would not be implemented until part way through 2006, the actual saving for that calendar year was projected to be $61m. It has been repeatedly stated on behalf of IBM that this was not a target. But both CHQ and UK management hoped for a high take-up rate. In the event, the transfer rate was only in the region of 20%.

794. On 14 November 2005 there was a third review meeting at which a finalised package of changes was presented. Mr MacDonald came to the UK for that meeting. He gave his approval for the proposals to be put to the Trustee, but these were subject to a number of matters which can be found under the heading "Rules" in Ms Salinaro's manuscript notes on the front page of her copy of the pensions briefing paper for that meeting:

i) Any guarantee on COLA longer than 10 years would be a "showstopper". IBM would "go to court if need be" over the issue.

ii) If the guarantee were to be longer than 7 years, further approval from Mr MacDonald would be required.

iii) As to winding-up, the notes read: "Need ML [Mr Loughbridge] approval if not excluding from wind up; JRM [Mr MacDonald] says has to exclude wind up".

795. The specific proposals to be put to the Trustee were:

i) A COLA guarantee of 5 years would be offered, and have a banded formula: no COLA for inflation rises up to 1%, 70% of inflation rises between 1% and 5%, and no COLA in respect of inflation rises above 5%.

ii) DB members would be offered the option of moving to DC accrual with enhanced contribution rates (that is to say to the Enhanced M Plan). Members moving would retain their full final salary link. DB members over 55 or with 30 years' service would not be entitled to move to DC accrual on enhanced terms: this would prevent them from benefiting from the changes, given that the C Plan was capped at 30 years' accrual.

iii) For those members who remained in the DB Plans, pensionable salary increases would be restricted to UK price inflation, capped at 5%.

iv) For all DC members, the earnings cap would be doubled, and the employer contribution rate for under 35s would be increased from 6% to 8%.

796. The revised cost savings were $100m on a full-year basis but only $70m for 2006 because the Project Soto changes were to be introduced part way through 2006. It was at this session that approval of the package was given by CHQ and the UK management was given the go-ahead to approach the Trustee. The board of Holdings does not appear to have been involved in any of this. This is surprising even given the powers reserved structure.

797. I turn next to the communication and discussion with the Trustee.

798. On 15 November 2005, the day after approval by CHQ and the UK team of the proposals, Mr Wilson and Mr Hirst met with Mr Lamb and Mr Newman to discuss those proposals. On 16 November 2005, Mr Wilson emailed a note of the meeting to CHQ. He recorded, among other things, that Mr Lamb was "very concerned about how this could be articulated against backdrop of last year's actions"; and that he, Mr Wilson, had confirmed that "accounting of pensions costs under US FAS was an important consideration for the company". Mr Lamb has confirmed in his own evidence, which I accept, that he was "upset at the time that the Company was proposing yet further changes so soon after the 2005 changes had been implemented" and "said to Mr Wilson that if the Company was intent on pushing ahead with the changes I felt that my position on the Trustee board might become untenable and I would need seriously to consider resigning".

799. It seems that CHQ was surprised by Mr Lamb's reaction ("stunned by the severity of the position taken by the Trustee Chairman" according to Mr Hirst in an email from him to Colleen Arnold) although UK management considered him to have reacted reasonably.

800. The next event was the production by the UK team of a briefing paper for the Trustee to be presented at the forthcoming TMM meeting on 8 December 2005. The paper focused on NPPC savings which Project Soto was intended to achieve. The introduction and background records:

> "In assessing its financial plans, it has become clear to the company that it needs to address a significant impact on the 2006 Income and Expenditure accounts from its Defined Benefit Pension Plans…..
>
> The rising pension expense….is largely the result of volatile economic forces outside the company's control."

801. The paper went on to explain that the increase in NPPC came at a time when competitive pressures on the UK business were increasing, and that:

> "it is now appropriate to put forward to the Trustee proposals which will improve our competitive positioning by reducing long term pensions expense and volatility whilst, at the same time, provide a competitive Defined Contribution pension arrangement for current and future employees."

We will find almost identical things being said in 2009 to explain and justify Project Waltz.

802. The TMM met on 8 December 2005 when the proposals were presented by Mr Hirst and Mr Heath. It is fair to say that the board members of the Trustee were fairly hostile to the proposals. Mr Hirst explained (and it is accepted that he was acting in a straightforward and honest way) that the changes were to address not just cost but volatility. And Mr Heath said the same thing. They did not, it is fair to infer, have the benefit of Ms Salinaro's thinking.

803. Mr Heath admitted that IBM had no new information which it did not have at the time of Ocean except that the market place was even tougher than had been anticipated, saying that with the benefit of hindsight, it would have been better to have brought forward the Soto proposals at the time of the Ocean proposals. More significantly, Mr Greene suggested that the proposals were being put forward because the fundamental problem was not an accounting one but was related to other factors such as longevity: but, as Mr Lamb pointed out, longevity had been addressed under the Ocean proposals by increased contribution rates and the sharing of future increased costs 50/50 between IBM and members. Mr Greene also argued that there had been a cost which had been built up over time, but here Mr Lamb pointed out that Ocean had been explicit about IBM's commitment to take responsibility for the past service deficit. I agree with Mr Lamb's ripostes. I also agree to this extent with Mr Tennet when he says that CHQ was attempting to resile from statements made just one year before: the purported justification given by Mr Greene was no justification (if one were needed) at all.

804. The Trustee's response to the proposals was set out in a letter dated 13 December 2005 from Mr Newman. The letter was written to ensure that there was no misunderstanding about the oral response which Mr Hirst and the four conflicted directors had been given at the TMM on 8 December 2005. Mr Simmonds notes that Mr

Newman's letter recorded the Trustee's "disappointment" that the proposals were coming so soon after the Project Ocean Changes. It is clear, I think, from the minute of the meeting and the other evidence which I have had that the word "disappointment" is a considerable understatement of the position of the board members. What Mr Newman actually wrote was this:

> "The Trustee Directors are disappointed that the Company has made these proposals so soon after the bargain the Company and the Trustee entered into on December 9th 2004; a bargain the Company indicated would secure the sustainability of the defined benefit plans and was a fair balance between the rights and expectations of pension plan members and affordability on the part of the Company."

805. The letter went on to explain the advice which the Trustee had received from leading counsel to the effect that IBM had no power to break the link, for past service, with final salary and that, ultimately, the question could only be resolved by the court. Mr Newman's letter was constructive, however. After noting the Trustee's careful hearing of Mr Hirst's explanation of the business challenges facing IBM, he wrote this:

> "As I have mentioned earlier the Trustee entered into a bargain with the Company a year ago covering both past service and future accruals but if the Company is in financial distress then the Trustee is prepared to work with the Company in the interests of all of the members of the Plan and the Scheme."

806. Mr Simmonds remarks that "financial distress" was not an expression that had been used by IBM to justify its proposals. That, however, seems to me to miss the point being made which was that a bargain had been made and that IBM was being required to jump a high hurdle to get the Trustee on side.

807. A further letter was sent by Mr Newman on 22 December 2005 that referred to the elements of the bargain that had been reached in 2004. Mr Newman identified the elements of the bargain as follows:

i) IBM agreed to give the WTC guarantee. This allowed the Trustee and the Actuary to agree to:

a) Use a best estimate basis of valuation;

b) Adopt a longer period over which to extinguish the past-service deficit;

c) Use a slower rate of shift to bonds;

d) Invest in the RFE sponsored GBF.

ii) The Trustee agreed to IBM's proposals to change the benefit structure. It was agreed that:

a) For future service, contributions would rise or accrual rates would decrease;

b) The past-service deficit would be funded by Holdings and employees would not be required to pay for that deficit or their accrued rights;

c) Changes in future service costs would be shared 50/50 between employees and Holdings; and

d) There were no plans for further major changes to the Trust Deed and Rules or pensions practice.

808. These are all matters I have considered at length in addressing the Ocean changes.

809. The UK team reacted to the Trustee's responses to the proposals presented on 8 December 2005 by making certain revisions. The team reformulated the restriction on pensionable salary increases from a cap at the rate of inflation up to a maximum of 5% to two thirds of salary increases granted. The UK team was, by now, projecting savings of $110m for a full year and of $75m for the part-year 2006.

810. This revised proposal was put to Mr MacDonald on 31 December 2005; he approved it. On 5 January 2006, the team took what Mr Wilson referred to as "our senior leadership team" through the changes in "a long and tough meeting". On 6 January 2006, Mr Wilson sent the revised proposal to Mr Lamb.

811. The longer matters dragged on, the smaller the savings would be for 2006 so that, from IBM's perspective, there was a significant degree of urgency. IBM needed to obtain the approval of the Trustee to the changes and so far as possible to get the DB members on side. From what I have said already, it is apparent that the UK team knew they had a difficult task to persuade the Trustee and the scale of that task can only have been underlined by the TMM meeting on 15 December 2005 and the subsequent letters from Mr Newman.

812. In order to resolve the apparent differences between IBM and the Trustee, it was agreed that there should be a meeting between, among others, Mr MacDonald and Mr Lamb. Mr MacDonald was, of course, very senior and no doubt Mr Lamb considered that if Mr MacDonald agreed something on the pensions front, that is what CHQ would adhere to.

813. The meeting, attended also by Mr Hirst, Mr Wilson and Mr Newman among others, took place at the Marriott Hotel in Portsmouth on 8 January 2006 (a Sunday). At that meeting, Mr MacDonald agreed on behalf of IBM that revised proposals would be put to the Trustee at its next meeting (on 19 January). The two revisions offered were:

    i) a cash lump-sum payment to the Plans in the region of £500m by 31 March 2006 in order to extinguish the deficit and to fund the 2006 service cost; and

    ii) more generous proposals in relation to COLA: the original proposal had been for a guarantee of annual COLA for a period of five years restricted to 50% of RPI (subject to a cap of 5%); the revision offered by Mr MacDonald involved a guarantee of increases by reference to 60% of RPI (capped at 4%) for five years followed by increases by reference to 50% of RPI (capped at 5%) for a further ten years.

814. Mr Newman made a note of the meeting. In that note he recorded that:

> "Randy confirmed that in his opinion the current package of proposals put the IBM UK DB Plans on a very firm and sustainable footing for the foreseeable future in their current form. Whilst he (Randy) could not give a guarantee that pension structure would never change again in the future, he confirmed that he had no intention of looking at this subject again and that there were currently no plans to do so".

815. Mr Tennet does not challenge this statement of Mr MacDonald insofar as it relates to his understanding at the time, although he submits that there were people in CHQ who knew it was not the case because the proposals would not solve the volatility problem. What is more contentious about what Mr MacDonald is alleged to have said relates to his use of the phrase "push back" and references to "sustainable". In a later email to Mr Heath, Mr Lamb described Mr MacDonald as telling him, at the Marriott Hotel meeting, that "he had no plans for change and would push back on anyone who wanted to revisit this topic during his watch".

816. Mr Tennet has spent a considerable amount of energy in addressing what Mr MacDonald said at this meeting, and in particular, the use of the words "sustainability" and "push back" and what they mean.

817. Mr MacDonald's understanding, as he explained in his oral evidence, of the word "sustainability" was that it meant something that is ongoing and consistent. He seemed to accept that that would be so not only if "things happen to go well or if things don't change", but also "even if things do change or things don't go quite so well". He later qualified that answer saying:

> "Even if they don't go -- you are suggesting that I am saying that things would be continuing even if business conditions changed and things didn't go well? No, I can't go there."

818. Mr MacDonald described what he was doing was to give Mr Lamb some assurance but not any sort of

guarantee. In answer to a question from Mr Spink he said this:

> "Look, what I was conveying is exactly what I think Jim was asking me: that he wanted some level of assurance. He put that in his witness statement. I completely agree with that. But I have done this for 42 years. I kind of get it. You can't ever guarantee anything other than something like the funding, because you put that in writing. I said I can't guarantee anything but, from what I can see right now -- paraphrasing -- I don't see this as an issue going forward. I genuinely meant that."

819. Nonetheless, he acknowledged that the assurance Mr Lamb was seeking was to give the Trustee confidence that, once the Soto changes were made, the Plans would remain open for the long term. That is a rather different assurance from the one that Mr MacDonald now perceives himself as intending to give. In the light of that difference, I asked Mr MacDonald a question which was essentially why he thought Mr Lamb was happy with what he had been told if he had not been given the assurance which he was seeking. The answer was this:

> "The impression that I left with, and I'm not quoting his words but the sense that I had is that he appreciated my candour and he understood that I couldn't "guarantee" anything, and we got up and shook hands and went our separate ways. There wasn't any adverse dialogue. There wasn't anything that was picking apart what I was saying, so I felt I gave some level of comfort."

820. He did not challenge the suggestion that Mr Lamb in fact took away a very different impression but did not think so at the time: "Now I would, but I didn't at the time".

821. Mr MacDonald says that he does not think he used the word "sustainable" and that Mr Newman's note was a paraphrase of what he said. I do not think, in the end, that he challenged the conclusion that what he actually said conveyed the same message as sustainability. Similarly, he acknowledges that he told the Trustee that although he could not guarantee anything for the foreseeable future, "things were going to be okay".

822. What I found very surprising about Mr MacDonald's evidence in relation to sustainability is that, so far as he was concerned, volatility did not come into the picture at all. The whole discussion, in his mind, was about funding; and reference to a "firm footing" was reference to a firm financial footing. What is clear, however, is that Mr Lamb (and indeed the UK team) thought that volatility was an issue with CHQ (as it was) and that the discussion they were having with IBM through Mr MacDonald related to the issues which had been the subject of previous communications and presentations, including volatility. That was a not an unreasonable basis for them to proceed on.

823. As to "push back", Mr MacDonald accepts that he used those words as well as "on my watch". And although this does not appear in Mr Newman's note, there is no dispute that Mr MacDonald told Mr Lamb directly "if Sam [Palmisano] or anyone else asks me to revisit this topic during my watch I will push back on them". Mr Palmisano was, at the time, the man who Mr MacDonald described as the "top man" in IBM.

824. There is, therefore, a large amount of common ground. The dispute is about what Mr MacDonald meant when he used the words "push back". The RBs says that, in context, it can only have meant "resist". Mr MacDonald did not accept that the ordinary meaning of the words was "resist"; still less did he accept that he used them in that sense. What he told me was this:

> "I think about it in terms of testing, challenging. Challenging: are you sure we have to do this? Why do we have to do this? We just did this – give me the facts as to why it is necessary. That is push back. If they convince me, I go forward. If I convince them that it is inappropriate, we don't go forward."

825. I am bound to say that, in England at least, the ordinary use of those words as a noun is "resistance" and as a verb "resist". I do not perceive anything in the context in which Mr MacDonald used the words that it should be given a different meaning. It is not unhelpful to consider what those present at the meeting actually understood Mr MacDonald to be saying when he used those words. The evidence of all of them other than Mr MacDonald himself, namely Mr Lamb, Mr Newman and Mr Wilson (as well as Mr Hirst in his witness statement), was that

they understood him to be using it in the sense of "resist". Mr Hirst added that such a meaning of "push back" "fitted with the overall impression he gave at the meeting".

826. In any case, if the words mean what Mr MacDonald says he intended them to mean, they really add nothing to what he would, or ought to have done, anyway. Suppose he had said to Mr Lamb that he would test and challenge any suggestion to make further adverse changes before making a decision. Mr Lamb could properly have thought to himself that that is precisely what Mr MacDonald ought to do and would have derived no additional assurance from the words at all. I do not need to decide what it was that Mr MacDonald actually meant at the time. What is clear, as I have said, is that the impression which he gave and which the other people at the meeting were entitled to gain was that Mr MacDonald would resist any future changes which were inconsistent with his understanding of sustainability. Mr Lamb and the others present were entitled to understand Mr MacDonald as giving an assurance – not a guarantee – that the Plans would remain open in the current form for longer than merely in the short term. He clearly did not give a guarantee: the most that he could have been projecting was a level of confidence that things would not change.

827. That conclusion about Mr MacDonald's assurance must be qualified, however. He was not giving an assurance that, if the external financial or trading environment changed significantly, the level of pension provision would not be revisited. What he was saying was that if the environment did not change significantly, nor would the Plans. My use of the word "significantly" is deliberate. It is intended to reflect the test which I have explained in relation to the *Imperial* duty. A minor change in the business environment could not be relied on as justification for a change to the pension provision in the short or even medium term. To react to such a change by reducing benefits could be "perverse or irrational" in the sense explained.

828. The extent to which any of this is relevant is a matter for debate. I only note for the moment that Mr Simmonds submits it is all totally irrelevant because there is no suggestion that the members ever knew anything about what Mr MacDonald had said. How then, it is asked, can any expectations, reasonable or otherwise, have been engendered capable of forming the foundation of a claim based on breach of the *Imperial* duty? The answer to that is that it cannot have been a factor in engendering any Reasonable Expectation any more than the assumption, known to Holdings, on the basis which the Trustee agreed to the Ocean changes, could give rise to a Reasonable Expectation. But such an assurance by Mr MacDonald is a factor to be brought into account in deciding whether the Project Waltz changes gave rise to a breach of the *Imperial* duty because what he said influenced the Trustee in its decision to agree the Project Soto changes.

829. At the conclusion of the Marriott Hotel meeting, Mr Lamb said that he would need to seek the approval of the Trustee but that he would recommend that such approval be given. That took place at the TMM on 19 January 2006 when Mr Heath presented the revised proposals. members would be asked to consent to the change, and any DB member not consenting would only receive a salary increase of two thirds of what they would otherwise be given. As later explained in a Q&A document prepared for members, decisions on an employee's salary increase would be made by his or her manager, who did not know what kind of pension the employee had, or what election he or she made. Once the manager had decided on the salary increase, one third of it, described as a "non pensionable salary supplement", would be taken away if the employee did not consent to the change in pensionability. As the RBs correctly observe, the award of a full salary increase was expressly unrelated to the performance of employees, but instead to their agreement to have their pensionable salary restricted.

830. I need to digress for a moment to consider IBM's attitude to a cash injection into the DB Plans which, it will be remembered, was in a state of significant deficit related to past service. CHQ was attracted by the idea of making a cash contribution:

i) CHQ was aware that the returns from additional cash contributions would boost NPPC. It knew this from, for instance, an analysis which Towers Perrin and Watson Wyatt had carried out in September 2005.

ii) Changes in UK accounting rules (FRS 17) were due to take effect on 31 December 2005. These changes would mean that pension liabilities would feature on Holdings' balance sheet. In practice, this would lead to the requirements of a substantial cash injection to be made either to the DB Plans or to Holdings itself to strengthen

the balance sheet: as was stated in the presentation by the UK tax and treasury team dated 4 November 2005 and as a result of the change "UKI no longer has adequate capital for its business", IBM UK's "business is currently being funded by the FRS 17 pension creditor [*ie* the UK DB Plans]" and a capital injection of £440m was required into the UK DB Plans or into Holdings within 6 months to ensure that Holdings maintained a suitable debt to equity ratio.

831. As well as being attracted by the idea, consideration was given to the possibility from time to time:

i) On 10 November 2005, Mr Koppl sent Ms Salinaro draft slides for the CHQ meeting later that morning. The slides, entitled "Project Soto – Update", dealt with all Soto countries and showed that CHQ was considering making a cash contribution of between $300m and $600m to its non-US pension schemes.

ii) On 5 December 2005, Mr Koppl reviewed some further slides, the "Pension Funding Decision Framework" slides, with Mr Loughridge. On one slide, headed "Roadmap to achieve pension expense target", one of the actions listed was "Contribute $450M to UK pension fund in Jan '06" which would generate $35m savings per year.

iii) Then, on 8 December 2005 Mr Donald DeAngelo discussed with Mr Koppl a slide of the draft presentation for IBM Corporation's Board of Directors, which suggested a cash contribution of $650m to the UK DB Plans, which would generate NPPC savings at 8% for a full year of $50m, or for the part year of $39m. It appears that a requirement to keep these considerations confidential was critical so far as keeping matters from the Trustee was concerned: Mr DeAngelo preferred to keep out of the presentation that the contribution would be made to the UK Plans "as we do not want this to interfere in any way with the negotiations on the Plan Redesign work… I would hate for it to get out and have it influence the negotiations…".

832. So it would seem that internally, at least, CHQ was committed or resigned, depending on your point of view, to the making of a significant contribution to the Plans by the time it had reached its agreement with the Trustee about the proposals to be presented to the membership. But the Trustee board knew nothing of that.

833. After that digression, I return to the TMM on 19 January 2006. The Trustee was told that, if it rejected the proposals, the offer of a lump sum payment would be withdrawn as it was only available that day. Mr Lamb reiterated the deep disappointment of the Trustee that the proposals had been brought forward "so soon after having reached an agreement with the Company in December 2004 which the Trustee had been led to believe was both affordable and would sustain the defined benefit plans." Mr Lamb said he undersood the accounting issues faced by IBM and the impact of welfare costs on those issues. He asked what action Holdings would take "to ensure that this position did not happen again". It is worth setting out Mr Hirst's response as recorded in the minutes:

> "In response Mr. Hirst stated that it had not been an easy issue for him and his management team and informed the TMM members that he had been asked the same questions by the members of the Employee Forum. He stated that, in his opinion, the Company would not have been able to negotiate the deal which is currently on the table with the IBM Corporation if the negotiations on funding and the Guarantee had not been successfully concluded a year ago. He further stated that getting a commitment on a cash injection to the pension plans was a 'big win' and believed that it would help to ensure that the possibility of getting into a similar position again was more remote than before. Mr. Hirst acknowledged that the revised Proposals did not represent the best possible choice but believed that they were the best possible option available and in his opinion were excellent compared to what was happening in many other pension funds."

834. The Trustee then agreed in principle to the proposals. But, as the minutes record, it would be wrong to conclude that anyone was happy with the outcome. A communication exercise with the members would follow.

835. The submissions from each side in relation to the Soto changes reflect very much the submissions made in relation to the Ocean changes. Both Mr Newman and Mr Bridges, who was at the time of Project Soto an independent Trustee director, stated in their witness statements that no assurances were given by IBM at the time

of Project Soto that there would be no further changes. I am sure that that is right in the sense that no express promise was made; indeed, Mr Hirst stated expressly that there was no guarantee as already explained. The RBs contend that the Soto changes, like the Ocean changes, were approved by the Trustee on the basis that the Plans would have a sustainable long-term future: Mr Simmonds' response to that is that was indeed the expectation of IBM's management at the time. One must be careful about that response. It was, I accept, the expectation of UK management that the Plans would have a sustainable long-term future and that there was no hidden agenda to make further changes in the foreseeable future. But whether that was CHQ's perspective is a different question. It is difficult to believe that Mr Koppl or Ms Salinaro, for instance, thought that the DB Plans had a long-term future. There is no evidence to suggest that anyone at CHQ, except perhaps Mr MacDonald, who was involved was genuinely supportive of the DB Plans.

836. Mr Hirst reported the Trustee's agreement to the proposals to Mr MacDonald on 20 January 2006. Mr MacDonald's response to Mr Heath, Mr Wilson, Mr Hirst, and copying in Sam Palmisano, was "you did a terrific job. We teamed well too. The three of you made a huge difference to IBM UK and IBM too. It was a **total** pleasure working with you and your leadership was quite evident every moment." CHQ, at least, was apparently very pleased with the outcome.

837. In the meantime, beginning on 11 January 2006, IBM had consulted on the proposals with the so-called UK Forum, an elected representative employee body used by IBM for the purpose of consulting on employee relations issues. The consultation continued through to April 2006. A total of eight meetings took place.

838. In preparation for the first meeting, Paul Simmons, UK Employee Relations Manager, emailed Declan Murphy (UK HR) with draft UK Forum Charts. He was clearly concerned with the issue of member trust as appears from his covering email: "we should also have a couple of charts addressing the issue of trust and whether this goes against what we communicated last year".

839. The presentation itself gave the same message as that given to the Trustee. The following are extracted from the slides:

i) "This rising pensions expense…is ….largely, the result of volatile external economic forces (beyond IBM's control)"

ii) Reference is made to the increasing "Competitive pressures on IBM's business"

iii) "But increasing pensions expense is consuming an ever growing portion of workforce investment [jargon for remuneration] (£48m in 2006 = 16/17% Operating Profit)"

iv) "To adapt to the ever changing competitive landscape and avoid this debilitating burden IBM must take action to adjust the risk of these types of plans to ensure a long-term sustainable competitive position"

v) "IBM must act now to consider proposals which will improve our competitive positioning by reducing long term pensions expense and volatility"

vi) "IBM is proposing to make a significant cash injection to further improve the security of the IBM Pension Plans"

vii) "The World Trade Corporation Guarantee will remain in place"

840. In relation to the pensions actions taken in 2005, the presentation explained that the Soto proposals tackled volatility and cost, as opposed to dealing with the past service deficit and increases in longevity as had been the principal focus of Ocean:

"

- The actions taken in 2005 secured the funding of the plan liabilities over a 9 year

period and have helped us to address rising pension costs in relation to improvements in longevity

- The guarantee remains in place
- However with hindsight, the actions taken were insufficient to address the underlying volatility of the pensions liabilities and increasing ongoing costs"

841. Another slide asked why the proposals were going to be any more successful. A number of factors would, IBM believed, "mitigate the current volatility" (namely transfers to the DC plans, a one-off cash injection further securing the Plans and a reduced, but guaranteed COLA commitment). The proposals formed part of a broader set of changes "developed by IBM Corporation to address pension costs and volatility across a number of countries". There one sees confirmation, again if it were needed, that it was CHQ which was driving the reforms and which was giving assurances. The proposals were seen by IBM as having an enduring effect:

> "Although there are no guarantees, these actions, along with those already taken, we believe, are sufficient to put our defined benefits pensions schemes on a sustainable footing"

842. The minutes record Mr Hirst as having been asked whether "IBM was clear about the goals so that we do not have to return to this next year". He replied "that there was no guarantee, but that the company was doing everything possible to prevent that and further issues". Mr Tennet submits that this statement, taken with the other material which I have just referred to gives the clear impression to the representatives that Soto would tackle volatility and that IBM was doing everything it could to address that issue.

843. Mr Simmonds has a different take on this exchange. He submits that what Mr Hirst actually made clear was that IBM was not precluding itself from making further changes even as early as the next year; after all, his statement that there was no guarantee was in response to a question about the need to "return to this next year". He goes further, saying this: not only does this mean that it did not preclude itself at the time of Project Soto from announcing the Project Waltz changes in 2009 but also it indicates that IBM did not consider itself to have precluded itself from making such changes at the time of Project Ocean. And he points out that there is nothing in the minutes to indicate that anyone raised the suggestion that IBM was in 2006 precluded from doing what it then proposed to do by reason of anything it had said or done in 2004 or 2005. In particular, nobody is recorded as relying on the guarantee (and what the members had been told about it) as an objection to the proposed Soto changes. Mr Simmonds goes as far as to submit that the very fact that the question was asked suggests that the questioner, for her part, did not consider that the Project Ocean precluded the proposals or further changes in the future.

844. Mr Hirst's answer was, of course, given in the context of the presentation as a whole, where it is interesting, I think, to note the use of the words "sustainable" and "volatility". In the context of this presentation and meeting, "sustainability" can surely only mean an ongoing scheme for future service; and that one problem in relation to sustainability, namely "volatility" had, been addressed (in spite of what Mr MacDonald says about what he thought the proposals were about). In saying that, I do not suggest that Mr Hirst's caveat about nothing being guaranteed has no content: a significant change in the financial and trading environment might lead to further changes having to be made.

845. Although Mr Hirst was making absolutely clear that IBM was not giving a guarantee, there was, to my mind, a clear representation about IBM's belief, namely that the Plans were thought to be sustainable and that volatility had been addressed. There was, at least, an implied representation that IBM considered that the Plans would not represent an unacceptable drain on IBM's resources in cash terms or give rise to unacceptable consequences for accountancy purposes. The message, it seems to me, is "We can afford to keep these Plans going" but no guarantee could be given because in reality all sorts of things might change. It was also implicit in the message that IBM was not, at the time, considering yet further changes in the future.

846. On 26 and 27 January 2006, the proposals were announced by Mr Hirst at three all-managers meetings in London, Manchester and Greenock respectively. In the bundle are to be found the slides comprising of the

powerpoint presentation of the proposals and a transcript of the presentation of one of the meetings. There is also a video of the presentation which I have viewed more than once. There is nothing to suggest that the transcript was ever made available to members at the time.

847. The RBs' written opening submissions and their written closing submissions both drew attention to certain aspects of the presentation, and more was said by Mr Tennet in his oral closing submissions. Drawing the threads together, I summarise the submissions in the following paragraphs. I start with what was said in the meetings:

i) First, Mr Hirst explained that defined benefit schemes in the UK were becoming more expensive as a result of "people living longer, bond rates falling, pensions having holes in them".

ii) Secondly, he explained that IBM UK was increasing the proportion of 'Services' business it undertook. Because "Services" business required a large workforce, workforce costs (what were called "welfare costs") were increasing, in fact they had trebled, and had to be translated into the rates charged to customers. The whole of the increased cost was due to pensions. Everything else had come down but pension costs had more than trebled.

iii) The increased costs had made IBM UK uncompetitive, compared with IBM UK's competitors without such DB liabilities.

iv) Next, "whether true or not", there was a "perception" from DC members that salary increase (the so-called "**SIP**") was restricted because of the costs of the DB Plans. I record that there is a dispute about whether that was in fact a widely held perception or that DC members considered that the cost of DB benefits for those who enjoyed them was somehow unfair.

v) The slides showed that "IBM is facing a significant financial impact on 2006 Income and Expense Accounts from the Defined Benefit Pension Plans that has to be addressed" which was "Largely, the result of volatile external economic forces (beyond IBM's control)" and "For 2006, is primarily due to the impact of lower long-term bond yields on the plans' liabilities." That may be true, but it had little, if anything, to do with concerns about the cost of ongoing benefit accrual: it was a past-service liability problem.

vi) At the end of the presentation Mr Heath displayed a slide containing the following under the heading "A Balanced Package".

"

> •Addresses IBM's long term cost and volatility objectives
>
> •Meets the Trustee's long term stability and funding objectives;
>
> •Meets employees objectives of protecting the pension fund…
>
> •Positions IBM UK to meet future business challenges: De-risking and reducing volatility. "

848. Mr Hirst spoke about the bargain which had been made the year before. The effect of what he said is not entirely clear. I think it is helpful to include the whole of the relevant part of the transcript of the meeting in order to attempt to understand the message which he was conveying. It is important to appreciate that Mr Hirst started this part of his presentation by reference to press reports:

> "Now some of you may be sitting there having read the Independent article and have already got it wrong: first of all I ordered you to be here; secondly, we're closing the DB scheme; so what other screw up did they make. Well, they're commenting on what a lot of people will feel. 18 months ago Larry you came to us and said "increase your

contribution and in return nine years the IBM company will guarantee the pension fund" and now you are breaking that bargain.

Now there's two points here. One, I learned very early in my sales life - perception is everything. I am aware that that is the perception. I need you guys to help me explain why that perception and what we are doing is still in place that we had a deal. The increased costs going forward as opposed to historic costs were what we asked for a contribution for. That's what we asked for - of an increase to six to eight. And in return the IBM company over a nine year period would fill the hole that currently sits in the pension plan. That bargain is still in place and I'm going to pause on that point because David is going to talk about it when he speaks towards the end of his presentation and I'm going to come back- you can ask any questions that you like.

But the bargain we signed is still on the table and the reason that the World Trade Corporation had to put that guarantee on the table is because IBM United Kingdom and IBM United Kingdom Holdings do not have sufficient funds to cover the pension and the pension deficit - we need the Corporation because of the losses that we have made and declared in the past as a company. So, David, I want you to come up and go through the detail."

849. It is to be noted also that Mr Hirst stated that Mr Heath would talk about it (*ie* the bargain) later in the presentation so that, in understanding the message which was being conveyed by the presentation overall, it is necessary to see what Mr Heath said too. Let me record what he did say:

"And the final element – component – within the proposals is to address funding. The company has agreed to fully fund – fully fund – the current deficit and to inject cash to the tune of close to $1 billion into the UK pension plans by the 31st March 2006. That in and of itself gives us a much greater stability, fully funds the plan and it enables us to move forward with much greater confidence.

The next question that might be asked is okay well so the company is going to do this; but wasn't one of the criteria in terms of setting up the guarantee over 9 years last year that we were in deficit and if the company ever did balance the plan that the company could then pull out of that guarantee? Yes it was but what we have negotiated with the company is to maintain the World Trade Guarantee for the period through to 2014. I am just going to go into what we agreed last year because I think it is important, as Larry said.

So the corporation will maintain the guarantee that was put in place last year through to 2014, irrespective of the funding status of the plan. Employee contributions will remain unchanged. We are not planning any changes in employee contributions as part of this package. However we did say as part of the package that we put last year, that every 3 years, the triennial valuation of the plan, we would look again at the cost of future service benefits and we would then look to increase or decrease employee and employer contributions on the basis of a 50-50 sharing dependent upon whether that was increased, whether future service costs continue to increase or whether there is a change of future service costs decreases. We are hoping that the package and measures we have put in place puts us on a better footing in relation to the triennial valuation but that's not due for another, I guess, another year or so yet. But that deal that we did last year, the agreement we put in place last year remains intact; no change, World Trade Corporation guarantee in place, and will remain in place supporting the UK company until 2014."

850. Then a little later, speaking to the slide which I have already mentioned at paragraph 846(vi) above - "A Balanced Package", Mr Heath said this:

"What this gives us is it does help IBM to address the long term cost and volatility issues that we have got within the plans and it does that in 2 ways, through the pensions in payment changes and

through the defined benefits changes that we are proposing to make. It meets the trustee concerns about long term stability and the funding of the plan going forward, and hopefully for many employees it will meet employee's objectives as well for protecting the pension fund that they have already accrued and to get some choice in terms of their future. What you have already got, as I said [is] protected, the choices [are] in respect of the future….."

851. In outlining the proposals, Mr Heath explained how the restriction in pensionable salary increases might affect a DB member over a 10-year period. Mr Tennet submits that this necessarily implied that members were entitled to expect that the way their pensionable salary increases counted towards their pension would remain unchanged for at least 10 years. I do not agree that it necessarily follows in the sense that a change would be inconsistent with the statement. This is particularly so given that the example was given to effect a comparison with what the position would be if no changes were made: the result would be that the member would receive something like 89% of his previous entitlement.

852. Mr Tennet submits that, from the explanation above, those present at the presentation could reasonably expect (and communicate onwards the message) that:

i) IBM had again very carefully (re)considered the costs of the DB Plans (particularly on an accounting basis) and specifically the volatility of pensions costs in future, and concluded that the Soto Changes would reduce costs and volatility of costs to levels it was content to bear for the long term;

ii) IBM had considered how its DB pension costs affected its competitive position, and how they foreseeably would affect its competitive position in future, and concluded that the Soto Changes would address pension-related competitiveness issues in the foreseeable future; and

iii) IBM had specifically considered and addressed any "perception" from DC members that DB costs were detrimentally affecting them (and in particular their SIP).

853. Mr Heath himself, in his oral evidence, told me that in his view, the presentation gave the impression that the proposals:

i) addressed pensions volatility and de-risked pensions;

ii) would result in a long term sustainable competitive position for IBM UK and that this is what the UK team "believed at the time";

(Mr Hirst's witness statement is to much the same effect as the above).

iii) IBM was prepared to stand behind the UK DB Plans on the basis of the current investment strategy and make the contributions necessitated by that strategy;

iv) IBM was content to allow DB accrual to continue on the reduced basis.

854. Mr Tennet perceives two different bargains being identified by Mr Hirst. The first, found at the beginning of the quotation above, was "increase your contributions" and then IBM "will guarantee the pension fund". The second was that the bargain involved merely an increase in contribution from members in exchange for IBM agreeing to fund the deficit over a 9-year period: it was in relation to that that he said the "bargain is still in place" or "is still on the table". Mr Heath referred principally to the funding guarantee, although what he said about review of contributions on each triennial review only makes sense on the hypothesis that benefit accrual is still taking place.

855. In the light of all this, Mr Tennet says that, reading the transcript and watching the video carefully today, one gets an entirely confusing picture of what message Mr Hirst was attempting to give and submits that it was doubtless at least as confusing for members. He concludes that one thing is obvious: this was no way to correct the misapprehension that IBM had given a legally binding guarantee that DB accrual would continue unchanged

until 2014; this is particularly so in the light of IBM's own Business Conduct Guidelines, and it did nothing to detract from the Reasonable Expectations which members held. Of course I have already concluded that the communications in relation to Ocean did no such thing, so Mr Tennet's premise is incorrect.

856. He also prays in aid what Mr Heath agreed with in Court, namely that if members were labouring under such a misapprehension, this presentation would not have corrected them. In fact, that is not what Mr Heath agreed with: he agreed that the slides would not have corrected any misapprehension, but that was not an admission that what Mr Hirst said about the bargain from IBM's perspective was unclear, and in any case he did not accept that members were under any such misapprehension. He would regard what he himself said as entirely consistent with the absence of any sort of guarantee about future accrual or about the absence of any future changes to the Plans at least until 2014.

857. There is one further point to make arising out of the Q&As session following the presentation. One questioner asked about how many DB members IBM expected to move to the Enhanced M Plan. Mr Wilson told the gathering that "we constructed this package very carefully to be quite robust in terms of the financial dynamics and quite neutral to the number of people that actually transfer…so that we wouldn't be overly concerned about having to hit a particular number or not". From that answer, Mr Tennet submits that the listener could reasonably expect that IBM was content to allow DB members to continue with DB accrual on the post-Soto modified basis. That is almost certainly true. But it does not answer the question about how long a member could expect accrual to continue on that basis or in what circumstances it would be proper for IBM to change the accrual rate or even close the DB Plans to further accrual altogether.

858. There is also a move away in the Q&As from the language of "addressing" cost and volatility to "mitigating" or "reducing" or "seeking to address".

859. Mr Simmonds has a different take on this presentation. He recognizes that Mr Hirst addressed the perception which might have been held by some people that IBM was about to break the "bargain" or "deal" that had been reached in 2004. But he says it is clear, and I agree, that Mr Hirst was saying that the perception which he had identified was wrong and that he was suggesting that the bargain had not been broken. Mr Simmonds goes further and submits that it was clear from Mr Hirst's description of the bargain that it consisted, on IBM's part, of a commitment to eliminate the Plans' funding deficits – or, as Mr Hirst put it, to "fill the hole". Regardless of what impression members of the audience might previously have had, Mr Hirst explained that the statement (in the first paragraph quoted above) that "for nine years the IBM Company will guarantee the pension fund" meant (as is made clear in the second paragraph) that the IBM Company over a nine-year period would fill the hole that currently sits in the pension plan. Nothing in Mr Hirst's comments says anything about a commitment to maintain benefit levels until 2014. In this regard, Mr Hirst's comments must have served to clarify in the minds of the audience the true nature of the guarantee and disabused them of the impression (if they had held such an impression) that the maintenance of future benefit levels formed part of the Project Ocean bargain.

860. Similarly, Mr Simmonds says that Mr Heath's comments at the meeting would have cast further light on – and would have served to make clear to the audience if they had been under any misunderstanding – the nature of the guarantee and the commitments into which IBM had (and, more importantly, had not) entered in 2004. His description of the guarantee – and, in particular, his observation that people might ask: "but wasn't one of the criteria in terms of setting up the guarantee over 9 years last year that we were in deficit and if the company ever did balance the plan that the company could then pull out of that guarantee?" – indicates that he considered that his audience would have understood a provision for early termination to have been one of the terms of the guarantee, showing that they would have had a fairly detailed understanding of the nature of the guarantee. It is said, in any event, that after listening to the passages of Mr Heath's presentation which I have set out, nobody in the audience could have been under any misconception as to the nature of the guarantee, *ie* that it was a funding guarantee and moreover that it did not amount to a commitment to maintain future benefit levels through to 2014.

861. Mr Simmonds makes the point that, contrary to what has been suggested on behalf of the RBs, it was perfectly clear from Mr Heath's words that the reference in the slide to "protecting the pension fund" referred only to

accrued benefits. It is clear, in my view that when Mr Heath used the words in his oral presentation he was referring to accrued benefits. Further, the reasonable employee hearing Mr Heath's presentation would, in my view, have understood the relevant line of the slide ("Meets employees objectives of protecting the pension fund and offers a choice for those impacted") as referring to protection of accrued benefits. However, I do not see where that gets IBM's case. The slide as a whole is clearly referring to much more than the employees' objective referred to. It is referring to a balanced package which also addressed IBM's long-term cost and volatility objective and met the Trustee's long term stability and funding objectives. And Mr Heath's presentation did the same. It is not right to say that, because the relevant line refers to accrued benefits, the slide as a whole, understood in accordance with the oral presentation, was saying nothing about the future.

862. It is of course the case that the membership as a whole did not have the advantage of the presentations from Mr Hirst and Mr Heath. But it was the role of managers (as acknowledged by Mr Johnson, a manager who did attend the presentation) to pass on faithfully the information that they had received at this briefing to their employees. Mr Simmonds says that it is to be expected that, when explaining the proposals to the workforce at large, the attendees at the all-managers meetings would have done so on the basis of an accurate understanding as to the nature and effect of the guarantee and, in particular, would have said nothing to suggest that the guarantee amounted to a commitment to maintain the existing benefit structure until 2014. I consider that that is putting matters too high. What managers ought to have explained to the workforce was precisely that which had been presented to them at the presentations. To the extent that there was ambiguity in what was presented, managers could not be blamed if they then failed to convey the message which Mr Simmonds now submits they should have conveyed.

863. It has been important for me to address the presentation and the submissions in relation to it in some detail because it is heavily relied on by both sides. But, in my judgement, it is actually of very little assistance. Of itself, I do not consider that the presentation makes clear one way or the other what IBM's commitment to future benefit accrual was: subject to two related caveats, I agree with Mr Heath who accepted, in his oral evidence, that for a person who mistakenly, as he would say, believed as a result of the Ocean communications that IBM was guaranteeing further benefit accrual to 2014 or some other date, this presentation would have done nothing to dispel that misunderstanding. So one is thrown back to the Ocean communications to discover what it is that the reasonable manager attending this presentation would have understood.

864. The first caveat is this. There is some support for IBM's position to be derived from the reaction (or rather lack of reaction) from those attending the presentation. As with the Webcast, the extended guarantee and the alleged commitment to continue to allow benefit accrual are separate matters. Even if it is correct that the guarantee does not of itself have anything to say about accrual, that does not mean that the presentation given by Mr Hirst and Mr Heath taken as a whole had nothing to say about accrual. In fact, it did say <u>something,</u> namely that, for those making the relevant election, only part of future salary increase would be pensionable. Although that is not inconsistent with a commitment to future accrual *per se*, it is inconsistent with accrual at the then current rates. Yet no-one at the presentation to managers appears to have suggested that the proposal was inconsistent with what IBM had, as is now alleged by the RBs, committed to such a short time before. If the message given by the Ocean proposals had been so strong – giving rise to the Reasonable Expectations alleged by the RBs and forming the central plank of their claim in these proceedings – it is remarkable that the presentation to managers provoked not a single question on the topic.

865. The second caveat is this, and lends some support to the RBs' position at least to some extent. IBM was expecting, indeed requiring, members to make elections about whether to transfer to the DC Plan on the basis of the material contained in the presentation (to be communicated by managers) and the subsequent communications. A member electing to remain in a DB Plan would have an expectation that he would be able to continue to accrue benefits in that Plan, albeit that part of his salary increases would be non-pensionable. Although he could, if things turned out unexpectedly, transfer to the DC Plan later on, he would not be able to obtain the enhanced terms on offer in June 2006. I do not consider that a reasonable member who elected to remain in his DB arrangement could form an expectation that, for the rest of his working life, or indeed until 2014, the DB Plans would remain open to future accrual in accordance with the Soto proposals or, indeed, that it would not be put into winding-up. The issues here are essentially the same as those which arise in relation to

Project Ocean and there is nothing I can usefully add at this stage to the discussion which I have carried out.

866. The proposals were announced to members and employees generally by Mr Hirst and Mr Lamb respectively on 27 and 30 January 2006. Mr Hirst's email making his announcement contains the following:

> "Earlier this week, I wrote to tell you that IBM UK is proposing to make changes to its pensions plans. During the last two days I have outlined these proposals to UK managers. I am now outlining these proposals to all employees. We will be working in consultation with the UK Forum to move forward with these proposals in the coming weeks.
>
> As you know, pension schemes around the world are being reassessed by many companies for affordability and long-term sustainability in a volatile economic environment. For IBM UK, rapidly rising pension expenses are placing direct pressure on our ability to invest in future growth, maintain profitability and operate in a market where global competition is ever more intense.
>
> Last year we took a number of actions to share the increased cost of longevity in the future service costs of our Defined Benefit pensions plans. Now we have developed a balanced package of proposals which address broader cost and volatility issues.
>
> Let me say some things right up front:
>
> - We are not proposing to close any of our Defined Benefit Plans (C, N, DSL & I Plans) in the UK.
> - Instead, our proposals are focussed upon the future, ensuring that the pension you have already saved is protected. We have developed a balanced package of proposals with the intention of offering choice
>
> So what are we doing?
>
> - We are proposing to limit the pensionability of future salary increases to those who stay in these Defined Benefit plans.
> - We are proposing to allow employees in Defined Benefit Plans to transfer into our Defined Contribution Plan (M Plan) on enhanced terms with no restriction on the pensionability of future salary increases.
> - We are proposing to make **improvements** to some aspects of the Defined Contribution Plan (M Plan).
> - We are proposing to change the basis of pension in payment increases.
> - IBM is proposing to make a significant **cash injection** to our UK pensions fund which will clear the current deficit by 31st March 2006.
> - The IBM World Trade Corporation Guarantee agreed last year **remains in place.**
>
> …..Whilst many of you who are already members of the Defined Contribution schemes may think that these proposals are of little relevance to you, I believe they are relevant to all IBM UK employees since they address the future stability and security of our pension fund and our overall competitiveness…….
>
> ……
>
> I believe the proposals outlined here are balanced. They address IBM's need to reduce pension expense, risk and volatility – and position our business to compete in a

sustainable manner….."

867. A number of points need to be made about this email.

868. Mr Hirst stated clearly that IBM was not proposing to close any of the DB Plans. I accept, as Mr Simmonds submits, that this was a response to rumours (to which Mr Hirst had alluded in his presentation to managers) circulating amongst the workforce and the press following the announcement earlier in the month of the closure of the DB plan in the United States. I also accept that the statement was entirely correct as a matter of fact: when Mr Hirst sent his e-mail, Holdings was not proposing to close the DB sections of the Plans and such closure formed no part of the Project Soto proposals. Moreover, closure was not even on the discussion agenda within the UK management team, although what CHQ were thinking about at this time is more open to question. The statement cannot, in my view, and here I agree with Mr Simmonds, on any reasonable reading of the e-mail be construed as a promise by Mr Hirst that IBM would never close the Plans to DB accrual or even as a statement that IBM's current intention was never to end DB accrual.

869. Not all of the RBs' witnesses accepted the proposition, when put to them in cross-examination, that Mr Hirst was not promising that the Plans would not close. For my part, I do not see how a statement that there is no proposal to close the Plans can be taken as a promise never to do so, or even in context not to do so before 2014. The reasonable reader of the email would not draw that conclusion although he certainly would draw the conclusion that IBM had no undisclosed agenda to make further changes in the future.

870. As can be seen from the first paragraph of his email, Mr Hirst explained that he was outlining the proposals being put forward by IBM. It was obviously not a detailed exposition of the changes. It was recognised that members would be faced with difficult choices. This was why members were to be assisted in making their choices; and so Mr Hirst informed members as follows:

"

- Today we are providing your manager with the presentation that was used in our manager meetings over the last two days.
- In the next seven days, we will make available a Webcast, and Q&A to help you better understand details of our proposals.
- During February, we will begin education sessions to help all Defined Benefit Plan members understand how their schemes currently operate, and how they would operate in the future under these proposals.
- .....
- To assist Defined Benefit Plan members in making informed choices about their pension provision, we will then run a series of workshops during April and May. These will be supported by modellers, seminars and access to independent financial advice on preferential negotiated rates.

Alongside this formal programme, it is vital that we maintain open and frequent communication so that questions and issues can be quickly identified and resolved.

You can address questions regarding your current scheme to EMEA ASKHR/UK/IBM ?You can address questions regarding the consultation proposals and communications to the UK Forum at **UK Forum Employee Rep/UK/IBM** or access the UK Forum teamroom Link where minutes from consultation meetings will be published."

871. The reasonable reader would not have thought that the whole picture could be seen from the email; and most certainty the reasonable member would not have made his choices based only on what he was told by Mr Hirst in

it (or in the letter from Mr Lamb which I come to in a moment). It is therefore important to read this email as part of, and together with, the wider communication exercise.

872. At least one of the RBs' witnesses said she did not read the Q&As. Mr Tennet submits that I should be very cautious about placing any substantial weight on them principally because it is very difficult to know which members read which Q&As (if at all) and when. That is not the correct approach. In addressing whether the communications gave rise to Reasonable Expectations, it is the conduct of the reasonable employee/member which is relevant and what individual members actually did or did not do is not to the point.

873. I consider that Mr Simmonds is correct when he submits that any reasonable employee would have considered all of the further information and would have taken advantage of at least some, if not all, of these further resources. A reasonable reader may not have read every document in detail; but he would certainly have looked at them and focused on questions of particular personal interest. If pensions are to be seen as a very important aspect of the employees' terms and conditions of employment (which they are), it is not sensible to think that the reasonable would be satisfied by this communication that there would be no change in the future.

874. In any event, there are certain key documents: the presentation, Mr Hirst's announcement and the announcement to members in a letter from Mr Lamb to which I now turn.

875. Mr Lamb wrote to members in the week of 30 January 2006, explaining that the Trustee had agreed in principle to the changes IBM was intending to make. Near the beginning of the letter he explained, in particular that:

> "The Trustee has carefully considered the Company proposals, has taken legal and actuarial advice, has been instrumental in IBM reshaping and improving its proposals, and for the reasons set out below has agreed in principle to the changes IBM intends to make."

876. There then follows text under a number of headings – Changes for Employees, Changes for Retirees, Changes for Deferred Members, Funding, Conclusion.

877. Under the "Funding" heading, Mr Lamb wrote:

> "IBM has agreed to contribute sufficient cash into the Plan to eliminate the estimated deficit at the end of 2005. This amount will be around £500m and will be paid into the Plan before the end of March 2006. IBM has agreed to pay all of its 2006 defined benefit contributions by this date. The support agreement negotiated with IBM World Trade Corporation last year will remain in place."

878. That reference to the support agreement can only be to the guarantee in the Funding Agreement. It provides further confirmation that the guarantee is to do only with funding. This paragraph of the letter gives no support at all to a suggestion that IBM was guaranteeing future accrual. Indeed, it lends support to IBM's case. This is because the earlier part of the letter, in accurately explaining the proposals, discloses that only base salary increase will be pensionable, and that the so-called salary supplement will not be. That is clearly something different from the then current position. If it is said that there was a guarantee of future accrual under Ocean (*ie* at the then current accrual rate), then that guarantee is clearly <u>not</u> being continued under the Soto proposals. But the paragraph quoted above records that "the support agreement", that is to say, the Funding Agreement including the guarantee, will remain in place. This results in an inconsistency: the guarantee which the RBs assert in relation to Ocean (and which they say was to continue until 2014) related to future accrual at the then current rate; but the ongoing guarantee clearly does not do so and could at most relate to a guarantee at the reduced accrual rate with only part of salary increases being pensionable. And yet Mr Lamb's letter stated that the support agreement "will remain in place".

879. That is, I appreciate, at a detailed level quite a sophisticated point and the reasonable reader of the email would not have been likely to appreciate it or have been able to articulate it quite as I have done. But the reasonable reader would have appreciated that in the future not all of his salary would be pensionable and that would, I suggest, have raised a question in his mind about whether IBM could properly make the change in the light of what, on the RBs' submission, would have been appreciated as the effect of the Ocean commitment – namely

that accrual of benefits should continue unchanged until 2014.

880. It is also to be noted that, under the heading "Changes for Retirees", pension increases are dealt with. For the first 5 years, increases were to be awarded at a specified rate; for the next 10 years, increases were to be at a lower specified rate. The period to 2014 includes, of course, the first 5 years and also 3 of the next 10 years. Mr Lamb wrote: "If the plan is wound up the pension in payment guarantee will fall way". That, it seems to me, is a possibility which is entirely inconsistent with the plan guaranteeing future accrual at the then current rate or at all and is not easy to reconcile with a long term commitment to keep the Plans open. The reasonable active member reading the letter would not focus only on the material under the heading "Changes for Employees" but, as a future pensioner, would have the material under the heading "Changes for Retirees". In any case, there is a limit to the selective reading of this letter for which the RBs could contend.

881. The section of Mr Lamb's letter under the heading "Conclusions" should be set out in full:

> "The Trustee is disappointed that IBM has found it necessary to bring forward these proposals a year after the Trustee agreed to increase employee contributions (or reduce accrual rates) to reflect a fair share of the increased cost of longevity on future service. The Trustee was led to believe that these changes made the Defined Benefit Plan affordable for IBM and sustainable.
>
> However, IBM has made it clear to the Trustee that making no change to pensions benefits is not an option given the very competitive UK marketplace, the higher cost of doing business in established geographies, and the fact that many of its competitors do not have the same level of pensions costs as IBM. These factors are particularly relevant in a services business where people cost is the major cost driver.
>
> Clearly members would prefer that their pension benefits remain at least in line with their expectations. For the reasons I have explained it has not been possible for the Trustee to secure this. However, the Trustee has secured for the members the best possible deal in the circumstances. Employees are being offered choice. The defined benefit plan remains open for future accruals, the opportunity exists for employees to transfer to a much enhanced M Plan, and pensions in payment will be guaranteed for the foreseeable future albeit at a lower level than established practice.
>
> The funding position of the Plan has significantly improved. A deficit at the end of 2003 of £900m has been reduced to around £500m at the end of 2005. The £500m cash injection I referred to above and the existence of the WTC support agreement will put the Plan on a much stronger footing, and in an exceptionally strong funding position relative to the overwhelming majority of defined benefit plans in the UK. The Trustee believes members will welcome the security of benefits this enhanced funding position brings.
>
> Although IBM is unwilling to give a commitment to the Trustee that there will be no further changes to pension benefits it has told the Trustee that it views these changes as long term and has no plans for further change."

882. What is clear from that is that there was to be no guarantee going forward of further accrual of benefits at the previously current rate. It is also clear that there was to be no guarantee going forward that there would be no further changes (or indeed a winding-up of the Plans). As to the Ocean commitment, it was recognised by Mr Lamb that the Trustee had not been able secure the position where the members' "pension benefits remain at least in line with their expectations" but that the best deal possible in the circumstances had been obtained. He did not suggest that IBM was acting in breach of any agreement which it had made or even of a commitment falling short of a promise or guarantee. I agree to some extent with Mr Simmonds when he says that any reasonable member reading this letter who was under the impression that IBM was committed to maintaining the benefit structure would have been caused, at the very least, to question that impression in view of the fact that the Trustee was accepting (albeit reluctantly) a change to the benefit structure: I say "to some extent" because, in my view, it is only in relation to future benefit accrual that he is right. Nothing was said one way or the other about other aspects such as ER policy.

883. Further, Mr Lamb recognised that IBM had made it clear that it was unwilling to give even a commitment that there would be no further changes. It did, however, view the changes as "long term" and had "no plans for further change".

884. This was a statement of Holdings' view. But there can be no doubt that some, at least, of those in Armonk knew that this view was being expressed. CHQ must be taken as approving of, and adopting, that view. Or if that is not so, it may nonetheless be highly relevant when considering a breach of its *Imperial* duties by Holdings.

885. Apart from that, the same points arise in relation to these statements as I have already discussed in relation to similar statements in the context of Project Ocean, but subject to the points made in the preceding few paragraphs.

886. The reference to "long term" and "no plans for future change" are however stronger than the statements made in relation to Ocean. A reasonable member reading those words in isolation would, in my view, be entitled to form a Reasonable Expectation that, in the long term (whatever that may mean) there would be no changes absent a significant change in economic and financial circumstances.

887. At this stage, and before coming on to further communication with the membership, I wish to say a bit more about what was happening between IBM Corporation and CHQ on the one hand, and those in the UK – the UK pensions team and the Trustee – on the other. I have dealt with some matters in the course of the narrative so far, but there are two particular matters on which I want to say a bit more.

888. Since Mr Lamb's letter is most recently in the mind of the reader, I record that drafts of that letter had been the subject of comment from and discussion with CHQ as well as other members of the Trustee board. Mr Lamb had sent a first draft to the Trustee directors on 25 January 2006, inviting comment. It prompted a number of responses. I do not propose to go into the detail of the drafting changes and the different attitude adopted by the conflicted and the non-conflicted directors, with the conflicted directors taking what, on one view, was a particularly company-friendly approach. The fact is that the board agreed the final draft. I should, however, mention the response made by Mr Lamb to a suggestion by Mr Heath which would have resulted in the omission of the words "long term" to describe the changes. Mr Lamb wrote this to Mr Heath:

> "David, if these changes are not long term then you need to confirm this and I will need to reopen the discussion with the non conflicted directors. The long term nature of these changes was an important factor in the trustee's decision process. No guarantees but we intend the changes to be long term is what I recall. If you are not intending them to be long term then speak up now. With regard to no current plans Randy McDonald told me he had no plans for change and would push back on anyone who wanted to revisit this topic during his watch."

889. Mr Heath did not respond, even to confirm the long-term nature of the changes, nor did anyone from IBM. The words remained in the final letter. Although members would not have seen this letter, it informs what the Trustee and Holdings meant by use of the word; and it goes to emphasise the importance to the Trustee's decision of the fact that there were no plans to alter the DB Plans in the future. Mr Lamb clearly did not distinguish between Holdings and IBM Corporation/CHQ in this thinking not least because the message was coming from Mr MacDonald. Mr Hirst cannot have made such a distinction either.

890. The other matter I want to mention is the suggestion made by the RBs that pressure was placed on the UK team by CHQ when driving through the Soto changes. There are three aspects: personal pressure on senior UK executives, a threat to withhold SIP from the UK if it did not make the changes required and a confrontational stance adopted by CHQ. As to the first of those there is nothing wrong with putting pressure on people providing that it is not improper pressure. As Mr MacDonald said:

> "You have to set goals, you have to set targets, you have to set standards, and at the top of an organisation you have to lead in many different ways, and one of those ways is to establish some

> level of pressure, to keep the pressure on so people understand the importance of what it is all about. It is not something that you can just take willy-nilly and expect that it will just happen."

891. It would not be right, as I think Mr Tennet hints would be right, to take from Mr MacDonald's answer an acceptance that improper pressure had been brought to bear. But whatever Mr MacDonald did or did not accept, the conclusion that there was personal pressure on senior executives is said by Mr Tennet to flow from the following:

i) The starting proposition is that a failure to comply with CHQ's wishes could have very serious consequences for them personally. CHQ had the power to control not just the future progression of their careers within IBM, but also whether they would continue to work in the Company at all. It is true that CHQ had that power; indeed, as Mr MacDonald confirmed, anyone who was perceived as not performing his job properly could be removed from post. But whether CHQ would use that power so as to put pressure on any of the UK team to take a decision which they did not believe was in the interests of Holdings (in contrast with IBM Corporation) or a decision contrary to what they regarded as a commitment to employees and members, is a different matter.

ii) In the cases of Mr Hirst, Mr Wilson and Mr Heath, the evidence shows, on Mr Tennet's assessment, that each of them was, threatened with the potential personal consequences of blocking CHQ's objectives.

iii) Thus Mr Hirst's evidence is that at a meeting on 4 October 2005 Mr MacDonald threatened him by asking, "how do you see your career going?". Those words do not necessarily constitute a threat. But in the context, they were certainly taken by Mr Hirst as a threat. The reason for that perception was that Mr Hirst had, according to his witness statement, already heard that Mr MacDonald had told the World Management Council that he was coming to the UK to "fix" Mr Hirst and the UK team. Mr Hirst's evidence is that he:

> "responded by taking my security identification card from my jacket pocket and placing it on the table between myself and Randy and saying to him, "you tell me". The message I was sending Randy through that action was to make it clear that I would not let CHQ use my career as a stick in relation to the pension proposals."

iv) Mr MacDonald did not recall saying he would "fix" the UK, saying that it was not the sort of word he would use. He certainly did not accept that it was his intention to make any sort of threat, although he accepted that Mr Hirst perceived it that way. He says that he was simply asking Mr Hirst "in a friendly way" about his future.

v) Mr MacDonald's account strikes me as surprising. It would be strange indeed for him and Mr Hirst, at a very tense time when highly contentious pensions changes were being debated, to have a friendly chat about career prospects. Even though he was not cross-examined I accept Mr Hirst's evidence and, whether or not he intended it, accept that Mr Hirst perceived Mr MacDonald as issuing a threat.

vi) As to Mr Wilson and Mr Heath, Mr Hirst states, "I was told by each of Stephen Wilson and David Heath that they had similar but more direct conversations with their line management regarding their careers. Stephen with Paula Summa in October 2005, and David with Federico Castellanos, who reported to Mr MacDonald, at an earlier point soon after the unveiling of the Soto proposals." I do not attach much weight to that, but it does go to confirm the evidence of Mr Wilson and Mr Heath themselves.

vii) Mr Heath agreed with this account and said that Mr Castellanos phoned him and asked something along the lines of, "I need to know whose side you are on. Are you with the Company or with the UK team?" His response was to the effect that the two interests were not mutually exclusive. But he certainly "felt a significant amount of personal pressure at that time". I accept that account.

viii) Mr Wilson's evidence is also that "we were under heavy personal pressure from CHQ". I accept that too.

ix) Further pressure was put on the UK team by asking them to present their proposals to Mr Loughridge and Mr MacDonald directly. Ms Salinaro had emailed Mr MacDonald to say this would be, "much harder for them, and, I believe, will get us to the end game". Mr MacDonald admitted that "we put pressure on people. I don't deny

that at all."

892. With the possible exception of the interchange with Mr Hirst, there is insufficient in this evidence (and nothing more came out of the oral evidence) to show that CHQ placed any improper pressure on the UK team. I must be cautious in placing reliance on Mr Hirst's evidence since (i) he could not be cross-examined and (ii) he seems to be suggesting greater, and possibly improper, threats to Mr Wilson and Mr Heath when their own evidence does not establish that. In any case, I see no reason to think that the actual decision of the UK team was in any way influenced by considerations of the personal position of any of the individuals concerned. Rather, they agreed to the Soto proposals because they were persuaded that the alternative of rejection would be even worse for employees and members.

893. As to the threat to withhold SIP, Mr Tennet relies on the following:

i) Mr MacDonald accepted that the "way I was thinking" was that "there will be no SIP, equity funding unless the individual countries make changes to pension plans".

ii) Mr Heath's recollection was also that, it "was certainly alluded to, that: we have got a limited pot to spend, therefore you choose how to spend it".

iii) Ms Salinaro suggested in an email to Mr MacDonald on 16 August 2005 that SIP could be used as "leverage" and they could "push [the countries] hard".

iv) Ms Salinaro's email to Mr Koppl of 30 August 2005 referred to at paragraph 760 above.

894. All those references are correct, although they must all be read in context. Like Mr Heath's observations, Mr MacDonald was expressing his concerns about the impact of pensions on the I&E account. Even Ms Salinaro – who comes across as the most strident voice of criticism – was focusing on the reality that there were limited funds available for remuneration and the issue was how to spend it. This was different from Mr MacDonald's attitude in relation to Project Waltz where SIP was actually suspended.

895. As to the allegedly confrontational stance adopted by CHQ, Mr Tennet relies on these factors which I consider are established:

i) Mr MacDonald agreed that he was effectively going "to play hardball, let's enforce deadlines, let's refuse to discuss alternatives".

ii) The UK team was given targets well in excess of CHQ's genuine requirements for Soto. CHQ's own internal target for the UK was initially $100m as shown in a chart prepared by Ms Salinaro in May 2005. However, the target CHQ subsequently gave to the UK was over double that at some $204 million. Mr Koppl was unable to explain why the UK had been given such an inflated target, except by noting that:

> "we often set targets for accomplishment. It does put some pressure on the recipient to achieve a goal". So I accept that"

This is indicative of a less than collaborative approach adopted by CHQ.

896. He also suggests that CHQ decided to mislead Mr Wilson over whether CHQ had decided to make an additional cash contribution to the Main Plan. It is clear, as Mr MacDonald accepted, that CHQ had decided to make a substantial contribution ($650 million) by 12 December 2005. In an email of 18 December 2005 from Mr Greene to Mr MacDonald and Ms Salinaro, cc'd to Mr Loughridge, Mr Greene asked what he should tell Mr Wilson: "I can say we haven't decided anything or I can go silent and leave it to you. How would you like me to respond?" Ms Salinaro's reply was that Mr Greene should tell Mr Wilson that "no decisions have been made". In Court, Mr MacDonald said that "The word "no" [in Ms Salinaro's email] is inappropriate". Whatever may have been going on in CHQ, what Mr Greene actually said to Mr Wilson was: "We have not made any decisions on funding levels. Our work is to understand our capacity and the implication".

897. Mr Tennet therefore submits that Mr Wilson was deliberately misled by CHQ. It is certainly the case that CHQ made a positive decision not to tell the UK team about its decision to inject a substantial sum into the Plans as that was seen as the best way to maximise the strength of its negotiating position. And it is certainly the case that Mr Greene informed Mr Wilson that no decision had been made on funding levels. In a sense, what Mr Greene wrote was true, although disingenuous, because CHQ had not decided whether to make a larger cash injection. But in another sense it can be described as deliberately misleading. What this does show however is the level of control of CHQ over pension issues.

898. Returning to communications, there then followed a member consultation and communications exercise. The proposals were explained to the employees through a set of communication materials provided over a period of 6 months. There was also a series of 5 webcasts and 54 roadshows, an intranet page dedicated to the proposals, on which various "Q&As" were made available, access to a "pensions helpdesk", an online comparator tool and the provision (at IBM's expense) of independent financial advice (from KPMG and Clarity) to individual employees.

899. I start with the Q&As. As I have already noted, Mr Hirst, in his initial announcement to the workforce on 27 January 2006, had referred to the Q&As as one of the additional resources that would be made available to members. In IBM's submission, a reasonable employee would have read these Q&As. I have already addressed how a reasonable member would have approached communications other than the crucial documents (the presentation, Mr Hirst's announcement and Mr Lamb's letter). The Q&As are nearly 90 pages long, and even the reasonable reader could not be expected to read the whole document in detail. But a reasonable member must be taken to have looked at the document and skimmed through it, being able to focus on any questions which he regarded of particular relevance to him. The reasonable C Plan member would, I consider, have focused on the Q&As relating to the C Plan. He would therefore have read the following:

> "**Q. What guarantees do we have on this offer – will IBM guarantee to keep the C plan active for a period (e.g. 5 or 10 years) or do we have to go through the uncertainty and trauma every couple of years?**
>
> - IBM cannot offer any such guarantee that it will not make changes to its pension plans in the future. However, we believe that actions being proposed now will reduce the expense and volatility of the pension plans and therefore our current expectation is that it will provide a platform for future stability."

900. The reasonable C Plan member would, in my view, also have read a number of other Q&As, in particular the following Q&As found in the section of general Q&As. To much the same effect:

> "**Q. How do we know IBM will not close the DB plans in the future?**
>
> A. IBM cannot offer any such guarantee that it will not make changes to its pension plans in the future. However, we believe that actions being proposed now will reduce the expense and volatility of the pension plans and therefore provide a platform for future stability."

901. Looking at those Q&A's "in isolation", it is clear that IBM was not promising to keep the Plans open at all let alone to provide continued accrual at the then current rates. Either it did not consider itself committed to do so (whether as the result of a binding promise or otherwise) by the Ocean changes and communications; or it did consider itself committed but decided to ignore its commitments and any assurances which had been given. Either way, it was clear that IBM was not willing to offer any sort of guarantee for the future. If a reasonable member was previously under the impression that the Plans were guaranteed to remain open for benefit accrual at current rates until 2014, he could not have thought that that was the position after reading this passage of the Q&As. The expression of belief in the second sentence of the answer cannot detract from that conclusion; and it is to be noted that this belief only relates to reducing the expense and volatility. It is, on my view, a weaker "commitment" than the one expressed in the Ocean communications where it can at least be argued that the changes were seen as a complete long-term solution to the volatility problem. Whether CHQ and Holdings actually did believe what was said in that sentence or whether its expectation as expressed was actually held, is a

different matter which falls to be addressed later.

902. IBM's position is underlined by two other Q&As:

> "**Q. How do we know IBM will not have to do this again one year later?**
>
> A. We believe the following factors will mitigate the current expense and volatility
>
> - Anticipated transfer of employees to the enhanced DC plans
> - Restriction on pensionability of future salary increases for DB members
> - One off cash injection by IBM further secures pension scheme
> - Reduced, but guaranteed future Pension in Payment Increases for a fixed period
>
> Although there are no guarantees, these actions, along with those already taken, we hope, are sufficient to put our pension schemes on a sustainable footing"
>
> "Q. Last year we had changes. This year we have changes. Does IBM rule out any further changes in future?
>
> A. IBM cannot offer any such guarantee that it will not make changes to its pension plans in the future. In order to remain competitive IBM will continue to monitor pension expense and benchmark our employee total reward package against that offered by our competitors."

903. There is one other answer I would mention, given in response to a questioner who asked whether, in the event of further changes and having chosen to stay in the DB Plan, he would be entitled to transfer to the M Plan on the enhanced terms of the current offer to avoid being disadvantaged. The answer was this:

> "We believe that actions being proposed now will reduce the expense and volatility of the pension plans and therefore our current expectation is that it will provide a platform for future stability. However, if in the future there is a need to make further changes to the Pension Plans, IBM could not guarantee that an opportunity to transfer on the same terms and conditions would be offered at that time."

904. And so, Mr Simmonds submits, it would be clear to the reasonable reader of the first of those Q&As that IBM was unable to commit to making no further changes even during the following year: it hopes that the Project Soto changes will be sufficient but it can go no further than that. He says that any person reading this Q&A would be left in no doubt whatsoever as to the possibility of future changes, even in the short term. No reasonable reading of this Q&A is consistent with a commitment as to the long term. Any reasonable reader would understand that, in the absence of a guarantee that there will be no further changes, the possibility must remain that there will be such changes (even if that is not what either IBM or the members hope or expect): to seek to dismiss the obvious meaning of this and other similar questions by saying, as Mr Turner did in cross-examination, that "timetable and context are paramount" is no answer to the clear and unambiguous message that IBM is conveying in its answer. Mr Simmonds accepts that, taken as a whole, the Q&As may have led a reasonable reader to hope or expect that there would be no further changes but no reasonable reader could have drawn the conclusion that IBM had provided a guarantee to that effect.

905. The RBs rely on other selections from the Q&As to present a rather different picture. There is, in particular, the, by now, familiar appeal to "sustainability" being achieved. Mr Tennet gave a few examples including these:

> "The proposals put forward by the company seek to address future long term pension expense and volatility to put IBM's pension plans on a sustainable footing"

"…. we can confirm that in developing the current proposed package of measures, IBM has reviewed in depth the impact these changes will have on their future cost base and are satisfied that they achieve the aim of reducing the current costs and future volatility that the company faces with regards to its Defined Benefit plans. We believe that the proposed changes represent a fair and balanced package that will help ensure the future security for the plans in question."

"The current situation IBM finds itself in is that pensions expense continues to increase year on year, influenced by volatile economic forces outside of the Company's control. Although there are no guarantees, these actions, along with those already taken, we hope, are sufficient to put our defined benefits pensions schemes on a sustainable footing."

"The significant cash injection being made by the company is intended to… eliminate the current deficit and, therefore, place the IBM Pension Plan in balance at this point in time. The cash injection does not, however, remove future volatility nor deal with the increasing cost of providing benefits for future service. It is this that the company proposals are seeking to address. A further increase in employee contributions was considered but the amount of any increase that would have been required to achieve the necessary level of savings would have been too high to make this option a viable proposition. Furthermore, whilst an increase in employee contributions may reduce the cost of providing benefits for future service, it would not reduce future volatility."

"The Company proposals do reduce pensions expense and volatility. Members who choose to stay with their DB Plan will contribute to this through reduced increases to pensionable pay, those who switch to the enhanced M Plan will contribute by reducing the Company's exposure to volatile DB expense and current retirees pensions in payment will increase at a lower rate (albeit guaranteed for the next 15 years) than has previously been the discretionary norm."

906. The first of those quotations is part of an answer to a question expressing concern that the proposals required members to agree long term to a set of proposals with only short-term guarantees. Before the quoted passage, the first paragraph of the answer makes some perfectly accurate observations about the balance-of-cost obligation of Holdings. And immediately after that passage (as part of the same paragraph) this appears: "To place any restrictions on the company's flexibility to fund the pension plan as described above would not be appropriate as this could impact IBM's future competitive position in the market place".

907. The second quotation comes from an answer to a request for data supporting the business case for the changes but declining to disclose the actual data. The question came from a member who did not "accept the 'sustainability' argument" as he put it, given that the members of the DB Plans represented only 33% of the active workforce falling to 20% in the next 5 years.

908. The third quotation comes from an answer to a question asking whether the Ocean changes aimed to solve "this problem". The answer explained that those changes were implemented to address underfunding in respect of past service and a predicted increase in future service costs. The reference to "volatile economic forces" cannot, I think, be a reference to NPPC volatility. Rather, the reference is to the volatility of markets, particularly equity and bond markets. In relation to that volatility, I consider that this answer is rather mealy-mouthed. Surely, I ask rhetorically, this market volatility is relevant to the Ocean changes because of its impact (in an English context) of the funding of the DB Plans which it was an aim of Ocean to address? The reference to pensions expense, however, may well be intended to subsume the impact on NPPC of the volatile economic forces referred to although, if that is so, it is hard to think that the questioner would have had any understanding of the point. Be all that as it may, it must be accepted by the RBs that this answer is only expressing a <u>hope</u> (the word actually used) that the Plans are being put on a sustainable footing. Holdings is saying no more, in this answer, than that the action taken is hoped to be sufficient to address the volatility issue; but that cannot be taken as a warranty that the actions actually are sufficient.

909. The fourth quotation was part of an answer to a questioner who suggested that, in order to ensure the long-term future of the DB plan, changes could be made to the Trust Deed preventing Holdings from funding its DC

liability from DB funds and relinquishing its ability to take future pension holidays.

910. The fifth quotatioj came in answer to a question suggesting that the programme, far from cutting Holdings' costs, would increase them. "Will all the pain of this programme be sustained by current retirees and DB members who stay in their plan?"

911. As to Mr Simmonds' submissions in relation to the Q&As set out in paragraph 904 above, Mr Tennet says that they miss the point. Although IBM did say in 2006 that there was a technical possibility of further change in future, it did not give members an impression that there was any likelihood of such change or of what kind of change there might be. Instead, it deliberately reassured members that the DB Plans were sustainable, and that volatility and cost issues had been addressed. Members were given a wholly false impression as to the extent to which (i) the changes addressed cost volatility; and (ii) IBM was prepared to live with whatever level of volatility it allowed to remain in future. In that context, he relies on IBM's statements about improving "our competitive position" by reducing long-term pensions expense and volatility.

912. Mr Tennet complains that the Q&As made no mention of past investment losses (which he says resulted from IBM's preferred investment strategy) as a major cause of the rising pension costs, which themselves led to the reductions to member benefits. Instead, the Q&As solely blamed falling long-term interest rates rather than investment performance. That appears in the following answer to a questioner asking what "volatility" means. I have highlighted the relevant words, but the whole answer is of importance:

> "Q….. I too would like to understand what "volatility" means. So I have two sub-questions: (1) What is it that is so volatile in the context of long term (multi-decade) investments that it is now unacceptable to IBM. (2) Is the volatility problem to do with long term investment performance; or is it short term balance sheet volatility made visible because of FRS 17 accounting requirements?
>
> A1. The short term volatility which has impacted the Company's pension expense **primarily relates to falling long term interest rates**. This has the effect of increasing the present value of the Plan's future liabilities, which in turn results in increased expense in the Company's accounts.
>
> A2. As referred to above, the volatility problem is **primarily due to falling interest rates, rather than long term investment performance.** FRS 17 is a UK Accounting standard but IBMs Corporate results are governed by the US FAS87 accounting standard. They use long term interest rates to value the plan's liabilities and the cost of providing pensions."

913. This answer is important because it brings US accounting standards into the picture presented to the members (for the first time so far as I am aware). If nothing else, it demonstrates that Holdings clearly knew that the US GAAP impact of the changes was a relevant factor in establishing the need for the changes. Indeed, it is entirely consistent with the reality which is that these changes were being driven by CHQ with a view to achieving results from the UK which would impact to the extent required on IBM Corporation's I&E account. Once that is recognised, the fall in interest rates is, in fact, the most significant factor since that is what produced the major impact on NPPC.

914. That is consistent with another Q&A. Mr Tennet relies on it as another example demonstrating that IBM placed the blame on falling interest rates rather than its own investment policy. But in the context of NPPC, the main culprit was falling interest rates so that answer is correct in identifying the primary driver:

> "Q. What is driving the increased costs that IBM is experiencing that could not have been foreseen during the round of changes made in 2005?
>
> A. The primary driver is lower long term interest rates since the start of 2005. These mean that the value of the accumulated pension liability in the Company's accounts is higher in today's money than it was. A report from Mercer Human Resource Consulting, published in January 2006, reported that pension deficits at the FTSE 350 companies rose by almost a quarter last year to £93 billion, despite strong equity performance."

915. Quite apart from that, I do not understand what Mr Tennet seeks to draw from this. On his case, Holdings has given a misleading answer and failed (perhaps even deliberately) to reveal the whole reason for the increased costs. But this misleading answer could not, so it seems to me, have engendered any expectation about Holdings' future conduct. What it might have done is to have influenced the decision which the member was taking; and it would then be arguable, even if there was no actionable misrepresentation, that the giving of the answer was a breach of the *Imperial* duty. It is not, however, part of the RBs' case that the Soto changes gave rise to a breach of the *Imperial* duty and it is not, in any case, clear what, if any, remedies would be available if it were. He can throw the point into the forensic melting pot to show, if the point were a good one, how Holdings was prepared to treat the members, but it cannot, as I see it, give rise to any Reasonable Expectation about either future changes to benefits or future cessation of accrual. It is irrelevant, in my view, to the claims in relation to Project Waltz. It is a separate question whether IBM actually was responsible for the problem by reason of its investment policies; and a further question, if so, whether it could justify, if justification is needed to avoid a breach of the *Imperial* duty, the Project Waltz changes by actions needed to solve the problem which it had created.

916. Other communications with members took the form of roadshows, consultations on an individual basis with KPMG or Clarity (3,740 members attended a 45 minute '1-2-1' consultation) and the comparator tool (which members could use to compare their projected benefits from the DB Plans with the Enhanced M Plan). The roadshows (54 altogether) took place in April to June 2006. They took place at 22 locations and were attended by 3,325 members. The ″Making an Informed Decision″ presentations to members were made at the roadshows and were made available on the intranet (see below) as well.

917. As well as those communications, the IBM pension intranet page was set up which received over 18,000 hits from about 6,300 members during the consultation period. The UK Forum met a total of 8 times, between 11 January 2006 and 24 April 2006. members were given educational "Proposed Pension Changes 2006" presentations, which explained the current benefits and how they were changing. The UK Forum collated member questions, and a total of 236 Q&As were published on IBM's "Pension Changes 2006" intranet site. IBM made a pensions 'Help Desk' available for members to submit questions.

918. The purpose of these communications was to enable employees to "make an informed decision" about moving to the Enhanced M Plan or remaining in the DB section. I do not think they add a great deal to the communications which I have already addressed. I deal with specific aspects in the following paragraphs.

919. The slides presented at the roadshows make express reference to a pension plan comparator tool. The reasonable member attending the roadshows would have appreciated that the comparator tool was "designed solely as a guide" and was "not a retirement planning tool". It was a guide to help the members compare the two options open to them. That was the only message which could properly have been taken from the relevant slide and the accompanying script. The comparison, however, was between two options which each assumed ongoing benefit accrual – whether by DC contribution or further DB accrual. The comparator tool cannot, I agree with Mr Simmonds, be seen as providing a guarantee. He goes further and says that it should have been clear to any member who attended a roadshow that the comparator tool was not intended to provide (and should not be treated as providing) representations as to future pension levels: it was a *guide* rather than a warranty as to future outcomes. However, it was part of the material on which the reasonable member would form his understanding of what IBM was telling him. But I would agree with Mr Simmonds to this extent, namely that the comparator tool is not in any way inconsistent with IBM's case; however nor is it inconsistent with the RBs case.

920. Mr Simmonds suggests that the comparator tool should not be relied on as conveying any message at all about the level of future benefits for another reason. The slide dealing with the comparator tool confirmed that it would include a user guide and, therefore, any reasonable employee who attended the roadshows would have had in mind the existence of the user guide. That guide was circulated by Mr Heath. IBM relies on several points arising out of it.

921. First, the comparator tool was but one of several resources to be used by members. The user guide includes this:

> "The Comparator Tool is intended to be used as one of several sources of assistance you can use in making your decision on whether to transfer to the enhanced M Plan, and its results should not be taken in isolation. I would urge you to consult the pensions Changes Website, particularly the Webcasts and the Q&A sections. You are also being given the opportunity to attend Roadshows, and to take advantage of one to one consultation sessions with external advisers."

922. Members were thus urged by the guide to consult the website, on which the Q&As were posted. Furthermore, just as the roadshows referred to the comparator tool, so too did the user guide refer to the roadshows, which members were encouraged to attend. The reasonable member would, I agree, have relied on all of the sources of information available to him.

923. Secondly, the comparator tool comes with an express caveat which, in my judgement, is very relevant:

> "The information used to illustrate your benefits under your occupational pension plan is based on data as at 6th April 2006. It does not take account of any future changes to legislation, financial and employment conditions or your pension plan, nor does it consider any alternative methods of saving towards retirement such as ISAs or stakeholder pensions."

924. No reasonable employee reading that caveat would, in my judgement, have understood that the comparator tool was other than merely illustrative and that its output could not reasonably be treated as a warranty on the part of IBM as to the future. But here again, this is not to say that the comparator tool as a whole is to be disregarded: it remains part of the communication to members and relevant to the understanding which the reasonable member would form. It is, however, significant because it refers to the possibility of "future changes to...your pension plan". That makes it impossible, I consider, to contend that the assumption on which the tool's calculations were based (*ie* that there would be no future change) was set in stone.

925. Members also had the opportunity to have one-to-one sessions with KPMG or Clarity to consider their own individual circumstances. KPMG was involved in the roadshows and its representatives spoke to some of the slides. One of those slides was headed "Factors To Consider". Although the text on the slide itself does not make any point about changes to future service benefits, the speaking notes included the following:

> "In summary, When making your decision some of the areas you need to consider are:
>
> The defined benefit scheme is ultimately financed by IBM therefore you are not directly exposed to investment or annuity purchase risk. However, the benefits are not absolutely guaranteed and it is possible for the terms of the pension promise for future service to be changed at any time in the future……"

926. Any employee who attended one of the roadshows would have been aware, therefore, that there was no guarantee as to the maintenance of the existing benefit structure. Mr Simmonds suggests that there is no reason to think that KPMG did not repeat, if not emphasise, this point in the one-to-one meetings with individual members that followed the roadshows. He finds support for that proposition in a summary by KPMG where it was reported as follows: "There was a general expectation that IBM would amend/close the DB Plan in the future". But that quotation was immediately followed by this: "However, many were of the view that they would rather accrue another 5-10 years in the DB Plan rather than switch to the M-Plan." The entire passage therefore shows that there was a general expectation of closure in the future but at least a hope that that would not happen within the 5 to 10 year period.

927. The other material which I should mention comprises two surveys of members conducted by the Pension Consultation Committee in September 2009 on which the RBs rely. One of these was concerned with member understandings as to what, if anything, IBM had promised in earlier years. I find this survey of limited value in identifying the actual understandings of members shortly after Project Soto, let alone of the notional understanding of the hypothetical reasonable member. The number of responses to the survey was not large; the evidence shows that at most 7%, and probably less, of the M Plan membership responded, although what percentage of the adversely affected members responded I do not know. The questions asked were slanted, for

instance:

> "What did you believe about future availability of the DB Plan at the time when you made your decision in 2006?"

followed by multiple-choice answers with a box for an individual answer under the heading "Other":

> - "IBM verbally promised to keep the DB pension scheme open until at least 2014, barring catastrophic failure of the company."
>
> - "IBM legally promised [to do the same]." and
>
> - "IBM did not make any promises regarding the future availability of the DB pension scheme".

928. I agree with Mr Simmonds when he says that the probative value of such a skewed exercise is extremely slight.

What did IBM believe about sustainability leading up to Soto?

929. Mr Tennet has addressed at great length the question of what IBM (in its global sense) believed about the sustainability of the DB Plans leading up to Project Soto as well as the question of what precisely was driving the changes. His case is that, as IBM well understood, the DB Plans were incompatible with the drive for year-on-year delivery of NPPC savings in order to deliver on its commitment to investors of an ever-increasing EPS. Further, IBM (or at least those in CHQ) did not believe, or could not reasonably have believed, that the Soto changes would bring about sustainability even if the then current financial and economic conditions continued. Still less could it have held that belief in pursuing its preferred return-seeking investment strategy. It is said that, whatever UK management may have believed, CHQ knew that NPPC volatility would not be solved by the Soto changes. Accordingly, the Soto communications presented a wholly misleading picture.

930. Further, he says that the driver for all of the changes – Ocean, Soto and Waltz – was the need to contain NPPC in order to ensure the required increase in EPS.

931. Since these points have become of major importance to the RBs' case, I must deal with them in considerable detail. I do so by reference to a number of points which Mr Tennet addressed under thevarious headings appearing below.

The fundamental incompatibility between IBM's commitment to investors and DB pensions

932. I turn first to what Mr Tennet describes as the inherent costs volatility of the DB Plans. I have already said something about the different uses of the word "volatility" (see paragraph 518*ff* above). Mr Tennet is here using the word in the sense of NPPC volatility. Mr Koppl, who, as I have said, was head of pension analytics and thus responsible for advising about the management of NPPC volatility, explained what this type of "volatility" was by reference to future pension assumptions or actual returns deviating from what was expected at the discount rate. He said that it amounted to a "lack of predictability" which was causing IBM to move away from DB plans; for CHQ, the "issue for us was the year-to-year change. The primary issue". I asked Mr Koppl when deviating from what was expected became sufficiently serious to be seen as volatility or, as he rephrased my question, when does it become material. A small deviation, he said, could be volatile and a large one could be volatile. So when speaking of NPPC, his view was that it came down to this: "Is it material to the Corporation from an earning standpoint?" I think this description of volatility gives a sufficient understanding for present purposes and I accept it as broadly correct.

933. I agree with this from Mr Tennet: NPPC volatility does not concern volatility around a baseline of zero *ie* volatility fluctuating between positive (cost) and negative (profit) figures. Rather, IBM was concerned with NPPC volatility that deviated from that which <u>was expected</u>, that is, the spread of outcomes from the median outcome. Expected NPPC was a function of:

i) known factors, resulting from past market performance which was still flowing through the NPPC calculation under the smoothing mechanisms; and

ii) projected factors, principally EROA and projected discount rates (but also other assumptions such as mortality rates).

934. Mr Koppl accepted – and his acceptance is not challenged by Mr Simmonds – that volatility (in relation to NPPC, PBO and cash funding) was a function of, and exacerbated by, the size of the liabilities and the investment strategy. Volatility, he said, is influenced by asset allocation and by the size of the liabilities. This is because:

i) discount rate fluctuations (and fluctuations in other assumptions, such as mortality assumptions) would have a much greater absolute effect if the liabilities are larger; and

ii) if the assets are invested in more risky, return seeking investments, the range of returns on assets would be greater (and in particular where the value of assets invested is very great).

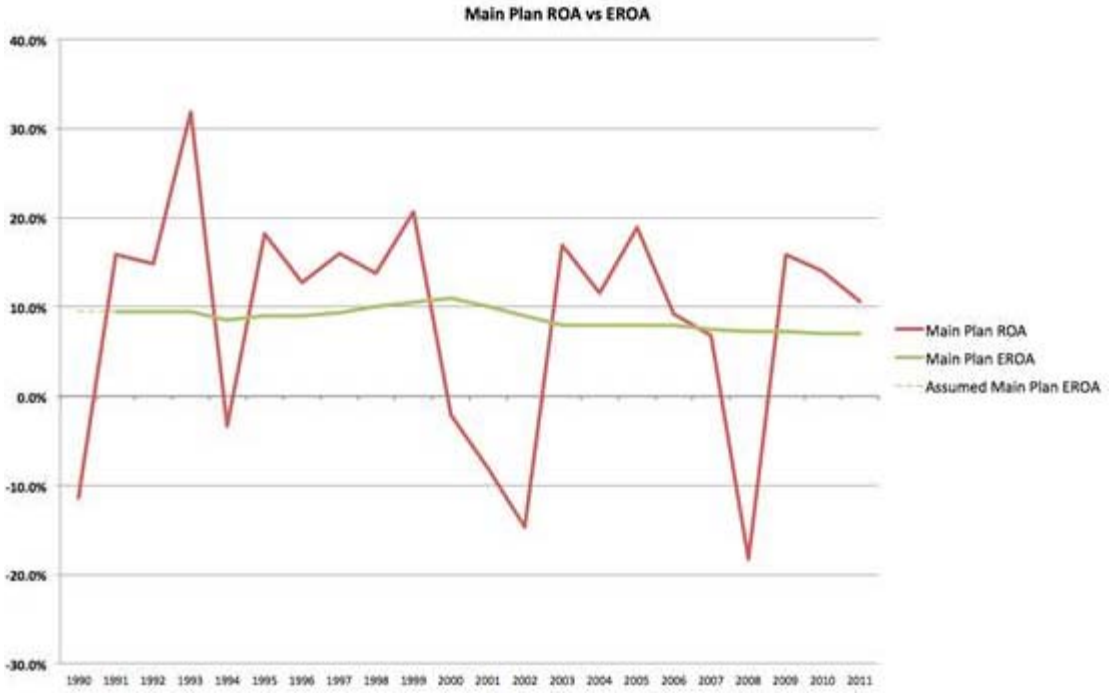
935. In the context of the discussion about volatility, it is worth setting out the following passage of Mr Koppl's cross-examination (where "you" is clearly a reference to IBM and not to Mr Koppl personally):

> "Q. You fully understood and accepted the trade-off between volatility and EROA which you were trying to maintain?
>
> A. Yes.
>
> Q. You understood that volatility was a risk to NPPC?
>
> A. Yes.
>
> Q. You understood it was a potential risk to IBM's equity?
>
> A. Yes.
>
> Q. And you understood it was a risk in relation to the funding of the scheme?
>
> A. Yes.
>
> Q. You took those risks with your eyes open, did you not, because of the income that was potentially generated by the pension assets?
>
> A. Yes.
>
> ……
>
> Q. IBM's strategy in relation to volatility was that it would not change asset allocation in its schemes to mitigate volatility unless the changes were consistent with the maintenance of the EROA assumption; is that a fair summary?
>
> A. It is kind of a sweeping statement. I am thinking – as I say, we have agreed to changes in asset allocation, but we have been considering what is the effect on the EROA. So I am trying to say over a period of time we have not been absolute and unbending, but we have been moderate or, let's say, wishing to proceed very gradually on such changes, and considering other things."

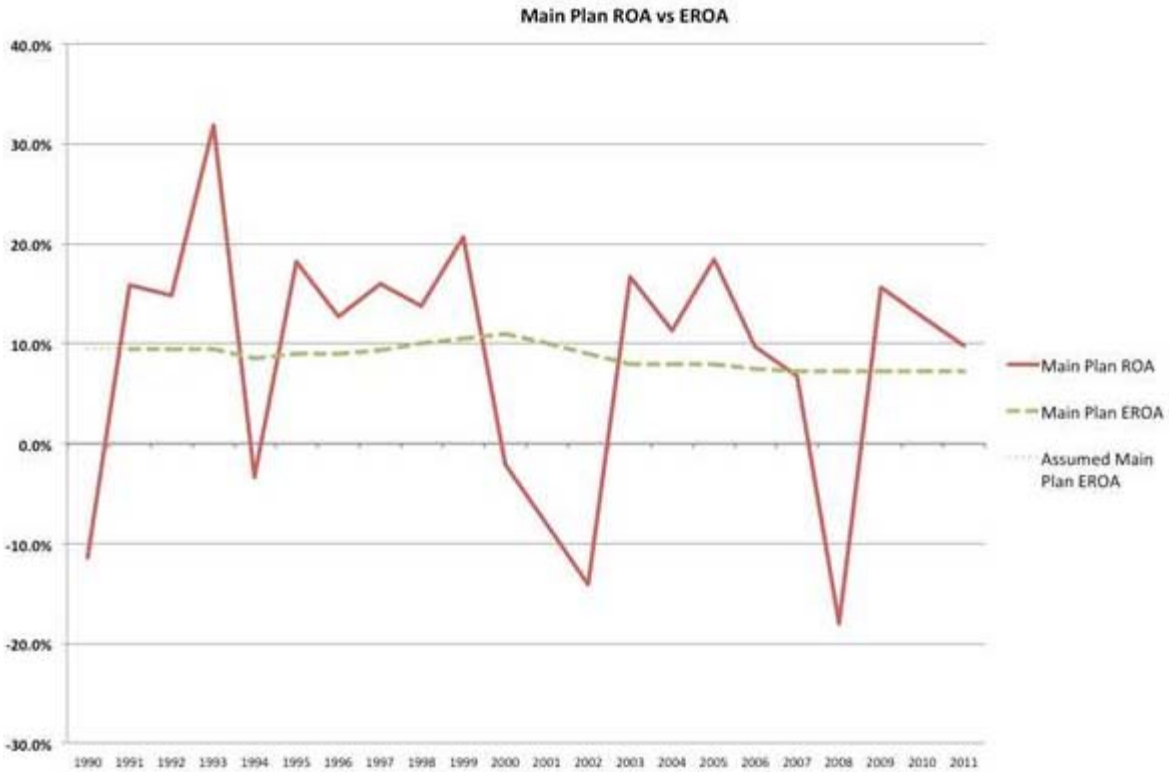
936. Mr Koppl accepted that IBM was "particularly exposed" to volatility because IBM's DB schemes had "a truly massive liability" which was "Second only to GM on a worldwide basis".

937. Moreover, the DB Plans were heavily invested in return seeking (and thus riskier) assets, and the value of the total assets was substantial (as at 1 January 2006, Main Plan assets were £4,369m and invested in 66.6% equities, 5.5% property, and 27.9% bonds).

938. The RBs have had prepared some graphs based on the core data to be found in the trial bundle. One of those graphs demonstrate the high volatility of return on assets, as against EROA. It can be seen that in no year between 1990 and 2011 was ROA equal to EROA, and it was rarely even close. In 5 of the years between 1990 and 2004 ROA had been substantially lower than EROA.



(For the reader viewing this in black and white the following chart explains the colouring)



939. Similarly, PBO was exposed to changes in discount rate. For instance, as at 31 December 2005, a 1% decrease

in the discount rate would have increased PBO by over £870m.

940. The assumptions adopted contained no margins for prudence, in accordance with US GAAP. As Mr Koppl agreed, the conclusion to be drawn was that in any one year there was just as much chance of the market failing to meet IBM's expectations as there was of it exceeding them.

941. Mr Koppl also agreed that the extent of existing volatility in January 2006 was such that he found it extremely difficult to predict what the savings were going to be in even 6 months' time. His projections at the time showed that a 0.5% reduction in the discount rate at the time of the upcoming remeasurement would reduce the NPPC savings for 2006 alone from £109m to £44m. He accepted that this same volatility applied with equal force to all NPPC predictions. As he said:

> "Looking forward in time, even on an annual basis as opposed to an interim basis for the year, yes, the same forces are at work and that is really the -- that is kind of an illustration of, at least in this case, the discount rate effect on the NPPC volatility."

942. Coupled with these considerations is the suggestion made by Mr Tennet that IBM was taking no steps to de-risk by agreeing that the Trustee should change the asset mix, moving away from return-seeking assets much more speedily than it had been. The extract from Mr Koppl's cross-examination speaks for itself: EROA was the guiding light but that did not preclude a very gradual change in asset allocation. That it would be very gradual is shown by this question and answer after the exchange which I have just set out:

> "…. effectively your first concern was to maintain the expected return of assets, EROA, and within those parameters was where you were prepared to look at volatility.
>
> Yes."

943. Further, as Mr Koppl explained, this was not just his approach but was the approach of CHQ:

> "Q: Can I ask you, Mr Koppl, was that relationship and this preference for the EROA assumption to be maintained before you did anything about volatility, was that your personal view or was that something which –
>
> A. It was me and my management, Jesse Greene and Mark Loughridge. I wouldn't say Mark gave us specific direction on every plan, I doubt that did on this, but he had seen the volatility analysis that I had done, and so we were thoughtful in terms of where we would propose to take down the asset allocation from equities to bonds, so ..."

944. Mr Tennet's next heading is **IBM's "commitment" to "deliver consistent earnings growth to investors"**. I do not think that there is really any dispute between the parties that IBM's agenda was to produce in fact the EPS which it had promised the market would be achieved.

945. But Mr Tennet submits that, from a rational perspective, NPPC should only have become a problem for a business if it were consistently greater than the employer's share of the Service Cost. The employer's Service Cost represented that operational cost to the business of providing a year's worth of pensions accrual. The other elements of NPPC – interest cost, EROA, amortisation of gains and losses, and prior service credits/costs and curtailments – all related to accrued benefits, and depended mainly upon market performance.

946. Put the other way, he continues, if NPPC was below the employer's Service Cost, the pension fund would be effectively subsidising the employer's operational cost of accrual. NPPC that was negative, so as to produce pure profit for an employer, could hardly ever be of concern. In such a case not only would the employer not have to pay for the provision of its employee's pension accrual, but also the pension fund would directly contribute to profits (*ie* EPS).

947. I do not agree with the submissions summarised in the previous two paragraphs. The submission ignores the

importance of NPPC as an element in the EPS and thus its effect on the share price. I perceive Mr Tennet's submission as no more than assertion and reference to subsidy as ignoring the role which DB Plans play when it comes to US GAAP accounting.

948. According to Mr Tennet (I agree with this), Mr Koppl's view, shared by CHQ, was that the primary concern was not the absolute level of NPPC, nor the level of NPPC relative to Service Cost, but the year-to-year increases in NPPC which might jeopardise IBM's commitment, described by Mr Tennet as apparently unbreakable and unrelenting, to deliver ever increasing profit growth to investors, year-to-year. This is illustrated by the following exchange between Mr Tennet and Mr Koppl:

> "Q. If we then move to 8.3 of your statement, you say:
>
> > "Both the absolute amount of retirement-related expense and the year-to-year increases can be a problem."
>
> Just pausing there, what you are really referring to here, is it not, is that it's not just you have to worry about the absolute amounts of retirement-related costs. It's the unpredictability, it's fluctuation?
>
> A. Yes, the year-on-year.
>
> Q. When we talk about retirement-related costs, although we are talking about retirement-related costs which include DC and OPEB costs, the fluctuation is caused by NPPC.
>
> A. Yes, it is.
>
> Q. The fluctuations cause a problem, do they, in your view, because they impact on forecast earnings published to investors?
>
> A. Yes, and if -- or, I want to come at that from two advantage points, they either impact on earnings published to investors or they compel the Company to take other action operationally. So in this example, in 2005 IBM had conducted, we call them resource actions or workforce rebalancing, here you would call them redundancies, that were -- and other pay and benefit actions that affected the employees, to overcome a 1 billion year-to-year adverse cost impact in 2005. So that is how the company overcame the 2005 $1 billion. Then facing 2006, we knew coming into 2006 that we had a half billion dollar year-to-year increase to somehow overcome, and then that was being aggregated made worse by investment performance and discount rates."

949. This relentless drive to maintain profit is also reflected, Mr Tennet says, in other parts of Mr Koppl's evidence. Mr Tennet takes some selective quotations from Mr Koppl's cross-examination which do not give an altogether fair picture of what he was actually saying. It is worth setting out the full passage where Mr Koppl was answering a question about the competitive disadvantage which he said IBM was under as a result of NPPC volatility. Mr Tennet challenged the scale of the disadvantage by reference to the impact of the DB Plans on PTI. Mr Koppl said this:

> "I would like to put this in the context from an investor's eye view. IBM each period, each quarter and each year, is reporting externally our results, in terms of profit and earnings per share, so while it is true that these plans can deliver profit in periods, prospectively each coming year the amounts can change, they can change up or down; that is the volatility element. So in the event that even if earning a profit, it is a smaller profit going into the next year. Then the issue is that the Company has to figure out a way to offset it in order to deliver what it otherwise would have without the pension in terms of profit growth. So the volatility is an issue that, without the ability to predict which direction those costs go based on movements in the financial markets, that the Company could be faced with adverse conditions that would cause it to operationally have to take actions that it otherwise wouldn't…… Here, DB Plans can deliver either a cost or a profit, and in spite of that we

are choosing to move away from them, for the lack of predictability."

950. As he had put it in his witness statement:

> "Investors in IBM Corporation, as in any corporate entity, expect consistent earnings growth each quarter and year and IBM Corporation therefore needs to maintain competitive costs."

951. Mr Tennet relies on other answers given by Mr Koppl about NPPC costs. Global NPPC in 2004 was $94m, which, as Mr Koppl stated was "a small absolute number in the context of the Company", in the context of a global Service Cost of around $1.25bn: "we are thinking of this from an investor perspective, and they look primarily at year-to-year performance. So we don't think about 2004 [NPPC] as having been low in a relative sense; the issue for us was the year-to-year change. The primary issue". Mr Tennet also made the point that the $94m figure was small in relation to the cost of accrual in that year. That point must, however, be put in context. Mr Koppl went on to say this:

> "I have to say to you, I understand the point about accruals, benefit accruals, but we don't think about it that way. It is clear that benefit accruals represent the value of the benefit being earned. We think about it in the total context. We are required under US GAAP to report six lines of cost, including with the ones that are made volatile by financial market performance, how the assets are invested and so forth. So from our standpoint we don't have a baseline that says the one true line of cost is the benefit the participants earned. Even though I can understand from the members' standpoint that may be how they think about it, from our standpoint we think about the total, and we have to deal with the total. If we could just deal with that one line, our life would be easy. DB Plans would be DC Plans and we wouldn't be in such a mode of trying to move away from them."

952. I will be coming to the 2010 EPS Roadmap: see paragraph 1075 below. This was first developed in 2007 but even before then, Mr Tennet suggests that IBM had a target for retirement related costs. I consider that the evidence does establish that IBM did indeed have such a target. But for Mr Koppl, I am satisfied that this was simply one of the elements which went to delivering shareholder value. His perception was that "companies that can deliver consistent earnings are worth more, from a shareholder standpoint, than companies that cannot" and so meeting overall targets was the principal aim.

953. Mr MacDonald gave evidence that in 2006 costs formed part of a "roadmap" for expected earnings and there would have been targets for them. This was, as Mr Tennet points out, a target for retirement-related costs in 2006 which depended upon assumptions as to investment performance that could not be guaranteed. At the time, IBM regarded itself equally as expected to deliver on the forecast targets as it had after the presentation of the 2010 EPS Roadmap, including in relation to pensions.

954. Mr Tennet refers to other examples of targets. In February 2005 IBM produced a "Retirement Related Expense Forecast", which included a detailed "Roadmap" for the future showing pension cost estimates. Further, a number of Soto presentations included "Roadmap items" when explaining how the NPPC objectives would be met. One slide was titled "Roadmap to achieve pension expense target". But the target in that last slide was achieved only "assuming no further erosion to discount rates".

955. The effect of such targets was, it is then said, that IBM could not tolerate NPPC in excess of what it had projected. It seems to me that that is not quite the right way of expressing matters. It is not the expenses targets which resulted in an intolerance of excess NPPC. Rather, it was the target for EPS which drove overall cost levels, of which NPPC was one. If changing financial circumstances resulted in an increase in NPPC, then that increase would have to be countered by steps which decreased NPPC and/or decreased operational costs if EPS was to be maintained. These expense targets do not of themselves demonstrate that IBM could not tolerate NPPC in excess of projections: it is the imperative to maintain EPS which might produce such intolerance. The evidence of such an imperative is not found in the expense targets: the targets were the effect, rather than the cause, of a particular EPS requirement and it was only if that EPS requirement had to be maintained, come what may, that expense targets had to be reviewed.

956. Mr Tennet turns next to the submission that the effect of volatile, unpredictable pensions costs, coupled with the unrelenting commitment to investors, was to render the DB Plans wholly unsustainable. He submits that when the propositions – truths he would say – that (i) the DB Plans' NPPC was inherently volatile and hard to predict and (ii) IBM could not tolerate any year-on-year increases in NPPC, are viewed together, it is apparent that the DB Plans were wholly unsustainable, because over a period of time some year-on-year increase in NPPC was practically inevitable. Stated in that way, that reasoning begs an issue, namely whether an increase in NPPC was necessarily, over a period of time, incompatible with the sustainability of the Plans. Nor is it necessarily the case that a year-on-year increase in NPPC was practically inevitable. Nonetheless, Mr Tennet is able to gain some support from Mr Koppl's evidence.

957. First, there is Mr Koppl's recognition that the UK DB Plans' NPPC was so volatile that it was difficult to predict even 6 months ahead (let alone over the term of the 2010 EPS Roadmap) as shown in this exchange:

> "Q. Just to look at those volatile economic forces, the first of them is that you were taking -- the NPPC improvements depended upon discount rates staying constant –
>
> A. Yes.
>
> Q. -- did they not? Would you agree with me that those discount rates had, in fact, been quite volatile at the time of Soto?
>
> A. Yes.
>
> Q. It had been the case that you had had difficulty forecasting the NPPC savings from Soto in six months' time because of the discount of rate volatility.
>
> A. Yes.
>
> Q. Effectively, what you were now doing was producing a road map target which was not just six months ahead, it was a three years ahead.
>
> A. Yes.
>
> Q. So there was a correspondingly greater chance of volatility in that time period.
>
> A. Yes."

958. Secondly, there is Mr Koppl's acceptance that volatility and the commitment to investors meant that the UK DB Plans were "doomed". The exchange with Mr Tennet was as follows:

> "Q. You say: [in his witness statement]
>
> > 'If this trend (low bond yields coupled with low asset returns) continued, the value of liabilities would increase, with no balancing increase in the value of the plan assets.'
>
> Then you deal with the NPPC effect. It is always true, isn't it, that if you extrapolate any bad trend for long enough, there is going to be a problem?
>
> A. I'm not sure what your point is. Is it the case that from -- I think this was looking from 10th June forward through the calendar year, so -- well, I mean, yes, if you forecast a bad trend, it's a bad outcome. I will answer that question.
>
> Q. If you make the hypothesis the bad is going to continue, you will end up with a problem.
>
> A. I take your point.

Q. If you are constantly going to speculate that short periods of bad returns are going to continue long-term, then DB pension schemes are doomed, aren't they?

A. Are they? Yes, I think they are.

Q. They are –

A. They are doomed. There is a trend here.

Q. Yes, but my point is they were doomed at this stage because if you have a requirement to deliver consistent growth to investors –

A. Yes.

Q. -- and that is what is driving you –

A. Yes.

Q. -- and you can't predict, as we have agreed, DB costs in pension schemes, and the pressure is to deliver quarter-by-quarter good results –

A. Yes.

Q. -- you simply cannot run DB pension schemes consistently with the corporate aims, can you?

A. No, [Mr Koppl clearly uses "No" in the sense of agreement with the negative proposition in the question] I think you are making an observation that relates to the long-term trend. Many companies, including IBM, are moving away from DB.

Q. The point is that, as you said, once you are into the stage of saying, well, a quarter's increase is going to cause a problem because it might continue, because we have to -- then these schemes are not sustainable on that basis, are they?

A. I don't -- the word "sustainable" has been used elsewhere. I will just say it puts pressure on IBM to try and reduce its risk.

Q. It's not in any way consistent with the way IBM is trying to run its model, is it?

A. I'm not following you, please.

Q. These DB plans are not consistent in any way with the way you have explained that IBM is trying to run its model.

A. The fundamental effects of DB?

Q. Yes.

A. Yes…….

……

Q. Again, if the UK Plan is going to come under scrutiny because of bad returns elsewhere, again it just emphasises how these plans are effectively very susceptible to very short-term trends, not just in the UK but elsewhere. Would you agree with that?

A. Yes."

959. What Mr Koppl was recognising there was that DB plans, as a class of pension provision, were not suitable for a business model which required year-on-year growth in earnings. In that sense, they were doomed as a method of delivery of pensions and this was why IBM and many others employers were moving away from DB plans. I do not consider that he was saying that the DB Plans operated by IBM were necessarily doomed (*ie* incapable of remaining in place as a viable vehicle for providing pensions to their existing members) or that they were unsustainable in the sense which I have already discussed. These were, after all, existing plans with which IBM had to live one way or another unless it could properly close them.

960. It is, however, true that the Soto changes were made in the middle of what Mr Tennet described as a "pretty spectacular bull run in terms of investment returns" in the UK. He put to Mr Koppl that they were made because of a decline in discount rates of just 0.25% in 2005 (which returned to 5.75% in 2006). Mr Koppl accepted that, but it was because "we are dealing with the year-to-year issue that gets updated each year based on the financial market performance in that year". But Mr Koppl did agree that if IBM was "looking to cut benefits each time bond yields fall annually over a 20 or 30 year period" it would be "making a lot of cuts". In a similar vein, Mr MacDonald accepted that, if the 2006 targets for pensions were not met, IBM would have to "look" at the level of pensions benefits being paid.

961. On the other hand, it is also worth remarking that Mr Koppl's evidence was that, at the time of the Project Soto communications, he did not intend to come back to the issue of DB accrual. I accept that evidence. It seems to me that he must have seen the Soto changes as addressing the concerns which he had so that he, the expert in this area, could not have perceived continuance of the DB Plans as incompatible with IBM's business model in the sense that they would need to be drastically altered or even closed to future accrual. He did, as his evidence shows, recognise the problems associated with the DB Plans in terms of the effect of NPPC on EPS and was alive to the risks inherent in the DB Plans. His preference may well have been to have only DC plans – I am sure it was – but that is not to say that he considered the continued existence of the DB Plans as impossible to reconcile with IBM's commitment to its investors at the time of Ocean and Soto – a commitment to achieve EPS of $10.

CHQ's fundamental opposition to DB accrual

962. The next matter I wish to address which Mr Tennet has raised is his assertion that CHQ was fundamentally opposed to DB accrual (articulating rather more strongly than I have put it in relation to Mr Koppl and his preference for DC accrual). The proposition is that CHQ was fundamentally opposed to DB accrual, largely because of the incompatibility between (1) the inherent volatility of DB costs; and (2) IBM's business model of achieving consistent earnings growth for investors.

963. As already explained under the preceding heading, Mr Koppl was concerned about volatility and saw DB plans as "doomed" in the sense which I have described. It was put to him that the way in which he himself had described the DB Plans made it clear that, to use the words of Mr Tennet's question, "they are inimicable, inconsistent with IBM's business model and the way IBM wishes to do business". Mr Koppl's response was to agree to this extent: "In the sense that IBM want to deliver consistent earnings growth to investors, yes".

964. He accepted that his aim, over a considerable time and at least since Soto in 2005 and 2006, had been to find ways of stopping the growth of DB liabilities. It was his view that the sooner IBM could have found a way to limit or reduce the competitive disadvantage of these schemes through stopping or reducing accrual, the better. Closing the DB Plans to future accrual was, he agreed, one of the obvious ways of doing so.

965. I do not propose to go into much further detail about the views of CHQ on the DB Plans. Mr Tennet describes it as outright hostility, relying on remarks made by Ms Salinaro. I do not think it right to attribute to CHQ the somewhat intemperate language which she used; indeed, Mr Koppl did not consider that her attitude was appropriate; nor did Mr MacDonald consider her views, expressed in the way they were, to be representative. But it is right, I consider, to say that CHQ would have preferred it if there were no further accrual under the DB Plans; senior executives had, indeed, been considering it as option (unknown to Mr Koppl) with Towers Perrin (in the autumn of 2005). And it is right to note that Mr Koppl accepted that CHQ was looking at proposals which

necessarily involved closure of the Plans notwithstanding that they had been told by UK management that this would be contrary to the message delivered to members the previous year (*ie* as part of the Ocean communications). Indeed, he said that, at the time of Project Soto, he would have preferred a mandatory closure of the DB Plans.

Soto would have had a minimal effect on volatility

966. Mr Tennet seeks to establish that Project Soto would have had minimal effect on volatility and that Mr Koppl and other executives knew that the issue of volatility had not been solved. Those who allowed a contrary message to be given to UK management, the Trustee and the members conveyed an inaccurate message, a factor which Mr Tennet seeks to feed in to his argument on breach of the *Imperial* duty.

967. I have received a mass of evidence on this matter, including a great deal of complex expert evidence about breadth of variance volatility or downside risk (which I will come to), the effect on PBO and the effect on PTI. It is absolutely clear that Soto did not solve the volatility problems facing the DB Plans. But equally, I am satisfied that IBM could reasonably have thought that there could be a positive impact on both breadth of variance volatility and on downside risk. I propose to take this aspect of the case comparatively (with other parts of this judgment but not absolutely) briefly.

968. So far as Mr Koppl is concerned, he accepted that he knew at the time that Project Soto would not have a great impact on breadth of variance volatility. However, his evidence, which I accept, was that he had no direct communication with UK management or the Trustee and was not aware of the messages which were being conveyed.

969. Mr Tennet says that Mr Koppl's was a view shared by Mr MacDonald who said under cross-examination that, "I knew we didn't solve the problem". However, that answer was given in the course of a long line of questioning. Mr MacDonald's answers made it clear, and I accept his evidence on this, that he was not aware that the Soto changes would not, or did not, solve the problem of NPCC volatility "beforehand", as he put it, in other words before Project Soto was agreed by the Trustee. But see paragraph 991 below, as to what he would have said had he known the impact was only marginal.

970. On 27 September 2005, Mr Potgieter of Towers Perrin emailed Mr Koppl and Ms Salinaro to discuss the Soto options. The email started in this way:

> "Just a thought for your back pocket as you go into the discussions with Randy and Mark. While we have been focussed on the 2006 P&L impact, in most countries we have also come across opportunities to reduce ongoing P&L and get IBM out from further long terms exposure & variability. In each case this comes with one time cost on the P&L and also cash implications. At this stage in each country we are trying to make changes that will involve a lot of effort and noise and we are not really solving our future volatility in each case (related to the past). If the changes don't add up to enough to get out of the P&L hole in 2006 I think we should consider the "nuclear" option i.e. wind up where possible, push/buy conversion to DC and settle as much liability as possible."

971. Ms Salinaro's response was "We've been confidentially thinking similarly. Behind the scenes…". That suggests strongly that the CHQ pensions team (perhaps other than Mr MacDonald) were well aware that Soto was not "really solving our future volatility". Further, it is hardly a ringing endorsement of the proposition that IBM saw the DB Plans as sustainable at that time; it even makes questionable the proposition that IBM had no current intention to make further changes in the near or even foreseeable future. And it clearly shows that CHQ's thoughts were not to be shared with UK management, something which Mr Koppl accepted. That requirement for secrecy was, it seems to me, a reflection of the fact that CHQ knew things that it did not want UK management to know because it would undermine the message which CHQ was sending out about addressing volatility and sustainability.

972. In his cross-examination, Mr Koppl agreed with Towers Perrin's assessment that future volatility was not being

solved, as is shown by the following exchange in relation to the passage from Mr Potgieter's email just quoted:

> "Q….. The problem which Towers Perrin correctly identify there is that your volatility problem is a function of your past liabilities.
>
> A. Yes.
>
> Q. That is what they are saying.
>
> A. Yes.
>
> Q. In a very mature closed scheme, those past liabilities substantially outweigh future liabilities; yes?
>
> A. To put it another way, service cost is maybe adding 1 per cent to the liability per year."

973. Later on he explained that NPPC volatility would continue:

> "Q…. It is not your position, is it, that whatever was being proposed by the UK was going to solve the pension problem?
>
> A. To define "solve", the volatility would continue, it would only be marginally reduced by the actions of Project Soto. NPPC volatility, to be more specific.
>
> Q. So the UK solutions were not going to really solve the pension problem, were they?
>
> A. I -- "the pension problem" is such a vague thing that I would rather not use it in my own language, but I would I agree that it wasn't going to solve NPPC volatility. I never had any -- this is a fairly technical subject, as you know, and what general managers and others who are not experienced with this -- the mechanics of this thought at the time, I don't know. For my part, I was clearly not believing that this would solve the volatility of NPPC.
>
> Q. Thank you. While we will see it achieved ultimately the cost savings, your advice is that it only had a marginal effect on volatility.
>
> A. Yes. I should say, over time that marginal effect kind of is cumulative, so there is -- it's bigger in the future than it is in year 1, but it is still marginal, no matter how you cut it."

974. Mr Koppl said that he did not remember "getting detail on PBO" numbers at the time of Soto. Breaking down the effect of Soto on PBO and its growth, he agreed that as a matter of principle:

i) In respect of the members who remained in their DB Plans, existing PBO was reduced slightly, because the full final salary link was broken (or at least reduced) so that only two thirds of salary increases would be pensionable. For the same reason, the growth of PBO was also slowed slightly, but DB accrual continued to add to the PBO.

ii) In respect of the members who switched to the Enhanced M Plan, existing PBO was not reduced at all, because those members retained their final salary link. However, the growth of PBO was halted in respect of those members, slowing the growth of PBO overall.

iii) As a result, he knew that volatility would continue to rise and might exceed the level it was already at, at the time of Soto. He also accepted that, ironically, the more people that switched to the Enhanced M Plan, the lesser the immediate effect on volatility. But that is not to say that the impact in the longer term would have been to reduce the level of volatility below what it would otherwise have been. That is true, but I do not see where it gets the RBs. The question is not whether volatility continues to worsen after Soto. The question is whether the volatility after Soto is worse than it would have been if nothing had been done.

975. Moreover, Mr Tennet submits that it was clear that it would take only a very short period of time for PBO and hence volatility – all other things being equal – to return to the level immediately prior to Soto. The total service cost in the years 2006-2008 was £183.6m, £20m greater than the £163m PBO reduction arising from Project Soto. Therefore, it was clear, he says, that, all things being equal, within 3 years volatility would be back to the level that necessitated the Soto changes in the first place: the Main Plan was just as volatile just 3 years after Soto. That may be so. But again, the comparison surely needs to be – when asking whether volatility had been addressed rather than solved – between the positions (i) following Soto and (ii) if the Soto changes had not taken place. PBO would inevitably been higher than it in fact was and to that extent, volatility would have been greater that it in fact was.

976. The experts were in broad agreement that significant breath of variance volatility remained after Soto. It was common ground that Project Soto had some effect on the volatility of NPPC. Mr E. Bradley Wilson's view, however, was that the reduction in liability risk and volatility "was not likely to be material". This is because volatility was a function of the size of the PBO, and the PBO was barely touched by Soto.

977. Mr Tennet points out that Mr Robbins agreed that "significant volatility in NPPC would have remained following the Project Soto changes due to the absolute size of the assets and PBO of the UK DB Plans. This would not have been addressable through benefit changes." However, that statement needs to be put in its context, in relation to which I need to quote the whole of the section of his report under the heading "Impact on volatility of NPPC" at paragraphs 4.2.15 to 4.2.19 of his expert report:

> "4..15 IBM's NPPC could have been expected to be highly volatile. The impact on NPPC of fluctuations in asset and PBO values could be significant, as I have shown in section 3.2.
>
> 2.16 Project Soto would not have been expected to address aspects of the volatility related to the investment strategy (see section 3.2). IBM was not able to address a large part of this risk through benefit changes, as UK legislation protects against changes to past service benefits.
>
> 4..17 However, the Project Soto benefit changes would have been expected to reduce IBM's exposure to changes in long term inflation expectations (due to the COLA change and the reduction in future pensionable salary increases). Project Soto would also have been expected to reduce the build up of DB benefits over time.
>
> 4.2.18 In my opinion, therefore, I would have expected the Project Soto changes to reduce IBM's exposure to volatility in NPPC.
>
> 4.2.19 Notwithstanding that there would be a material impact on volatility, I consider that significant volatility in NPPC would have remained following the Project Soto changes due to the absolute size of the assets and PBO of the UK DB Plans. This would not have been addressable through benefit changes."

978. Mr Robbins' contention, contrary to that of Mr Wilson, was that the impact described above was material. Mr Wilson noted that Mr Robbins, in his report and the joint report, had "not defined what he characterises as material". But it became apparent at the end of the cross-examination of both witnesses that they were not talking the same language. Mr Wilson explained that he was referring to materiality in an audit context. Mr Robbins was obviously rather surprised by this. In answer to a question from me about a possible difference of approach, he said that the audit materiality was not something that he referenced in his report and it had certainly not been mentioned in the joint report or in the discussions which the two experts had held. So although Mr Wilson might have been referring to audit materiality, Mr Robbins meant something different:

> "… when I was commenting on a factor being material, it was because I felt it was material by relevance to the size and scale of the UK profits and therefore, presumably, the decisions that UK

management would take about the business and the pension scheme. I wasn't focused on whether it was material to an auditor who had to sign off a true and fair view of accounts."

979. Mr Robbins also contended that what he called the "downside risk" – that is, one single figure representing the worst possible projected outcome in a given year – also represented "volatility". Mr Wilson considered that "downside risk" was not a measure of volatility. It was Mr Koppl's view that volatility referred to the spread of outcomes. This is all a matter of language, it seems to me, and of what the use of the word "volatility" means in the context of that use. Although Mr Tennet asked Mr Robbins a number of questions about the downside risk, and took him to some graphs and tables to illustrate the points he was making in his questions, Mr Robbins was never actually asked – at least, I have not found it in the transcript and will no doubt be corrected if I am wrong when this judgment is considered by the parties in draft – why he disagreed with Mr Wilson about whether downside risk could sensibly be described as volatility.

980. This particular disagreement about whether downside risk is properly seen as volatility does not seem to me to be of much, if any, significance. "Volatility" is relevant to the RBs' claim because "volatility" was the word used in some of the Soto communications. In that context, it is clear to my mind that the references to volatility included breadth of variation "volatility"; whether they included the downside risk must be very open to question. The reasonable member reading or hearing the communications would, I consider, apply the ordinary meaning of the word "volatility". What the reasonable member would have expected is that the proposals addressed (even if they did not solve) the unpredictable variations in pension costs and in the gap between assets and liabilities.

981. Mr Wilson accepted that Project Soto reduced the PBO and thereby reduced breadth of variance volatility and that it included one feature that reduced volatility independently of reduction in PBO, namely a reduction of exposure to the inflation assumption as a result of the COLA changes in Project Soto. He also accepted that the reduction of the amortisation period in Project Soto was a result of the comparison between the demography of the Plans before and after the changes, so that the proposal might not have had the effect of extending the amortisation period:

> "Q. Just talking about the amortisation period for a second, as we now know, one of the effects of Soto was to reduce the amortisation period, but the question of whether the amortisation period in Soto would have been reduced is a function of a comparison between the demographic of the scheme before Soto and the demographic of the scheme after Soto, isn't it?
>
> A. It's a point in time measurement that would just really be the measurement after.
>
> Q. Exactly, but if the period were -- if you imagine the demographic of the scheme before Soto and you imagine that numerous members had left but the members that had left fitted exactly the demographic of the scheme before Soto, then you would still have the same amortisation period, wouldn't you?
>
> A. Yes."

982. The parties' conclusions from all of this evidence could not be further apart. Mr Tennet submits that it cannot be said that Project Soto had a material impact on volatility. Mr Simmonds submits that I should take from the expert evidence on this issue that there was some basis for concluding that Project Soto would have a positive impact on volatility, whether assessed on either the breadth of variance basis or the downside risk basis or both.

983. I consider that Mr Simmonds is correct to say that there was some basis for concluding that Project Soto would have a positive impact on volatility. Mr Tennet may be right to say that such impact was not material, using that word in the sense of audit materiality. But I consider that Mr Simmonds' submission is correct if the positive impact is assessed using Mr Robbins' approach to materiality.

984. I hardly think, however, that the modest impact, even if it is a material impact, justifies that expansive statements made in the communications, some of which I have referred to at paragraph 905 above. This is especially so

given the secrecy on which CHQ was insisting: see paragraph 971 above. Those statements include the following:

> "…..to address future long term pension expense and volatility to put IBM's pension plans on a sustainable footing"
>
> "….IBM….. are satisfied that they achieve the aim of reducing the current costs and future volatility…"
>
> "Although there are no guarantees, these actions, along with those already taken, we hope, are sufficient to put our defined benefits pensions schemes on a sustainable footing."
>
> "The cash injection does not, however, remove future volatility nor deal with the increasing cost of providing benefits for future service. It is this that the company proposals are seeking to address….."
>
> "The Company proposals do reduce pensions expense and volatility."

What other senior executives knew

985. I have so far dealt only, or at least primarily, with Mr Koppl and Mr MacDonald. What about other senior management? It is clear, in my view, that Mr Greene, Mr Loughridge, Mr Castellanos, and Ms Salinaro were fully in the loop and must have been aware of Mr Koppl's projections and Towers Perrin's advice. Ms Salinaro was certainly of the view that volatility problems were not being solved by Soto.

986. It is unclear precisely what other senior management, whether in CHQ or in the UK, actually knew. It is apparent, and I am satisfied on the evidence, that such people were reliant on Mr Koppl and others at CHQ, with the knowledge of such matters, to inform them of the position. It is also apparent, and I am satisfied, that UK management were heavily dependent on CHQ for their understanding of (i) the effect of Soto on volatility and (ii) the levels of volatility with which CHQ was content.

987. Mr Tennet submits that CHQ repeatedly told the UK that volatility was being "solved" or at least mitigated to levels CHQ was content to bear. He has brought to my attention a large number of things said in witness statements and in oral evidence which establish that one of the aims of Soto was to address volatility.

i) Mr MacDonald agreed that he told the UK team on 28 September 2005 that "we need to solve the pension problem" and that the impression he gave the UK team was that "CHQ was looking to be satisfied that any solution they had come up with would solve the pension problem long-term". That quotation from a lengthy passage of cross-examination does not really give a fully accurate picture of Mr MacDonald's evidence. He accepted that solving the pension problem long-term was the ultimate objective of CHQ:

> "Q. Would you accept that the impression you are giving to the UK team here is that CHQ was looking to be satisfied that any solution they had come up with would solve the pension problem long-term?
>
> A. That was our ultimate objective. Yes.
>
> Q. That was the impression you were giving to them, that is what you wanted their solution to achieve?
>
> A. That is what we started with, and they have come back with different proposals, saying they thought this was more appropriate.
>
> Q. Can you see why the UK would have come away from this meeting believing that you were looking to solve the pension problem long-term?

A. It wouldn't have been just this meeting. I have been consistent on that.

Q. If we go……

A. "Not just a year problem ..."

Q. "... to be solved. Need to fix problem for long-term." Yes?

A. Yes, I read that."

But the extent to which UK management might be able to introduce changes to achieve that objective was a different matter: just after that passage, the question of legal risk was the subject of questioning ending with this:

"Q. Would you agree what you are really saying is, look, you are pushing UK management to go as far as it felt it could go? You weren't saying what level of legal risk is acceptable; they had to decide what level of legal risk they were satisfied with.

A. Yes, I think that is correct."

ii) That is all very well. But what Mr MacDonald meant by the "pension problem" is not at all clear. I am doubtful that he had any real understanding of volatility.

iii) Mr Heath's email to Ms Salinaro of 12 October 2005 shows that the UK thought it was addressing volatility. In that email, Mr Heath set out some questions which Ms Salinaro had asked and gave his responses. He explained in answer to question 1 that "we" (*ie* UK management) had developed the package of measures to address two key issues that IBM had asked them to focus on namely (i) $92m cost saving for the year and (ii) reduction in long term volatility. Question 8 and the answer were as follows:

"8. How was the $59M cost reduction related to RPI change calculated? And same question for the $29M savings to then go from this reduced DB to DC. The $29 should be net of an increase to bump pay increase assumption back up for the group opting for DC, if I understand the proposal correctly. I'm having trouble getting to these numbers based on what I've seen before. I would imagine that these numbers are very sensitive to the demographics of those who stay in the plan. We need to understand that sensitivity and how far off our estimates could be. What will the UK business do, if the estimates turn out to be off and are producing lower savings than anticipated? How can the UK business make up the difference in fiscal 2006 and beyond to make its plan?

The numbers are shown below the $29M saving moving from DB to DC is offset by the cost of providing DC. This particular proposal is designed to reduce volatility rather than reduce cost and it is that basis that we have used for designing the DC option to make it reasonably attractive that we encourage people to take the leap. There is limited cost increases/reductions based on the numbers of people who take the option the real prize here is volatility. The only significant issue is the early sign up bonus. We can take you through this tomorrow, will be easier face to face."

iv) So clearly Mr Heath saw Soto as reducing volatility. In spite of the mass of material I have seen, I do not know what he relied on in saying what he did.

v) Mr Koppl agreed that volatility reduction "was one of the stated aims of the project".

vi) Mr Hirst explained in his witness statement that the UK team tried to put together a package "which would resolve the issues of volatility and competitiveness", and that "the Soto changes were always intended to be…a long-term solution to the pension problem identified". His understanding of Soto was that it "addressed the

issues of volatility and competitiveness to the satisfaction of CHQ…I considered that CHQ believed that the final proposals would deal with volatility and competitiveness as otherwise they would not have accepted them".

vii) Mr Heath's evidence was that he thought Soto would address volatility, and that the Soto Proposals would be a long-term solution to the problem identified. He thought that CHQ would be satisfied with the reduction in volatility and agreed with Mr Hirst's witness statement on this point.

viii) Because it was relying on CHQ, the UK appears not to have carried out any of its own assessment of the existing volatility in the DB Plans, or of the effects of Soto on volatility.

988. Mr [Stephen] Wilson understood that the objective was to address volatility. Since both Mr Tennet and Mr Simmonds rely on what he said in his oral evidence, I think that I need to set out a somewhat lengthy interchange between him and Mr Simmonds. This was directed at a slide in which a number of factors are identified as an explanation of how expense and volatility was being addressed, namely anticipated transfer of employees to the enhanced DC plans, restriction on pensionability of future salary increases for DB members, one-off cash injection by IBM further securing the pension scheme and reduced, but guaranteed future Pension in Payment Increases for a fixed period. The exchange went like this:

> "Q. Was it correct that your view and the view of management was that those factors or elements would operate to mitigate volatility in the plan?
>
> A. Yes, to mitigate. Not to eliminate.
>
> Q. No. The reason for that is, if DB members transfer –
>
> MR JUSTICE WARREN: I'm sure you both know what you are talking about but I really am confused by the word "volatility". I had it in opening and it still means different things in different contexts. I just want to be clear what you are talking about.
>
> MR SIMMONDS: Mr Wilson, what are you talking about?
>
> A. I think the Judge may be right to be confused, because unfortunately I believe the word was -- did acquire something of an umbrella status that was perhaps less clearly defined than it could have been. I think it at some times meant the volatility that could occur in IBM's net periodic pension cost in absolute terms; in other words, the swings and the ups and downs in pension cost. I think in other contexts it was taken to mean just reducing the extent to which the DB liability would grow in the future, and that therefore this could damp down future volatility because the DB liability would be smaller than it otherwise would have been, and would grow less slowly.
>
> MR JUSTICE WARREN: Did NPPC come into this, when you see this word being used?
>
> A. I think that the objectives of the Corporation in Soto were: number one, to get rid of the year-on-year increase in the immediate period; number two was to make long-term cost savings; and number three was to address volatility, which in their minds that meant to reduce the growth of the DB liabilities in absolute terms. Those things, I think, have a beneficial effect on the level of variability, to use a different word, that could occur in NPPC but they would not eliminate that variability, because you have large assets and large liabilities which are still subject to the amount you ascribe to the return on assets and what is happening to discount rates and inflation rates and other financial market conditions."

989. However, whatever extent to which he thought volatility had been addressed by Soto, Mr Wilson was told by Mr MacDonald that CHQ thought "we had met the objectives that we had been set": UK management were clearly entitled (i) to think that volatility had been addressed certainly for the short term and in my view, for the medium term (whatever duration those concepts might have) and (ii) to communicate this to members.

990. Mr MacDonald was also reliant on Mr Koppl. He did not know a great deal about volatility; his evidence was that he "knew instinctively that there is volatility in DB Plans". He told me that he would not have looked at any volatility modelling: "the actuaries would do that for me". He was reliant on others. As he said in his oral evidence:

> "Perhaps in my naivety, but when the finance people tell me that we are investing $1 billion and we are taking the funding that we need to do for that year and putting it into that $1 billion up front, they gave me a comfort level that indeed we were doing the right thing. I have to rely on their representations."

991. Surprisingly to me, he does not appear to have been aware that targets for the addition to EPS to be derived from retirement related costs were to be achieved by IBM anticipating levels of profit from its DB pension schemes, which would then be offset against DC and other retirement related costs.

992. Mr Tennet submits that both the UK management (Mr Hirst and Mr Heath) and Mr MacDonald gave evidence to the effect that if they had understood the true position as to volatility they would not have made the statements to members and the Trustee they in fact made:

> i) Mr Hirst said that:
>
> "CHQ repeatedly told me that the problem had been solved and I received numerous congratulatory messages, both oral and written, to this effect…If I had known that the very issue that was meant to be addressed by the changes was still considered unresolved by CHQ, then I would not have agreed to the changes, because, in those circumstances, it would have been obvious to me that CHQ would have wanted to revisit the issue in the future."
>
> ii) He also said:
>
> "... that the position was that which I understood at the time, namely that in terms of the underlying volatility of the scheme, it had been de-risked to CHQ's satisfaction, and the UK management considered the changes to be right for the business. I also said that the proposals met the Trustee's concerns about long-term stability and the funding of the plans; my understanding accorded with that of the Trustee."
>
> iii) As with all of Mr Hirst's evidence, I must treat what he said in his witness statement with caution since he was not available to be cross-examined.
>
> iv) Mr Heath confirmed Mr Hirst's evidence, saying that he made the communications to members and the Trustee because "that is absolutely how we felt at the time".
>
> v) Mr MacDonald maintained that if he had known the facts that he now knew he "would have made the same statements [to the Trustee about sustainability etc]" adding this: "but then put additional statements around it so that people understood what I was saying". He said that "if there was [a] marginal impact [on volatility] I would have said – if I had known… "Look, this is the way I think things are, a firm footing, it looks like basically, based on what I know, we don't have much to worry about. Correspondingly, I have seen some data that says the opposite of that. Right now we are on a firm footing, but we need to understand going forward it could be this…". That is how I would have done it. If I had that data". He concluded that his views of the scheme as being on a very firm and sustainable basis were "Perhaps wishful thinking but I … honestly believed we were done, for a while" and "…it may have been optimistic".

993. For his part, Mr Koppl actually knew the true position and was concerned about volatility and would not himself have made the statements in fact made.

994. Incidently, I note that Mr Koppl was present at the meeting on 28 September 2005. He did not correct what Mr

MacDonald had said at the meeting. Nor is there anything to suggest that he took steps to correct the misunderstanding shared by Mr MacDonald, Mr Hirst and Mr Wilson that volatility was being solved. This makes it even more difficult than it would otherwise be for Holdings to distance itself from matters which its management did not know but which CHQ did know.

995. In essence, therefore, Mr Tennet's argument based on the facts as he puts them, is that Holdings had no basis on which to make the representations about sustainability and commitment which it did. What is more, those at CHQ who knew the true facts could not properly have made the representations. Holdings is unable to shelter behind the good faith and lack of knowledge of its own management.

996. In his closing written submissions, Mr Tennet appeared to me to be putting this misrepresentation argument as one in support of a free-standing breach of the *Imperial* duty. He noted that IBM accepts that, had it dishonestly made the statements it did in 2005 and 2006, there would be a basis for a claim for the breach of the *Imperial* duty. He submitted that there is no reason to accept as a matter of principle that if an employer makes false statements without having reasonable grounds, the members' trust and confidence in the employer could not be undermined. It is a matter of fact in each case, but in each case the test has to be whether the behaviour was such as to objectively be likely to undermine the relationship of trust and confidence.

997. He also drew attention to the impact on the members of the mis-statements: many of them have acted in reliance upon the statements which, even if they did not give rise to expectations, could properly be taken as statements about IBM's belief that the DB Plans would be sustainable which they were not. He suggested that 80% of the members "were persuaded to remain in the DB schemes in 2006 on the basis that it was not more risky to do so, we say, than DC accrual". Those members then lost out in 2009 by having to accept a pensionable pay freeze (or no pay increase at all) and had lost the chance of transferring to the Enhanced M Plan with increased employer contributions.

998. It needs to be noted, however, that this way of putting the case (which has been described variously as the "de-risking" claim or the negligent misrepresentation claim) as a free-standing breach of the *Imperial* duty, has never been pleaded and was only raised at a very late stage, in the RBs' closing. As is usual, the draft of this judgment was submitted to counsel for corrections. As part of that exercise, Mr Tennet has informed me that it was never the RBs' intention to rely on a free-standing breach of the *Imperial* duty at the time of the Ocean and Soto changes: he intended only to submit that the RBs can rely on the statements in determining whether any disappointment of Reasonable Expectations gives rise to a breach of the *Imperial* duty. If I misunderstood the submissions made, I regret that. Mr Simmonds did, in any case, address the point. He submitted that it was simply too late to raise the point, but nonetheless addressed the substance of the argument. I consider that, for completeness I should deal with the arguments and I will come to Mr Simmonds' answers in a moment. But before I do, there is a discrete point which I wish to deal with here. It is, I am afraid, a substantial digression, ending at paragraph 1021 below.

Whose duty?

999. At the end of the section of the judgment dealing with the law, I raised the argument that if misleading statements were made by Holdings, they were nonetheless made in the belief of those making them, and of Holdings, that they were true: this is not conduct, it is said by IBM, which could give rise to a breach of the *Imperial* duty. I said that I would return to the point and this is a convenient place to do so.

1000. The evidence which I have already addressed establishes clearly that it was CHQ which was the driver for the pension changes in relation to each of Ocean and Soto. As we will see, the same is the case in relation to Waltz. There may have been some lack of communication within the CHQ team since it does not appear that Mr Koppl was aware of some of the things which were being said to UK management by CHQ or of what UK management were communicating to the employees; nor were UK management always aware of the information which Mr Koppl was giving to his colleagues in CHQ. But what is clear is that CHQ as a whole knew, and to a large extent directed, what was happening in the UK in relation to pensions. The "powers reserved" system meant that the critical pension actions could not be taken without Armonk approval. To come at that point from

a different perspective, Holdings was part of a corporate structure, with IBM Corporation (and within it CHQ) at the top, whose governance resulted in the team at CHQ having significant control over certain aspects of Holdings' activities including control of the direction of the pensions projects.

1001. This gives rise to two related issues. The first is how, if at all, the involvement of CHQ in the Ocean and Soto changes impacts on the assessment of whether Project Waltz gives rise to any breach by Holdings of its *Imperial* duty. The second, related, question is how, if at all, the answer to that question is affected by any incorrect statement made by Holdings (through the various communications, including announcements and presentations by Mr Hirst and Mr Heath) in the course of Ocean and Soto, in particular where it was not known to Holdings that a statement was incorrect.

1002. I deal with the first question ignoring the RBs' case that the statements in the various communications concerning volatility and sustainability were materially incorrect. The rival contentions are in essence as follows:

i) IBM submits that CHQ's involvement has no impact at all. The *Imperial* duty is one which rests on Holdings alone and there is no constraint on what IBM Corporation and CHQ can decide to do, including the imposition of targets. Mr Simmonds rejects Mr Tennet's submission which he slightly unkindly formulates as "well, you lump it all together because Holdings and CHQ were joint decision makers". When it came to Project Waltz, IBM Corporation/CHQ was not constrained by the *Imperial* duty or any similar duty owed to the members or the Trustee from taking such steps as it saw commercially desirable, including meeting its EPS target. Holdings itself (whether this is part of the global strand or the local strand which I describe later does not matter) was then entitled to make its own commercial decisions taking account of the targets which CHQ had set and of the business repercussions (for instance, the impact of internal investment and employee reward program(me)s) if CHQ's requirements were not met.

ii) In contrast, the RBs say that that is a wholly unrealistic approach. CHQ cannot, it is said, on the one hand effectively impose targets, particularly the upwardly-moving targets introduced when the Spring Plan was imposed, having allowed Holdings to make statements and commitments, and then, on the other hand turn round and say that these statements and commitments are worth nothing because IBM Corporation itself owes no direct duty to the members. In effect, although Mr Tennet did not articulate in quite this way, Holdings can be in no better a position than IBM Corporation would be if it were subject to the *Imperial* duty and had made the statements giving rise to the members' Reasonable Expectations (if any).

1003. These different approaches lead to materially different results. Let me start with the global strand and address it on the basis that there is no separate local strand: the only justification is the global strand. For the details of these two strands see the discussion of IBM's business justification for Project Waltz in paragraphs 1329*ff* below.

1004. On IBM's approach, it is enough, under the global strand, to justify Project Waltz (if justification is needed at all) that there is a need to meet the EPS targets (with Holdings being expected to contribute its share to the required pension cost savings); the decision by CHQ to require the Project Waltz proposals was a business decision for CHQ unconstrained by any duty to the members. On that basis, Project Waltz was entirely rational from CHQ's perspective. It was then a management decision for Holdings whether to adopt Project Waltz; and given the concerns about internal investment and salary increases over which CHQ had a great deal of say, it really had no choice but to adopt the changes. Holdings' own decision was therefore entirely rational and not open to challenge.

1005. In this context, it is important to note the following factors:

i) the influence and control which CHQ had over the direction of pensions in the UK;

ii) the manner in which that influence and control was in fact exercised; and

iii) (although this may be part of ii)) the responsibility which CHQ must, in my view, take for the message which was given to members in both the Ocean and Soto communications. Just as IBM worldwide is a global

business with its local arms answerable to Armonk, so IBM Corporation/CHQ must take responsibility for the representations made to members with its knowledge and approval, especially bearing in mind that those representations were made with a view to obtaining the assent of members to proposals, in each case, driven by CHQ's own agenda.

1006. The result of IBM's approach, in the light of those factors, suggests to me that there is something wrong with that approach. In effect, IBM Corporation is to be permitted to make its own business decision without taking account of the impact on Holdings and the members of the UK DB Plans ignoring wholly the Reasonable Expectations (if any) which it has allowed Holdings to engender. Holdings is then in practice compelled to adopt the proposals.

1007. IBM Corporation and CHQ can, of course, make whatever business and commercial decision they like and this court, at least, cannot interfere with their decisions and actions. But what this court can and should do, in my judgement, is to hold that, by imposing targets and requiring changes to the UK DB Plans, IBM Corporation runs the risk of putting Holdings in breach of its (Holdings') *Imperial* duty. Whether it actually does put Holdings in breach of its *Imperial* duty should be assessed by asking whether Project Waltz was an appropriate response to the problems facing IBM Corporation taking into account the Reasonable Expectations (if any) of members.

1008. Moving away from the argument based solely on the global strand, I now turn to consider the local strand. As Mr Simmonds agrees, the two strands are not wholly independent and to some extent the local strand can be seen as a manifestation of the global strand. Indeed, Mr Chrystie saw it as precisely that.

1009. I can understand the submission that the local strand had a number of elements. There was, according to IBM, a need to address Holdings' current and future lack of competitiveness. IBM says that this lack of competitiveness is demonstrated by its failure to meet its PTI targets and its low position compared with other Integrated Marketing Teams ("**IMT**"). But even accepting that that was so (a matter discussed elsewhere), it cannot seriously be contended (as I also explain elsewhere) that proposals as damaging to the members as the Project Waltz proposals would have been put forward if it had not been for the global strand. Thus the local strand, like the global strand, turned on the imposition of targets by IBM which were, in turn, driven by the 2010 EPS Roadmap.

1010. On IBM's approach to the *Imperial* duty, the starting point for Holdings in deciding whether to adopt the Project Waltz proposals on the basis of the local strand was the requirement by CHQ to meet certain targets (targets which moved without warning when the Spring Plan was announced). Given those targets, it was a wholly rational decision, it is said by IBM, to agree to the changes. Absent any Reasonable Expectations, it would be difficult to argue with that.

1011. As with the global strand, IBM Corporation/CHQ are entitled to impose whatever targets they consider commercially appropriate and this court cannot interfere with their decisions and actions. However, although Holdings can rely on those targets as an element of the local strand it cannot, in my judgement, do so immune from the possibility of challenge. It is necessary, in my view, to go behind those targets to see why they have been imposed. Once again, the factors listed in paragraph 1005 above are relevant. And once again, the question to ask is whether Project Waltz was an appropriate response this time to the combination of problems facing both IBM Corporation (the requirement to meet the 2010 EPS Roadmap) and Holdings (the need to improve competitiveness) taking into account the Reasonable Expectations (if any) of members. This involves, of course, a careful consideration of IBM's business case which I come to later. It is not a straightforward exercise.

1012. If I am wrong in that approach, then the issue is potentially far simpler to resolve. Thus, on IBM's approach, the global strand starts with the position that IBM Corporation/CHQ's decision and conduct in deciding to put forward and promote the Project Waltz changes was not constrained in any way by any Reasonable Expectations. And in assessing whether Holdings itself is in breach of its *Imperial* duty, the question is whether, given that the changes were required by CHQ, Holdings would be acting perversely and irrationally (in the sense which I have described) by agreeing to the changes (to which IBM says, of course, that the answer is obviously

that Holdings would not be acting in that way) notwithstanding that the changes would disappoint the RBs' Reasonable Expectations.

1013. I would add here that IBM's position has one unattractive (at least to me) aspect. On IBM's case, whether any particular proposals (such as the Project Waltz changes) actually give rise to any breach of the *Imperial* duty has to be judged against the need to attain the EPS target. On the one hand, the global strand relies on the recognition of IBM as a worldwide operation with each region contributing to the overall enterprise. It is appropriate to impose targets on the regions in order to achieve an objective which the centre wishes to achieve *ie* to stick to the 2010 EPS Roadmap and to control pension costs globally in the future. If there is a justifiable business case for preferring the attainment of EPS targets over other desiderata, such as increased employee remuneration or indeed continued pension provision, Holdings can be required to play its part. In essence, (and this is a point made by Mr Simmonds in his oral closing) IBM Corporation is simply the (ultimate) shareholder of Holdings and is entitled to act, as any shareholder, in a way in which it considers is in its best commercial interests.

1014. But on the other hand, IBM wishes to emphasise the different legal personalities of Holdings and IBM Corporation when it comes to establishing a breach of the *Imperial* duty, a duty resting on Holdings alone. Mr Simmonds suggests that IBM Corporation was acting as any shareholder is entitled to act, in its own interests, so that he would no doubt say that the contrast which I have just identified is not surprising and is not an unattractive aspect. But IBM Corporation is not, in relation to Ocean, Soto or Waltz, simply an (ultimate) 100% shareholder of Holdings. I refer again to the factors mentioned in paragraph 1005 above, in particular factor iii). I do not perceive IBM Corporation as standing in the same position as the shareholder which Mr Simmonds has referred to. Nor would the members who have worked in a culture, under either the old Watson-style management or under the new Gerstner/Palmisano-style management, which sees IBM worldwide as a single enterprise to which all employees owe their loyalty.

1015. The second question is how any mistake in the communications to members or the Trustee (and in particular Mr MacDonald's assurances at the Marriott Hotel meeting) affect the answer to the first question. The relevant mistake, of course, is the misrepresentation alleged by the RBs concerning volatility and sustainability in the light of all the evidence about the financial circumstances of the UK DB Plans and how, if at all, Projects Ocean and Soto would address or solve the problems to which they were addressed. The question then is whether the existence of the error is something which is to be brought into account in assessing whether Holdings was in breach of its *Imperial* duty:

i) A wholly innocent mistake might be excusable when assessing whether the conduct in question (approving and implementing the Project Waltz proposals) was conduct which no reasonable employer would follow.

ii) In contrast, if the individuals in CHQ who actually approved the communications and allowed them to be made knew that the communications contained material errors, that would significantly assist the RBs in their case: it would be far easier, than in the case of an innocent error, to say that no reasonable employer who had knowingly misrepresented the position to the members would have implemented the proposals. But I must make clear that this is not to say that, even in the case of a knowing misrepresentation, a particular set of changes which disappoint Reasonable Expectations will necessarily give rise to a breach of the *Imperial* duty: it cannot be said, *a priori*, that acting contrary to Reasonable Expectations always give rise to a breach of the *Imperial* duty even where those expectations have been engendered by a false statement. This is a different question from whether the making of the false statement is, of itself, a breach of the *Imperial* duty, but that is not the position which I am now addressing.

iii) A case between those two extremes would be where the mis-statement was made innocently by the individual actually making it but was known to be wrong by the entity on behalf of which the individual was acting. For instance, Mr MacDonald made certain statements at the Marriott Hotel meeting which the RBs say were incorrect. If they were incorrect, Mr MacDonald himself is to be acquitted, at least by me, of any bad faith. But if what he said was contrary to the facts known to IBM Corporation/CHQ, then the error may carry more weight in favour of the RBs in the assessment of the breach of the *Imperial* duty arising as a result of the Project

Waltz changes.

1016. This last point gives rise to another issue which is whether Mr Koppl's knowledge is to be attributed to IBM Corporation/CHQ. Mr Simmonds makes the points (i) that it was Mr MacDonald who was the decision maker within CHQ in relation to the matters with which this action is concerned and (ii) that Mr Koppl was not a decision maker but was, essentially, an analyst and technician providing advice to the decision makers.

1017. I do not know how the law of New York would attribute the knowledge of individuals to a corporation and thus I do not know how the knowledge of people within CHQ would be attributed to IBM Corporation. It is appropriate that I assume that law to be the same as English law. The leading authority in this area is *Meridian Global Funds Management Asia v Securities Commission* [1995] 2 AC 500 ("***Meridian***"). Although a decision of the Privy Council (the Opinion being delivered by Lord Hoffmann), it has been regularly applied in cases governed by English law.

1018. After a review of some of the case law and a characteristically lucid discussion of the principles, Lord Hoffmann turned to consider the decision in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 and Viscount Haldane's use of the phrase "directing mind and will" of a company. That can be a useful concept in the exercise of attribution of knowledge to a company but it is not always to the point. As Lord Hoffmann put it at p 511C:

> "It will often be the most appropriate description of the person designated by the relevant attribution rule, but it might be better to acknowledge that not every such rule has to be forced into the same formula."

1019. Applying the principles which lie behind the decision in *Meridian*, I do not consider that Mr Koppl was in a position where his knowledge was, *ipso facto*, to be attributed to CHQ in matters relating to pensions. Having said that, IBM Corporation must, of course, be taken to have known the results of Mr Koppl's work to the extent that he shared them with senior management engaged in pensions policy and implementation, but that attribution is not because Mr Koppl knew the facts, but because he had communicated them to sufficiently senior people. In particular, material prepared by Mr Koppl and contained in presentations to CHQ personnel or to investors is to be taken as known by IBM Corporation and CHQ. But by the same token, work which he had carried out but not communicated to anyone would not form part of the knowledge of IBM Corporation/CHQ, still less would his uncommunicated opinions about the volatility and sustainability of the UK DB Plans form part of that knowledge.

1020. In any case, there is no doubt that Ms Salinaro, and I think it highly likely (and so find) that the same is true of Mr Loughridge and Mr Greene, knew that the Soto proposals were not solving the volatility problem. That is sufficient, in my view, to establish that IBM Corporation/CHQ knew that to be the position. To the extent that a solution to that problem was a pre-requisite to sustainability, it would not be correct to describe the UK DB Plans as sustainable in the absence of a solution. However, a partial solution might justify a description of "sustainable", but for that to be so, the partial solution would have had to make an actual contribution to reducing volatility.

1021. In that context I have addressed the competing view concerning materiality of Mr E Bradley Wilson and Mr Robbins. My conclusions (see paragraphs 978*ff* above) are that there was some basis for concluding that Project Soto would have an impact, albeit modest, on volatility and that such impact can be seen as material.

The de-risking claim

1022. After that substantial digression, I return to the "de-risking" claim or the negligent misrepresentation claim. Mr Simmonds has referred to a number of communications to demonstrate that the statements made were not incorrect and to place a very different interpretation on them from that for which Mr Tennet contends.

1023. The first important communication is Mr Hirst's announcement on 27 January 2006, as to which see paragraph 866 above. He referred on a number of occasions to "addressing" cost and volatility. He did not use the words

"sustain" or "sustainability" in relation to the DB Plans, although he did do so at the end of the announcement in relation to the business. I agree with Mr Simmonds that addressing cost and volatility is not the same as solving it; and given that Mr Hirst described a balance between IBM's need to **reduce** (my emphasis) pension expense, risk and volatility, the reasonable member reading this announcement could not take it that the problems had been solved. That said, the message is in my view nonetheless certainly stronger than "Well we've looked at cost and volatility but there's not much we can do really": it would not be right to describe a message such as that as having "addressed" cost and volatility. Addressing surely carries with it, in this context at least, a partial solution. The reference to the changes as addressing "the future stability and security of our pension fund and our overall competitiveness" does not detract from that conclusion. It will be apparent from what I have already said that the changes did address volatility, but produced only a modest improvement.

1024. One point worth emphasising is the contrast which Mr Hirst drew between Ocean and Soto.

> "Last year we took a number of actions to share the increased cost of longevity in the future service costs of our Defined Benefit pensions plans. Now we have developed a balanced package of proposals which address broader cost and volatility issues."

1025. The suggestion there being made can only be that Ocean had nothing to do with broader cost and volatility issues. But the Ocean communications had many references to sustainability and to the Plans being on a firm footing, statements which would reasonably be read as relating to all aspects of the Plans which might result in a lack of sustainability and in the Plans standing on quicksand. The message from the totality of the Ocean communications, in my judgement, went well beyond addressing simply the increased cost due to improvements in longevity.

1026. Mr Simmonds says that all of these communications to members under both Ocean and Soto were seen by Mr [Stephen] Wilson and he approved them, or at least made no suggestion that they were inaccurate or should be qualified. This was so notwithstanding (and here I agree with Mr Simmonds when he says) that Mr Wilson, as CFO and chair of the Investment Committee of the Trustee, would have been aware of the volatility problem and that volatility was, in part at least, a function of the large absolute size of the Plans' assets. He relies on the exchange which I have set out at paragraph 988 above. The statements made cannot, he submits, possibly be read as a promise, guarantee or warranty that cost and volatility problems had been solved. He suggests that such a contention would mean that Mr Wilson had approved communications which he knew to be wrong and so had knowingly misled the members: no such case is put forward by the RBs: indeed, they could hardly impugn their own witness in that way.

1027. Mr Simmonds submits that the de-risking/negligent statement claim is "utterly hopeless". His first point on this aspect of the case is that, even if there were no reasonable grounds for what was said, that cannot, as a matter of law, give rise to a breach of the *Imperial* duty. I have already dealt with the competing submissions in relation to negligent statements giving rise to a breach of duty. I refer back to paragraphs 450*ff* above. From that discussion, it will be apparent that the issue in the present case, as I perceive it, is not whether Holdings was in breach of its *Imperial* duty in making the statements which it did but whether its actions in implementing Project Waltz gave rise to a breach of its *Imperial* duty taking into account those statements.

1028. Thus, if the RBs establish the Reasonable Expectations which they assert, in deciding whether the disappointment of those expectations gives rise to a breach of the *Imperial* duty, the accuracy of the statements made is a factor to be brought into account; and if they were inaccurate, it may be relevant to know whether they were made with any reasonable grounds and what reliance was placed on them. Although a free-standing claim based on misleading statements may be a new one, the material on which the RBs now rely was not introduced at the last moment: it formed the essential factual background against which they made the claims which they originally made and can be relied on in relation to those claims.

1029. In contrast, if the RBs do not establish the Reasonable Expectations on which they rely, then I do not see that there is scope for a case based on breach of the *Imperial* duty in relation to the communications. This action is about whether Project Waltz has given rise to a breach of the *Imperial* duty: it is not about whether Holdings

was in breach of its *Imperial* duty in making the statements which it did in circumstances where the members were intended to rely on those statements in making their decisions.

1030. In this context, I should note that Mr Tennet said this in his closing speech:

> "If there were absolutely no expectation in this case engendered of any sort, then I would not be saying of the first three elements [closure of the DB section, change in ER policy, 2009 Non-Pensionability Agreement] that of themselves they were a breach of the duty to maintain trust and confidence."

1031. He is there looking at the Project Waltz changes and addressing the issue in the case namely, did the Project Waltz changes give rise to a breach of the *Imperial* duty. He is quite clearly talking about the Reasonable Expectations which he relies on, expectations about what Holdings would or would not do in the future. He is not talking about misrepresentations or misleading statements made at the time of Ocean or Soto. Indeed, as I have already said, it is not really apt to describe statements as giving rise to expectations as to present facts: expectations are about the future. Further, (perhaps I am repeating myself) if some breach of the *Imperial* duty is said to arise as a result of the statements and the decisions made in reliance on them, that is an entirely different claim from one based on the Project Waltz changes themselves giving rise to a breach of the *Imperial* duty.

1032. In my view, therefore, the RBs cannot rely on an entirely free-standing breach of the *Imperial* duty arising from the statements made in relation to Ocean and Soto. But they can rely on them, and draw attention to such inaccuracy as there may be in the statements and whether or not they were made on reasonable grounds, in determining whether any disappointment of Reasonable Expectations gives rise to a breach of the *Imperial* duty. Accordingly, it remains relevant to consider the submissions so as to decide whether the statements in the communications were inaccurate (as matters of fact or of implied representation about the beliefs of Holdings and IBM Corporation/CHQ as to expense and volatility).

1033. Mr Simmonds' identifies the question as being whether Holdings had reasonable grounds for making the statements which it did. I do not think that that is in fact the right question given my analysis under the heading "Whose duty?" in paragraphs 999*ff* above. Another question needs to be asked which is whether IBM Corporation/CHQ had reasonable grounds for allowing the statements to be made; in other words, whether IBM Corporation/CHQ could properly have made the statements themselves.

1034. In relation to the question which Mr Simmonds asks, he says that there is no basis on which the RBs can assert that Holdings itself had no reasonable grounds on which it could have made the statements which were made. I agree with that. First of all, such a case was not put to Mr Heath or to Mr Wilson; indeed, their own individual good faith is not challenged. Mr Hirst's witness statement said nothing about this: he was the RBs' witness and if they were to make a case based on a suggestion that Mr Hirst could not reasonably have made the statements which he did they should have explained that in the witness statements. But neither he, nor Mr Wilson nor Mr Heath, would of course have been likely to accept that they could not reasonably have made the statements which they did on the basis of what they knew at the time; and whether they could have made those statements if they had known what they know now is not to the point. Secondly, UK management was largely dependent on CHQ in assessing the financial position of the Plans and their future viability. It was reasonable, in my view, for them to take their lead from CHQ. Moreover, CHQ was content with the Ocean and Soto proposals – hardly surprisingly since they had promoted them. And Mr MacDonald was happy with the Soto proposals. I do not consider that any criticism can properly be made of UK management for making the decisions which it did in relation to Ocean and Soto.

1035. Mr Simmonds suggests that the RBs are playing on the fact that Mr Koppl had a deeper understanding of the true position. It might be said that he knew that there was not much of a future for the DB Plans or that there might be further changes in the offing. He says that gets the RBs nowhere.

1036. His first reason for saying that goes back to the issue of imputation of CHQ's knowledge to Holdings. The case is not, he says, whether CHQ would have appreciated that they had reasonable grounds for these statements but is whether Holdings did. There is, he says, no legal basis for asserting that the knowledge of a particular

individual, Mr Koppl, at CHQ, is to be attributed to the executives in the UK. It is not possible, he says, to attribute the knowledge of Mr Koppl to CHQ; still less is it possible to attribute the knowledge of CHQ to Holdings. It is important to note that Mr Simmonds accepted that Mr Koppl himself would probably have agreed that he would have had no reasonable grounds for saying that the DB Plans were sustainable or that volatility had been addressed in any significant way. I think it can be put rather more strongly than that in the light of his evidence about the DB Plans being doomed; it is almost certain that he would have agreed, and my impression of his evidence is that he did agree, although I am unable to identify the precise passage in his cross examination.

1037. As to Mr Koppl's knowledge being attributed to CHQ, the case is not one where knowledge locked up in his head is to be attributed; rather it is the information which he disseminated in his various presentations which demonstrated the problems which the UK DB Plans were facing which Ocean and Soto were stated to be addressing or solving (depending on your point of view). He was not working in isolation. Mr Loughridge, Mr Greene and Ms Salinaro, at least, were involved. Clearly someone in CHQ approved the communications which were made on behalf of Holdings, as to which see paragraph 1020 above.

1038. Mr Simmonds is right to say that, as a general proposition, it is not possible to attribute the knowledge of a shareholder in a company to the company itself. But that is not the process which has led me to my conclusions about how CHQ's knowledge is to be taken into account in assessing whether Holdings has breached its *Imperial* duty. It is appropriate to do because of the factors which I have identified in my discussion of the issue. The process is not one of attribution of CHQ's knowledge to Holdings.

1039. Mr Simmonds is also right to submit that there is nothing in Mr Tennet's point about outright hostility by CHQ to the UK DB Schemes. I have dealt with this at paragraph 965 above. Even if there had been hostility in the sense which Mr Tennet implies, I do not consider that that would have anything but the most marginal impact on an assessment of whether the Project Waltz changes gave rise to breach of Holdings' *Imperial* duty.

Conclusions on Project Ocean and Project Soto

1040. I now wish to state my conclusions concerning Ocean and Soto against which to assess the Project Waltz changes in the contexts of Holdings' *Imperial* duty and contractual duty of trust and confidence. The most important area to deal with is the extent of any Reasonable Expectations engendered by Holdings or CHQ in the course of the Ocean and Soto changes. Mr Simmonds has focused on the Reasonable Expectations (or rather lack of them as he would say) which the members held after the Soto changes had been agreed. His case is that, whatever may have been the members' expectations after Ocean, by the time the Soto changes had been agreed, members could no longer have had any expectation that further changes would not be made in the future. By proposing and implementing the Soto changes, Holdings had shown absolutely clearly that it did not regard what it had said at the time of Ocean from preventing it proceeding with the further Soto changes: the members were disabused of any (mistaken on Holdings' case) expectations which they had about the future. As I understand the submission, that is not limited to future benefit accrual, but applies equally to any change to the structure of the DB Plans and in particular to any change in early retirement policy.

1041. A related point made by Mr Simmonds pointing to the same conclusion is this: The RBs are not suggesting that the Project Soto changes were contrary to the *Imperial* duty, even in the light of what had been said in 2004. In IBM's submission, therefore, none of the statements made in 2004 can give rise to a breach of the *Imperial* duty in 2009.

1042. I do not agree with those submissions. Test the matter by this example:

i) Assume that the Soto proposals had never been made.

ii) Assume that Holdings had made unequivocal statements as part of the Ocean communications which clearly engendered Reasonable Expectations that the DB Plans would not be closed to further accrual at current rates before 2014 and that there would be no change to early retirement policy before that date.

iii) Assume that, in those circumstances, implementation of the Waltz proposals would give rise to a breach of Holdings' *Imperial* duty.

iv) Now suppose that, shortly after the implementation of the Ocean changes, Holdings had said that although it had made statements giving rise to Reasonable Expectations, it was retracting them and they should no longer be relied on.

v) In those circumstances, could Holdings say that the Waltz changes could not, as a matter of principle, give rise to any breach of the *Imperial* duty because, by the time the Waltz proposals were presented, the members could, in the light of the retraction, have no expectation that the relevant changes would not be made? In my view, the answer to that question is "Clearly not". In my view, once a Reasonable Expectation has been engendered, it is right to look at the entire course of conduct after that has occurred to see whether Holdings' actions are contrary to that Reasonable Expectation. And if the answer is that those actions are contrary to that Reasonable Expectation, it is necessary to move on to consider whether those actions give rise to a breach of the *Imperial* duty. In resolving the issue of breach of duty, all the circumstances must be taken into account – including the retraction – in assessing whether there has been a breach of duty.

vi) The position is the same in my view where, rather than retracting the statement giving rise to the Reasonable Expectations, Holdings introduces changes to the UK DB Plans which are contrary to those Reasonable Expectations; and this is so whether or not the introduction of the changes is agreed to by the members or not. It remains appropriate to look at the whole course of conduct to see whether, taken as a whole, it is contrary to a Reasonable Expectation which has been established. Whether that whole course of conduct gives rise to a breach of the *Imperial* duty, account will be taken of the nature and extent of the earlier changes and whether the members consented to them.

1043. Moving away from the example to the facts, the Project Waltz changes are, in principle, capable of giving rise to a breach of the *Imperial* duty if they are contrary to the Reasonable Expectations engendered by the Ocean communications. Whether they do give rise to a breach of duty falls to be assessed in the context of the entire history including the Soto changes and the communications surrounding Soto. It is true that no claim is made for breach of the *Imperial* duty by reason of Project Soto; but that does not mean that Project Soto wiped the slate clean. If the Ocean communications gave rise to Reasonable Expectations, disappointment of which could amount to breach of the *Imperial* duty, I do not see why Project Soto has to be seen as a licence to take actions which, absent the Soto changes, would have been a breach of that duty. A statement by IBM in the course of the Soto communications that further changes were not ruled out cannot, by itself, be taken as extinguishing a pre-existing Reasonable Expectation. Rather, the question whether Project Waltz gives rise to a breach of the *Imperial* duty must be answered in the context of the whole history from the start of Project Ocean and take account of how Reasonable Expectations engendered as part of Project Ocean might endure through Project Soto. Of course, in addition to that, account must be taken of any fresh Reasonable Expectation engendered by the Soto communications themselves. It must, however, be appreciated that, on my analysis, the disappointment of Reasonable Expectations is only the start of the assessment; the issue always comes back, under the test which I have identified, to whether particular actions taken by Holdings were such that no reasonable employer would have taken them.

1044. Having said that, it is of course the case that account must also be taken, in assessing whether there has been any breach of the *Imperial* duty, of the Soto communications and in particular the extent to which they confirmed the message contained in the Ocean communications and the extent to which they sent a fresh message to members.

1045. I have already dealt at some length with the question of what, if any, Reasonable Expectations were to be derived from Ocean. One of those related to future accrual; as to that, I do not consider that the Soto communications convey a message significantly different from the Ocean communications. Of course there was the difference that future accrual was being modified but that is not inconsistent with the Ocean message being modified too, namely that benefit accrual in accordance with the Soto changes would not be further changed for some period of time in the absence of a significant change in financial and economic circumstances.

1046. As my review of the history shows, there were many representations about the Soto changes being long-term and producing sustainability, and statements to the effect that volatility and cost had been addressed. There is also the important, to my mind, an email from Mr Lamb to Mr Heath (see paragraph 888 above**)** to which there does not appear to have been a response with the result that the words "long term" remained in Mr Lamb's letter to members. And there is the famous "push back" promise by Mr MacDonald. Although neither the letter nor a report of the "push back" conversation would have been known to members, they are relevant in two ways: first, they illustrate Holdings' and CHQ's thinking and secondly they gave the Trustee reassurance which was in turn reflected in the message given by Mr Lamb to the members. And then there is Mr Heath's evidence that the January 2006 presentation to managers sent the message that the Soto changes would result in a long term sustainable competitive position for Holdings.

1047. On the other hand, there are statements which show that Holdings was not entering into any commitment about the future: its statements were carefully hedged to ensure there were no guarantees or promises. The speaking notes from one-to-one sessions with KMPG also show that benefits were not guaranteed and that "it is possible for the terms of the pension promise for future service to be changed at any time in the future……". The possibility of a change "at any time" is antithetical to any sort of Reasonable Expectation (in contrast with hope) that things would not in fact change. The Q&As on which IBM relies make clear that there was no guarantee not to change the Plans, so that benefit accrual could change or even cease. However, it is unsurprising that Holdings did not provide answers to the questions (all querying whether IBM would keep the Plans open) simply stating "We reserve the right to amend Plans at any time, including changing future accrual and even closing the Plans".

1048. That was not the message which IBM wanted the members to receive; instead, members were to be reassured that nothing unpleasant was round the corner so far as Holdings knew. That reassurance was given in the Q&As. Thus we find in the answers:

i) That the actions taken "will reduce the expense and volatility of the pension plans and therefore provide a platform for future stability."

ii) Identification of a number of factors which Holdings believed would mitigate the current expense and volatility which "we hope, are sufficient to put our pension schemes on a sustainable footing".

1049. I have set out one important Q&A at paragraph 902 above. It is helpful to have it to hand so I repeat it here:

> "Q. Last year we had changes. This year we have changes. Does IBM rule out any further changes in future?
>
> A. IBM cannot offer any such guarantee that it will not make changes to its pension plans in the future. In order to remain competitive IBM will continue to monitor pension expense and benchmark our employee total reward package against that offered by our competitors."

1050. Again, this demonstrates clearly the absence of any binding commitment by Holdings to keep the Plans open. I have recorded Mr Simmonds' submission on this Q&A in paragraph 904 above. In particular, he says that any person reading this Q&A would be left in no doubt whatsoever as to the possibility of future changes, even in the short term, adding that no reasonable reading of this Q&A is consistent with a commitment as to the long term.

1051. This Q&A might be said to demonstrate that not only was there no commitment given that there would be no changes but also that the reader could not even form an expectation that there would be no change even in the immediate future. There would be something in that point if this particular Q&A stood in isolation. It does not do so. Instead, it is a single Q&A in a large set of Q&As comprising not only the others to which Mr Simmonds has referred, but also the ones to which Mr Tennet has referred.

1052. Reading all the Soto communications on which the RBs and IBM respectively rely together (and *a fortiori* when reading them against the background of the Ocean communications), my view is that the RBs have established that the reasonable member would have formed the Reasonable Expectation that benefit accrual (in accordance

with the Soto changes) would continue into the future; but the reasonable member would have appreciated that a change in financial and economic circumstances (including trading and competitiveness) might cause Holdings to make further changes to the Plans and that to do so might be a decision which Holdings could reasonably take. Even if the Soto communications themselves do not justify my conclusion, they do not wholly displace the similar message given by the Ocean communications concerning future benefit accrual (although, of course, the rate of accrual after Soto would be different).

1053. As to how far into the future that Reasonable Expectation is to last, it is relevant to note that, under Project Waltz, the actual termination of future accrual did not take place until closure of the Plans in April 2011, some 6 years after the Ocean changes were brought into effect and longer than that from the date of the Webcast. Although the reasonable member was entitled to hold a Reasonable Expectation derived from the Ocean communications concerning future accrual, I do not consider that such an expectation could have endured past 6 April 2011 if Soto had not intervened. That may not matter because a similar Reasonable Expectation is to be derived from the Soto communications but with a different starting point from which to measure the appropriate time. The starting point here is sometime in the first half of 2006 when the proposals were approved by the Trustee and communicated to the members. In my judgement, the reasonable member was entitled to expect (*ie* to hold a Reasonable Expectation) that benefit accrual would continue at least until April 2011. The reasonable member would have been right to see Project Waltz as conduct contrary to his Reasonable Expectation concerning future benefit accrual (absent a change of circumstances).

1054. I turn now to the other important Reasonable Expectation concerning changes to past service benefits. For the reasons I have already given, the reasonable member was entitled to hold a Reasonable Expectation that, in relation to his service up to the time of the implementation of the Ocean proposals, he would be able to take advantage of Holdings' then current early retirement policy until 2014 unless there was a relevant justification for a change in policy. The Soto communications do not, so far as I am aware, mention early retirement policy; nor was a change in that policy discussed by Holdings with the Trustee. Indeed, there is nothing to suggest that, at this stage, even CHQ had a change in such policy in its mind as even of remote possibility.

1055. The Q&As which I have just referred to in relation to future benefit accrual are relevant also to the change in early retirement policy in that they demonstrate that Holdings was not giving any promise not to make further changes to the Plans. But read in context, it seems to me that the answers in the Q&A are mostly directed at questions concerning future accrual. Perhaps the most supportive answer from Holdings' point of view is the one which I have repeated at paragraph 1049 above. But even that answer is premised on a review of Holdings' requirement to remain competitive particularly in regard to the total reward package it offered compared with that offered by its competitors.

1056. What is more significant than those Q&As is Mr Hirst's presentation, which I have considered at length. Mr Hirst said, referring to the guarantee, that "the bargain we signed is still on the table"; and Mr Heath explained that Holdings had "agreed to fully fund – fully fund – the current deficit…" and "what we have negotiated with the company is to maintain the World Trade Guarantee for the period through to 2014". He also referred to the guarantee; "But that deal that we did last year, the agreement we put in place last year remains intact; no change, World Trade Corporation guarantee in place, and will remain in place supporting the UK company until 2014". For the same reasons which I have given in my discussion of the Ocean communications, I consider that these statements indicate the same commitment to preserving the early retirement policy as I identified in that discussion. But even if that is wrong, there is, in my view, nothing at all in the Soto communications which qualifies, or justifies a departure from, the message given by the Ocean communications in relation to early retirement policy.

1057. That deals with the Reasonable Expectations which members were entitled to carry forward after Soto. I need now to state (or in some respects re-state) my conclusions about the De-Risking claim.

1058. The first point is that, for reasons already given, the RBs cannot rely on an entirely free-standing breach of the *Imperial* duty arising from the statements made in relation to Ocean and Soto. But they can rely on them, and draw attention to such inaccuracy as there may be in the statements and whether or not they were made on

reasonable grounds, in determining whether any disappointment of Reasonable Expectations gives rise to a breach of the *Imperial* duty.

1059. UK management, including in particular Mr Wilson, considered that the Soto proposals addressed those issues which it thought IBM wished to have addressed, namely to meet the $92M cost saving for 2006 and a reduction in long term volatility of pension plans with the UK team's particular proposal being designed to reduce volatility rather than reduce cost. UK management made the statements which it did in the communications believing them to be correct and were no doubt comforted in that belief by the enthusiastic recognition by CHQ of achieving the changes.

1060. As to IBM Corporation/CHQ, whatever Mr MacDonald himself may have understood, I think it is clear that they collectively knew (using that word in the sense of the knowledge which is properly attributable to them) that the message which they intended to be given by the Soto communications, and which was in fact given, was not consistent with what they appreciated the reality to be. The issue of volatility was addressed by CHQ in the sense of having been considered by them; but not even a partial solution was really provided. I accept that the Soto changes had some positive effect on volatility but the extent of the amelioration was only small in the context of the problem which IBM Corporation was facing. That CHQ knew a message was being given which was, at best, hugely optimistic, in all likelihood disingenuous and, on an extreme view, deliberately misleading, is underlined by its requirement for secrecy: CHQ knew things that it did not want UK management to know because it would undermine the message which CHQ was sending out about addressing volatility and sustainability.

1061. These conclusions feed in to the assessment of whether the Project Waltz changes gave rise to a breach of Holdings' *Imperial* duty and I will return to them in that context.

Post-Soto and Pre-Waltz events

1062. There are a few matters which I should mention in relation to the post-Soto period before Project Waltz got on to the dance floor.

Amendment to the Funding Agreement

1063. The first is the amendment of the Funding Agreement and the extension of the guarantee. I have set out the bare facts of the amendment at paragraphs 123*ff* above. It is appropriate to give some more background.

1064. I can start with the TMM on 22 February 2007 when the assumptions and methodology to be used in carrying out the actuarial valuation of the UK DB Plans as at 31 December 2006 was discussed. The minutes record that one matter discussed was whether the sufficiency of the security provided by the guarantee from IBM WTC would need to be reviewed in the light of legislative changes under the Pensions Act 2004. Mr Greene was tasked with investigating whether a guarantee might be obtained from IBM Corporation rather than just IBM WTC. Watson Wyatt's accompanying papers emphasised the importance of the guarantee in supporting the investment strategy and valuation basis. Absent the guarantee, "the ongoing funding target would be on a "conservative" basis". It was explained to Mr Greene (by an email from Nabarro) that without a guarantee which was sufficiently strong (in terms of duration and financial covenant), the "best estimate" basis might not be sufficiently prudent to comply with the legislation.

1065. The Investment Committee also met on 22 February 2007 when IBM's proposed swap programme to address the mismatch of investments and liabilities was considered. The £500m proposed swap programme, however, which would be in respect of £500m of a total bond allocation of about £1,700m, would only reduce the value of assets at risk in the fund by £3m from £667m to £664m: "the risk reduction benefit of just doing the proposed £500 million tranche is immaterial and it only makes sense as a first step on the way to a bigger programme."

1066. On 12 April 2007, Mr Koppl wrote to Mr Wilson to give his view that the best solution might be to obtain a guarantee from IBM Corporation. Mr Greene expressed a similar view. A 3-year extension could be offered if the Trustee agreed to IBM's requests on asset allocation "aimed at improving long term investment performance"

namely that (i) there was a move to a global equity benchmark (25% being a reasonable objective) and reducing the UK equity allocation; (ii) there was a move to global managers, rather than regional (*ie* UK) fund managers; and (iii) the Trustee "Participate in the IBM pooling vehicles for global equity, emerging markets and potentially currency".

1067. On 21 August, 2007, Mr Wilson sent Mr Koppl slides that considered whether a 3-year extension to the guarantee should be offered to the Trustee: an extension would enable the "best estimate" financial assumptions to be maintained in future, avoid more conservative mortality assumptions, avoid a change in the investment strategy to a "potentially 4% p.a. or more" movement to bonds allowing continuation of a moderate move at 3% pa, and encourage the Trustee to consider "Company recommendations on return seeking assets". The slides showed projections that the extension of the guarantee would reduce 2008 NPPC to $18m (rather than $56m without it) from $100m for 2007; 2008 company funding would increase from $71m for 2007 to $91m (rather than the larger figure of $102m without it).

1068. On 5 September 2007, Mr Lamb wrote to Mr Wilson to propose that the guarantee be extended, allowing the Trustee to maintain a 3% per annum move into bonds from equities for the Main Plan, and to maintain the best estimate funding basis. In the absence of such an extension, Mr Lamb thought the result might be a "comprehensive review of asset allocation strategy and an acceleration of the move out of higher risk/reward seeking classes and into bonds". Two days later, Mr Koppl and Mr Greene met Mr Loughridge, who agreed to support re-issuing the guarantee by IBM Corporation and its extension for 3 years. However, Mr Loughridge had been shown the 2008 pension cost forecast by Mr Koppl, and was "concerned about the UK cost im[p]acts from the asset allocation shift to bonds, inflation and mortality". Mr Loughridge wanted further work to be done on "how to reduce or offset those impacts".

1069. As for the I Plan:

i) The I Plan asset allocation strategy was different because it was less mature: it had no bond allocation at all. Mr Scott (Director, IBM Retirement Funds Europe) suggested a move of 20% towards bonds, recognising that the I Plan currently had "the most aggressive (and least diversified) asset allocation in the IBM pension system". His own approach was that an asset allocation even for a brand new DB plan that only had active members would not go beyond 70-80% equities. As he said:

> "I know equity reductions have implications for RoA but I'm not sure the company looks reasonable if it insists that some allocation to bonds (up to 20%) isn't warranted particularly when we have at least that in all of our other DB plans."

ii) Mr Koppl's reaction was that such a move to 20% bonds would be "premature". Against the advice of IBM RFE, he suggested a 3% pa move to bonds over 3 years which he regarded as reasonable.

iii) Mr Scott then explained to Mr Koppl that the current 8% return assumption could be maintained even with a 20% move to bonds (and so I Plan EROA and NPPC would not be affected). The reason was that the actual EROA based on the previous year's assumptions was calculated at 8.75%, but IBM was capped by accounting rules to using 8%. In essence, he was saying that a 20% allocation to bonds would not reduce accounting EROA to below 8%. He added; "In some ways it may benefit us to make this move because at the moment we take the additional equity risk but don't get the additional I&E benefit." Mr Koppl's response was to say that this was "great news" and that he agreed and supported the change to 20% bonds, clearly being satisfied that there would be no accounting cost.

1070. Mr Wilson formally wrote to Mr Lamb on 25 September 2007 to agree to extend and transfer the guarantee, subject to his confirmation that the best estimate valuation basis would continue to be used, and that the Main Plan move to bonds would be no more than 3% per annum over 3 years, and the I Plan move to bonds would be no more than 20% over the next three years.

1071. In the same letter, Mr Wilson said that IBM UK would meet the cost of future service accruals in full with no amortisation of the surplus as at 31 December 2006 for the next three years, but would review funding beyond

that period in the light of conditions at the time.

1072. He ended his letter with this:

> "Finally the Company welcomes the Trustee's statement that agreement to its requests will put the Trustee in a better position to consider requests from IBM for the Trustee to invest in reward seeking assets which would be expected to lead to improved investment returns. We look forward to a positive discussion on these matters over the coming months.
>
> Like you, we believe that agreement on these points is very good news for the Plans and their membership."

1073. On 25 October 2007, the TMM agreed to these terms. Mr Lamb sent members a letter in which he announced the extension of the Funding Agreement to members some time in November 2007. The announcement showed that the Plans were now in surplus. This was not least because of the substantial additional contributions made by IBM under Project Ocean and Project Soto. A draft of this announcement was sent to all the Trustee Directors including Mr Greene on 29 October 2007 inviting comments before the final version was sent out. The final version included this:

> "I am pleased to tell you that following discussions between the Company and the Trustee IBM has agreed to:
>
> • transfer the obligations under the Funding Agreement from World Trade Corporation to IBM Corporation
>
> • extend the period covered by the Funding Agreement by three years to March 2017
>
> • not use the £228m surplus to reduce the Company's contributions to the Plan over the next three years
>
> • make the contributions recommended by the Scheme Actuary and documented in the Schedule of Contributions
>
> I am sure members will welcome this demonstration of continuing commitment to the Plan from IBM."

1074. The amended Funding Agreement was executed on 15 November 2007: see paragraph 125 above.

The 2010 EPS Roadmap

1075. In 2007 Mr Loughridge devised the 2010 EPS Roadmap: in IBM's Notice of the 2008 Annual Meeting, he was described as having "Developed long-term EPS roadmap to 2010 to enhance investor understanding of financial model". He presented it to investors on 17 May 2007:

i) The roadmap set out a target of delivering "Double-Digit Earnings per Share Growth over the Long-Term". By "Long-Term" it appears that he meant by 2010: at least, slides referring to the "Long-Term" contain the roadmap to 2010. That involved increasing annual EPS from $6.06 in 2006 to $11.01 in 2010. There had already been a steady increase from $3.76 in 2003.

ii) There were a number of elements to the Roadmap. EPS growth would be achieved through revenue growth, margin expansion, the share repurchase programme, growth initiatives, future acquisitions, and from a 'retirement related costs' contribution to the targeted increase in EPS. In other words, profits generated from the worldwide DB Plans would offset the costs of DC and other retirement related provision (which were forecast to be relatively static over the period).

iii) The slides showed that pensions had in fact generated profit for IBM in 2001 and 2002 worldwide (that is to say DB profits had eclipsed DC costs). Pension costs showed an expense of $2.5b in 2007 (the largest figure on the slides) and that from 2007 pensions costs were set to fall dramatically to $0.7b, based on 31 December 2006 assumptions. In effect, EPS targets were being set which were reliant on income being generated for IBM from DB Plans. It is interesting to note the sensitivity analysis in one of the slides. The figures are for the US; the worldwide impact was stated to be approximately 2x US impact for Discount Rate and Return on Asset Changes. The figures presented were these:

Assumption Base Point change Pre-tax income impact

Discount rate +/- 25bp ~ $90m

Interest Crediting

Rate +/- 25bp ~ $30m

Expected Long-term

Return on Plan Assets +/- 25bp ~ $120m

Actual vs Expected

Return on Plan Assets +/- 25bp ~ $5m

1076. Savings in pensions costs were targeted to produce $0.90 per share. It is worth putting the target for EPS into context:

i) In 2006, worldwide DB Service Cost was $1,431m, but NPPC was just $1,293m. Mr Tennet says that that meant that the DB Plans were not costing IBM their full cost of accrual, and so they were already reducing retirement related costs by $138m. That is true in the sense that NPPC was less than the Service Cost. The full Service Cost was nonetheless being incurred in the sense that the liabilities of the DB Plans were increasing by an equivalent amount each year.

ii) The total of DB Service Cost and the remaining costs of accruing DC and retiree medical benefits was $2,566m. But the 2010 EPS Roadmap had its 2006 baseline retirement related costs at $2,428m as is shown, for instance, in the slide titled "Retirement related Cost Forecast – 2010 Outlook" in the "Retirement Related Cost – Forecast and Roadmap" dated 26 August 2008. The difference, as one would expect, between these two figures is the same $138m, effectively a subsidy from the DB Plans.

iii) In order to contribute $0.90 more to EPS by 2010, retirement related costs would have to fall to just $707m, meaning that worldwide NPPC would need to be around $(430m) profit. This figure is arrived at as follows: In 2006, DC costs and non-pension post retirement benefit costs totalled about $1,135m. Assuming that those costs remain flat, a total retirement related cost of $707m can be reached only if a profit of $(1,135 – 707) *ie* $428m is found somewhere and that can only be in the NPPC figure. Given a DB Service Cost of $1,431m (see (i) above), and the need for an NPPC profit of $428m, NPPC would need to be $1,859m less than DB Service Cost, that is to say nearly $1.9b.

CHQ's continued consideration of investment strategy and volatility

1077. Mr Wilson and Mr Ferrar, Mr Heath's replacement as UK Director of HR, met IBM's Retirement Plans Committee on 16 May 2007; the committee included Mr MacDonald, Mr Loughridge and Mr Greene. On that occasion, they met to discuss the UK Plans. The slides for the presentation had been reviewed in advance by Mr Koppl, Mr Greene and Mr Wilson. The slides covered the following points:

i) Project Soto had "met the financial objective to reduce annualised 2006 NPPC by $110M". There was no

mention of volatility in the slides.

ii) A chart on one slide showed how NPPC was expected to fall well below service cost and then turn negative in 2009. The chart shows a large spike in NPPC for 2006. A later slide showed under the heading "Issues":

> "The current asset allocation is heavily skewed to equities, 61%, with bonds at 33% and property, 6%. The equities are held as return seeking assets but are a poor match for the liabilities"

against which under the heading "Action taken" appeared:

> "Agreed phased switch from equities to bonds due to take the Plan to 35% Bonds by end 2007 Forthcoming ALM likely to result in continued switching process over time."

iii) The same slide noted that the duration of the bond portfolio was about 8 years with the duration of liabilities being about 16 years and that the funds did not hold sufficient inflation linked assets to match the inflation exposure of the liabilities. The actions taken in respect of those extended to an interest rate swap programme which "is being entered into" to increase the duration of £500m of UK bonds to 16 years and an inflation swap programme which "is being entered into" to match the inflation exposure in £500m of liabilities.

1078. CHQ produced a presentation around 1 January 2007 titled "IBM Pensions – Financial Strategies" which again considered "IBM Financial volatility" which was stated to be the key issue. The presentation considered DB pensions expense, and volatility of cash and stockholders' equity caused by DB fund performance: the notes to the first slide include the following:

> "The key issue is financial volatility
>
> • Volatility comes from movements in the financial markets as they affect both the pension liabilities, for future benefit payments, and assets
>
> **The liability**
>
> ……
>
> • Small movements in bond yields make big difference in liability, example:
>
> • 25BP decrease, ¼ percentage point, worldwide increases liability $2+B
>
> • From Y/E 1999 to 2005 US discount rate dropped 225 BP, increasing liab $10+B. Similar rate drops in many non-US countries occurred…..
>
> **Funding** - Rating agencies treat unfunded pension liabilities like debt, so they reduce the amount of money the company could borrow to do acquisitions or any other investment one-for- one.
>
> • Goal is to fully fund the plans to PBO but subject to tax efficient contributions.
>
> **Assets**
>
> …..
>
> • Volatility example - 1 bad year in the markets (2002) -10% ROA in US, worldwide loss was $7B "

1079. A later slide (slide 4) described IBM's DB pensions liability as large: projected PBO was $87b compared with 2006 revenue of $91b and non-pension assets of $93b. This led to the stated conclusion that there was "Potential for significant volatility to IBM cash flow, earnings, and equity". A further slide contained a chart of retirement related plan income and (cost) which again showed the significant increases and decreases in income or cost

concluding that "Substantial volatility continued for future years". The RBs' opening submissions remark dryly that these statements were in stark contrast to what IBM told UK members in 2006, namely that volatility was being addressed to IBM's satisfaction; but that was, perhaps, true in the sense that IBM was prepared to live with this volatility because of the perceived commercial benefits its policies engendered.

1080. On 29 June 2007, Ms Mary Kerrigan of Watson Wyatt wrote to Mrs Ross. Her letter, headed "Is it not the time to de-risk? Strategic moves from equities into bonds in current market conditions", contained the following:

> "the current terms for switching from equities into bonds look reasonably favourable when considered relative to recent history, and at least neutral when considered relative to experience over the last ten years. … terms are now at their most attractive level since the latter half of 2003".

1081. Her letter was not an actual recommendation to move into bonds, however. Her conclusions included the following:

i) Pension schemes, such as the IBM Pension Plan, that are considering a strategic move into bonds as part of an overall de-risking strategy should review the current switching terms as a matter of priority.

ii) She did not advocate that the Trustee consider a switch on tactical grounds (*ie* to make money in the short term), but large changes in the prices of assets held for strategic reasons should result in a review of strategy.

iii) Any decision to make a strategic switch from equities into bonds was intricately linked with the Plan's funding level and expected future contribution pattern. She therefore recommended that prior to implementing any switch, the Trustee should review the appropriateness of the Plan's current asset allocation strategy and the potential impact of a change in investment strategy on funding requirements.

iv) Her letter concluded with the following paragraph:

> "Finally, we would note that the position has changed materially over the last six months and particularly sharply over the last few months. We expect this to create further demand for bond purchases, which unless met by either willing sellers or more issuance could see the opportunity reverse as quickly. Whether or not you believe it is appropriate to de-risk at the present time, it would be sensible to establish a means of monitoring this issue and consider a dynamic approach to managing asset allocation to capture future opportunities."

1082. The RBs complain that, despite the advice from Watson Wyatt that there was now a good opportunity to de-risk, which might not last, IBM decided to continue with its "slow move to bonds" strategy. It was, however, a strategy in which the Trustee concurred, however, reluctantly.

Further global projections

1083. On 27 July 2007, Mr Koppl sent an updated retirement related costs forecast to Mr Loughridge. The second slide showed that since the May Investors' Briefing, which was based on 31 December 2006 assumptions, worldwide pension assumptions had improved so that costs to July 2008 were projected to be $977m lower than forecast. Further, long bond yields had increased since 31 December 2006, reducing global pension costs by £342m pa. This, one might remark, is an example of financial volatility (which will have an impact of NPPC volatility) as the next slide shows, noting that "These rates are highly volatile and may be different at Y/E 2007". In the UK, the discount rate had risen from 5.00% at y/end 2006 to 5.75% at July 2007.

The pensions measurement adjustment

1084. The Soto Changes generated pensions savings as already described. In January 2008, CHQ and Holdings considered how these savings would be reflected in the accounts. Mr Koppl produced some slides, "6 Alternatives -U.K. $100M 2008 Y/Y Savings" ,considering how to manage the savings. As Mr Koppl later

explained to Mr Scott in an email dated 16 September 2008, there was a concern that if the savings flowed to unit measurements, any pricing done on a cost plus profit basis would pass the savings through to customers as lower prices. In other words, if not managed correctly, the Soto savings would flow through into reduced prices the UK set for its services to customers, and would not result in "incremental EPS improvement" which was the whole rationale for CHQ's strategy.

1085. The solution eventually adopted became known as the pensions **"Measurement Adjustment"**. It was an adjustment to the way the UK's PTI (pre-tax income) and also RM PTI (region measurement basis PTI) was calculated. Mr Koppl explains how this operated in the context of NPPC (it is the best explanation I have). For purposes of PTI calculation, the Measurement Adjustment fixed UK domestic NPPC at a "floor" (but not a "ceiling") of 2007 domestic NPPC. He explained that "domestic" pensions costs are those which relate to revenue in that country; there would be further pensions costs related to work charged to IBM units in other countries which were not adjusted. This meant that:

i) If future domestic NPPC were less than 2007 levels (for instance as a result of the Soto savings), NPPC would remain at 2007 levels for the purposes of PTI calculation. UK PTI would therefore be depressed by the Measurement Adjustment, as NPPC costs would be treated as higher than they in fact were.

ii) If future domestic NPPC were more than 2007 levels, PTI would be calculated on the basis of that higher, actual, level.

iii) The Measurement Adjustment was asymmetric. Pensions savings were not credited to Holdings but additional pensions costs were deducted from PTI.

The March investor presentation

1086. Mr Loughridge gave another briefing to investors on 6 March 2008 presenting an optimistic picture. The transcript of his presentation records that he considered the 2010 EPS Roadmap to be on target to achieve $10-11 EPS by 2010. He then explained that he was currently projecting closer to $1 EPS from pensions (rather than $0.90), but that he would leave the Roadmap target where it was. Internally, IBM's "Retirement Related Cost Forecast" at the time was projecting $0.99 EPS from pensions in 2010.

Post-Soto and Pre-Waltz

1087. In late April 2008, CHQ was already considering "UK DB Pension Alternatives", such as buy-out solutions, for the UK DB Plans with Towers Perrin. On 28 April 2008, Mr Greene forwarded an email from Towers Perrin to Mr Koppl. Included in the email was this:

> "About a year and a half ago I visited with you and Don and Larry (together with Cecil Hemingway) to talk about de-risking IBM on the pension side. We were thinking that now that IBM had done a lot to curtail future benefit accrual in DB there could be a play on the finance side. You said that IBM was comfortable riding the risk for a while but could be open to relooking it in the future. I think that it bears a relook at this juncture - particularly in the UK as your second biggest DB market where there have been a number of developments. The big opportunity is to settle or refinance some or all of the inactive benefits….."

1088. The UK team had no input into this; they were not even informed of it. Indeed, Mr Michaud and Mr Koppl positively agreed in a "sametime" chat on 15 May 2008 that they should not be told.

1089. On 8 May 2008, there was a TMM when the question of NPPC was raised under "Any other business". The minutes record that Mr Wilson made a presentation on the NPPC figures and record the following:

> "[Mr Wilson] reminded the TMM Members that NPPC was a measure of looking at pension costs from a US accounting perspective and noted that the chart in the agenda set out the combined position between 2006 and 2008. Mr. Wilson summarised the key points from the chart and

explained the effect that the movements in the discount rate and the credit crunch were having on the NPPC. He noted that the numbers on the chart took into account the mortality assumptions from the 2006 Actuarial valuation.

Mr. Lamb reminded the TMM Members that it was important that the Trustee was kept aware of the NPPC numbers as they had been cited by the Employer in 2006 as part of the reason why it needed to introduce changes to the IBM pension plans. He stressed that it was important that the Trustee looked at these numbers periodically to ensure that IBM's accounts were not getting back into a situation where the Company felt that it would need to revisit the Plan costs…."

1090. On 3 September 2008, Mr Michaud sent Mr Ferrar and Ms Roin a "list of open UK benefits topics" and suggested that he joined a meeting with KPMG on 1 October 2008 to discuss these. DB redesign in the UK was not on that list. Mr Ferrar's involvement had been appreciated. Ms Roin drafted a note on 9 September 2008 to Mr Castellanos explaining Mr Ferrar was the first UK HR Director to welcome CHQ's help. Her note supported Mr Ferrar's idea of IBM UK hiring its own pensions actuarial and legal advisors to assist them, without having to rely upon the advice provided to the Trustee by its own advisors. It explained that the UK would not have the authority to hire pensions advisors itself, but would require a note of authority from CHQ. Authorisation from CHQ was duly granted and was communicated to Mr Ferrar by Ms Roin on 10 September 2008. Mr Ferrar then put in hand arrangements for selection of the new advisors.

1091. Although investment decisions were the responsibility of the Trustee, there is no doubt that IBM had considerable influence over those decisions. Indeed, it followed on as part of the Ocean and Soto Changes that the Trustee adopted a policy in relation to de-risking (in particular, matching) which they would not have adopted if it had not been for the Funding Agreement in particular. The RBs do not now complain that the Trustee's investment decisions, reflecting IBM's desire to pursue an investment policy which slowed down the Trustee's de-risking programme, were improper: it is accepted that those decisions were within the range of acceptable decisions albeit that, according to Mr Tennet, the investment strategy was at the riskier end of the spectrum. I am happy that Mr Tennet has made that clear in the RBs written closing submissions since he spent some time in his cross-examination, of Mr Koppl in particular, that IBM would have been expected to be more cautious in its investment policy than a smaller company with a smaller pension scheme because of the greater volatility of a large scheme simply by virtue of its size. I do not propose to go into the questioning of Mr Koppl on this topic any further. It is sufficient to say that I accept his evidence that IBM made the decisions which it did for perfectly sound commercial reasons. If it is the case, as Mr Tennet suggests it is but Mr Simmonds says it is not, that this investment policy has resulted in the need for changes when there would otherwise have been no need, that is a factor to be brought into account in assessing whether Project Waltz gave rise to a breach of the *Imperial* duty.

1092. The RBs' complaint, accordingly, is that the risk of the investment strategy was precisely that IBM might find itself in difficulty if markets were to fall. IBM deliberately took that risk in order to maximise the profits from the DB plans and cannot, it is argued, be entitled to rely on the consequences of the risk materialising to justify closure of the DB Plans to further accrual.

1093. In this context, it is said that IBM's preferred investment strategy was a slave to IBM's EROA assumptions. Although Mr Koppl would not use the word slave, he accepted that EROA was a guiding issue. He acknowledged the trade-off between NPPC volatility and EROA: see the passage from his cross-examination in the context of volatility at paragraph 935 above.

1094. It must be borne in mind, however, that although a different investment strategy might have reduced exposure to the volatility in financial markets and thus the impact on NPPC volatility, it could not eliminate it. No-one suggests that IBM should have procured as precise a matching of liabilities to assets as was possible (which would not have been very precise at all given the nature of the liabilities concerned and the nature of assets available in the market). A substantial level of volatility – in terms of exposure to volatility in financial markets including bonds as well as equities and in terms of NPPC volatility – would inevitably have remained. Project Waltz may, even in those circumstances, have been perceived by IBM as a necessary exercise. So when Mr

Tennet submits that IBM cannot be entitled to rely on the inevitable (he says) consequences of a decision it took freely as a justification for closure, that is to ignore the possibility that closure would have been a rational business decision for IBM even if the investment decisions had been different and in line with decisions which the RBs suggest should have been taken. It is also to ignore the possibility that NPPC volatility was not in fact affected by the actual asset allocation as compared with the asset allocation which Mr Tennet suggests would have been more appropriate.

1095. There are other items of evidence which show that IBM's concern was to maintain the EROA and therefore, to keep the equity allocation high. I mention some of them:

i) As Mr Koppl explained in relation to the I Plan, he had received, in September 2007, advice from Mr Scott who requested a 20% switch from equities to bonds. Mr Koppl did not want to do this but Mr Scott explained that it could be done without reducing the EROA. With that advice, Mr Koppl agreed that it should be done.

ii) When a significant contribution was proposed to be made to the Main Plan in 2006, IBM wanted an asset mix for the investment which preserved the FASB long-term EROA for 2006. Mr Koppl agreed that IBM's EROA assumption was driving its perception of what the scheme's investment mix should be.

iii) One of the key aims of offering the guarantee in the Funding Agreement was to persuade the Trustee to adopt a more equity-heavy allocation than it would otherwise have done, by slowing down its switch programme.

iv) The extension of the guarantee was, as Mr Koppl accepted, partly in order to persuade the Trustee not to accelerate the switch to bonds which it would otherwise have done.

v) In his email to Mr Scott dated 7 October 2008, Mr Wilson referred to the missed opportunity in the summer of 2008 to "switch [into bonds] more aggressively". He described the current investment strategy as a "slave to the NPPC ROA assumption".

1096. Mr Tennet says that the 2010 EPS Roadmap was treated by IBM as an absolute commitment to investors which could not be broken. To describe the commitment as absolute may be slightly too strong but not much. The message given to the market was itself fairly strong and, whilst no investor could regard a presentation as a promise, a failure to deliver to the market that which it had been told it could expect might, I accept, have had a serious impact on IBM's share price. So keeping to the 2010 EPS Roadmap became a corporate imperative. A word of caution, however, is necessary. The commitment was to achieve "Double-Digit Earnings per Share Growth over the Long-Term"; the 2010 EPS Roadmap showed how this was to be achieved. Although the Roadmap showed various components going to that growth commitment, I do not think that each and every element of that target was itself an independent commitment, albeit that internally IBM considered that each component of the target had to be met. An above-expected achievement of one element coupled with an under-expected achievement in another would be consistent with the Roadmap commitment provided that the overall growth was as predicted. Further, the growth was to be achieved by 2010; CHQ may have wished to see a month by month improvement in EPS, but that was not the commitment to the market, at least in the 2010 EPS Roadmap. It is has not, of course, escaped the critical eyes of the RBs' legal team that IBM appears to have regarded the "commitment" to the market as more important that the "commitment" to the members notwithstanding, in their analysis, that the message to the market was a weaker message than the one which on their case was given to the members.

1097. The 2010 EPS Roadmap left IBM with little room for manoeuvre (Mr Tennet would say none at all) if market performance were to fall short of the expectations:

i) The 2010 EPS Roadmap was based on 2006 year-end EROA assumptions: if EROA fell there would be an "adverse effect" in relation to the Roadmap as Mr Koppl accepted.

ii) He explained in his witness statement and confirmed in cross-examination that each element of the Roadmap (including the retirement related element) was "expected to achieve its own 2010 EPS Roadmap targets"

notwithstanding any market challenges that each element faced and the facts that pensions gains were subject to economic forces beyond IBM's control and that there was a greater chance of volatility over the 3-year projected period than the previously acknowledged risk of volatility over a shorter 6-month period. He agreed that he had envisaged that if the Roadmap targets were not achieved, he was going to have to make benefits changes to pensions:

> "Q. You are obviously a very intelligent man, Mr Koppl, and you obviously are aware of all these facts. You must have realised that there was a very substantial risk that, in fact, things would not work out over three years as planned. What did you envisage would happen in that situation, if things did not go according to projection?
>
> A. I have to say, if there were minor perturbations the Corporation might have just dealt with it, but it was the severity of what happened that caused the Corporation to act.
>
> Q. What were you envisaging? Let's just not focus on the severity at the moment; what were you envisaging would happen if the road map targets weren't going to be achieved by the pension schemes, in the event that it was going to cause you to miss the target?
>
> A. From a CHQ standpoint, the desire was to achieve the target, so there was a potential that I would be expected to develop actions to try and overcome that.
>
> Q. By "actions" you mean –
>
> A. Something within the domain of the retirement-related costs. Just to put this in context, when the financial crisis began in 2008, I had started to develop actions on defined contribution plans and retiree medical, for example, that could have helped to offset the adverse impact of the crisis.
>
> ……..
>
> Q. It certainly wasn't the case, was it, that DB pension cuts were off the agenda in that situation?
>
> A. No.
>
> Q. At this time, you are suggesting that that would have been within the range of actions to ensure that the pensions element of IBM's business achieved -- I am quoting now -- "its own 2010 EPS road map targets"?
>
> A. Yes."

iii) So, as Mr Koppl explained it, he was addressing in 2008 the shortfall of the retirement related costs from the 2010 EPS Roadmap projections and not the relationship between operational running costs of retirement related benefits and the actual cost.

iv) Mr MacDonald agreed that "when the DB schemes failed or looked like they were going to fail to produce profits in 2010 that IBM was expecting, [I] looked to DB members to accept reduced benefits to make up some of the shortfall in the profits". In his witness statement, he referred to the impact of the financial crash of 2008 on pension costs, noting the dramatic adverse effect which was projected with a consequential adverse impact on the projected 2010 EPS. He stated that:

> "It was not the case that pensions were asked to make any larger than previously expected contribution to the costs savings as a result of the rapidly-changing financial environment, but rather that all areas of the business, including pensions, were required to take steps to ensure that they would achieve the levels of savings that had been set

out in the 2010 EPS Roadmap, despite the financial crisis."

v) Mr Tennet asked him about that:

> "When you talk about contributions to cost savings in that paragraph, what we have seen…. is that what was actually projected to happen after Soto was that the income from DB pension scheme assets was going to increasingly offset the cost of DB accrual, and then from about 2008/2009 it was going to become a profit for IBM which was going to subsidise the cost of its other schemes. So when you say that pensions were not asked to make any larger than previously expected contributions to cost savings, you would accept that what you are actually saying is that when the DB schemes failed, or looked like they were going to fail, to produce profits in 2010 that IBM was expecting, you looked to DB members to accept reduced benefits to make up some of the shortfall in the profits.
>
> A. That's correct."

vi) As Mr Tennet puts it, pensions were on their own. If they failed to perform in line with expectations, pensions cuts would have to be made. I agree.

Project Waltz

1098. I have referred to the Project Waltz changes in paragraph 17*ff* above and described the five essential elements of it. I do not propose to go into the same detail as I have done with Ocean and Soto and the history of meetings and discussions which took place after Soto and leading up to Waltz, although I shall refer to them where relevant.

1099. Mr Simmonds explains the backdrop to the proposals, namely the 2010 EPS Roadmap and the implications for the commitments made by IBM in that document (and for IBM's business generally) of the global financial crisis that struck (with such catastrophic effect as he would say: the RBs have a rather different take on the implications for the DB Plans) in 2008. As far as the UK was concerned, the proposals also formed, according to IBM, an important part of a larger project to transform the business in order to improve its profitability and competitiveness. The RBs say sticking to the commitment in the Roadmap was the beginning and end of the matter.

1100. The market collapse that occurred during the 2008 global financial crisis (and, in particular, the collapse in asset values) was projected to have a dramatic effect on pension costs (as represented by NPPC) which, in turn, had an adverse effect on the projected 2010 EPS. As a result, all areas of the IBM business (not just its retirement plans) were required to take steps to achieve the level of savings set out in the 2010 EPS Roadmap notwithstanding the financial crisis. I do not think that this is contentious. Even if it is, I agree with it. But that is not to say that the steps actually taken in relation to the DB Plans were justified, if justification is needed. In July 2008, when the financial crisis was just beginning to develop, the 2010 projected retirement-related costs for IBM worldwide were $970m, *ie* some $263m worse than the 2010 EPS Roadmap figure of $707m. This projected figure had increased to $1.162bn (*ie* $455m worse) by 15 August 2008 and to $2.028bn (*ie* $1.3bn worse) by 10 October 2008. The corresponding contributions to EPS had fallen from $0.90 under the Roadmap, to $0.76 and $0.66.

1101. Mr Loughridge met with Mr Palmisano on 24 July 2008 to discuss retirement related costs. Clearly this was in the context of the decline in world-wide financial markets to assess the impact on IBM's pension plans worldwide. Some slides had been prepared for the meeting by Mr Koppl. They revealed the following material:

i) The 2010 EPS Roadmap forecast from pensions was now $0.70: "The biggest driver of the drop to $0.70 EPS is weak pension YTD [year to date] actual ROA". This was the first forecast which had indicated that the 2010 EPS Roadmap, of improving retirement related costs from 2006 levels so as to generate additional EPS of $0.90 in 2010, might not be met: at the time the UK Main Plan had 2008 ROA to date of -7%.

ii) On the positive side, one slide showed that discount rates worldwide had improved. UK discount rates had increased from 5.75% to 6.5%, reducing NPPC by $94m. This offset to some extent much of the NPPC impact of the market falls (which Mr Tennet described at one stage of his submissions as "not massive").

iii) UK NPPC projections were better than they had been on 15 August 2007. 2008 UK NPPC was projected to be $10m (rather than $28m), and 2009 NPPC was projected to be $(97m) (rather than $(33m)). Retirement related costs were still due to improve globally to 2010, albeit at a slower rate.

iv) Some possible courses of action were suggested if it turned out that financial markets did not recover. This indicated that the gap between the projected savings and the savings which had originally formed the basis of the 2010 EPS Roadmap was not acceptable and would need to be addressed. The possible courses of action were at that stage directed at DC schemes and other areas but did not include the UK DB Plans. However, it was said in the speaking notes that if the suggested actions were not attractive, "other employee pay and benefit actions would be required". That could, potentially, include action in relation to the UK DB Plans, but there is nothing to suggest that that was in the minds of Mr Koppl, Mr Loughridge or Mr Palmisano.

1102. On 26 August 2008, Mr Koppl gave a presentation to Mr Loughridge and Mr MacDonald on the same issues. The projections were marginally worse with an EPS contribution of $0.66. He reported again on the various potential options for mitigating the adverse impact of the financial crisis on DB costs and these were discussed at the meeting. Initially, these options were confined to reducing DC benefits and benefits under medical plans. This, however, was agreed to be inconsistent with IBM's strategy of generally encouraging DC benefits rather than DB benefits. Mr MacDonald did not like the idea of DC changes so soon after the closure of the US DB plans. Mr Koppl was tasked with considering the options. He left the meeting thinking that changes to DB plans globally was the only alternative to the ones discussed at the meeting (relating to DC schemes and medical schemes principally in the US).

1103. In cross-examination, Mr Koppl accepted that there was, at that time (August 2008), no unprecedented fall in stock markets but he nonetheless regarded the projection resulting in a shortfall on the $0.90 EPS increase as a problem.

1104. It is of note that, shortly after this, it appears that projections for UK NPPC prepared in September 2008 by or for CHQ were more favourable than the ones prepared in August 2008. What the changes for projections for worldwide NPPC were I am unable to discover if, indeed, it was ever brought to my attention.

1105. Next in the chronology, Mr Koppl started work. One of the options he was considering was the cutting of DB benefits. On 9 October 2008, Mr Provost of Towers Perrin sent an email to Mr Koppl and another IBM manager, David Hemmerling (CHQ Treasury - Pensions Strategy) following a phone call earlier that morning to discuss "the next areas of focus with regards to the cost and risk exposure of the larger pensions plans that IBM is sponsoring around the world". He went on:

> "Clearly the recent market turbulence (fall in equity markets, rises in inflation in some countries and instability in bond markets coupled with hugely uncertain outlook) has forced many companies to rethink and look into strategy to reduce or mitigate exposure to DB obligation. The work you are embarking on is the natural next step of [what] was started a few years ago (2005/06/07 - first wave of Soto work). The majority of the cost and risk exposure for these large pension plans is related to the older active (but mostly inactive) participants. We understand that IBM has once again assembled a cross functional team (HR, Finance and Legal) to quickly look into country specific opportunities to help reduce risk exposure and reduce long term costs."

1106. I think it is a rather slanted interpretation of what Mr Koppl was doing to say, as Mr Tennet does, that he "snapped into action" so that by early October "his work on cutting DB benefits was well underway". Mr Koppl, in my assessment, is a straightforward professional person. He was looking into different ways of achieving the goal which his employers wished to achieve, namely to meet the EPS target and within that objective to produce a contribution from pensions worldwide of $0.90. To portray him as a gleeful slasher of costs – which I am afraid is the impression that I have of the submission – is not a fair portrayal.

1107. On 15 October 2008, Mr Koppl produced his *"Retirement Related Cost – Potential Actions"* slides for a board of directors' strategy meeting. I do not propose to go into it because it was superseded by the updated figures which Mr Koppl prepared as a result of the urgent request from Mr Loughridge to which I have just referred.

1108. The updated figures, using data as at 10 October 2008, for 2010 EPS improvement from pensions was projected to fall to $0.21. The driver for the change was the decrease in ROA as against EROA. So far as concerned the UK, the updated difference between the original EPS Roadmap projections in 2007 and the current projections were:

i) 2008 ROA was -20.7% for the Main Plan, and -26.9% for the I Plan. The asset falls flowing from the ROA shortfall were projected to cost $122m in 2009, $248m in 2010, $378m in 2011, and $512m in 2012. A key element of that accounting loss was the fact that ROA was not just less than zero, but that it fell short of the existing EROA assumptions of 7.25% and 8%.

ii) The UK discount rate had improved from 5.75% to 6.75%. This was projected to save $91m in 2009, $52m in 2010, $36m in 2011, and $24m in 2012.

iii) UK inflation rates were assumed to be higher, costing an additional $139m each year from 2009. The long term UK inflation assumption increase, as Mr Koppl later explained, would "I think be reduced in the next forecast", so that the UK 2009 year-on-year increase "may be overstated".

iv) Mr Tennet draws attention to the fact that these figures were produced at the very low point of the market in 2008: by the end of 2008, ROA in the US and UK had improved (in the UK ROA was -18% in 2008).

1109. Turning to country-specific forecasts, Mr Greene emailed Mr MacDonald on 16 October 2008 with a single slide forecast of global NPPC to 2012 by country. It showed a very different picture from the NPPC forecasts one month earlier:

i) UK NPPC was expected to rise from 2008.

ii) UK NPPC would still be substantially less than IBM's service cost in 2008, 2009, 2010.

iii) The greatest pension costs came from Germany, UK and Japan, because these had the largest closed DB schemes.

iv) By contrast, the US scheme, which had already been closed in 2008, was projected to produce profits from 2008, although the level of profits would start to decline from 2011.

1110. It was at this time that the global project known as Project Whisper – the project which in the non-US countries turned into Project Waltz – came into being. The genesis is set out in Mr MacDonald's witness statement at paragraphs 11.9 and 11.10, the contents of which I accept:

> "I also initiated Project Whisper in October 2008 in response to the deepening financial crisis. Lehman Bros had just collapsed and we could see that we were in an economic crisis or were about to be. In light of this, we were looking at various possible scenarios and considering what could be done to stabilize the 2010 EPS Roadmap. We were seeking a creative approach to reducing costs in the short term and the long term, and pensions were just one part of that discussion.
>
> Project Whisper was a comprehensive exercise initiated by me and led by Federico Castellanos, with other senior HR executives in attendance, including Jonathan Ferrar, who was by then the UK Director of HR. The team that I had nominated met in Armonk, New York for several days, beginning on 15 October 2008. I asked the team to consider all available options from a HR perspective (JRM tab 21). I asked them to compile a menu of options dealing with what could be done quickly in order to rein in costs. For example, I recall that following these discussions, we

looked at the company's car program worldwide and committed to reduce the annual cost of it by US$120 million."

1111. Mr Tennet has a different take on this. He says that "at this time of the decision to do something", the markets had obviously fallen, but much more severe falls were to come, noting that market falls were particularly bad at the start of October 2008. Indeed, it was the severe falls which prompted Mr Loughridge to ask Mr Koppl to produce an update of the retirement related costs forecast overnight. Mr Tennet submits that the further falls in the market played no causative role in the decision to proceed with Project Waltz because the decision had already been taken prior to those falls. I reject that submission. First of all, Mr Tennet is clearly referring, when he says "at this time of the decision to do something", to the meeting on 26 August 2008 or, if not then, then at some later time when Towers Perrin were instructed. The fact that Mr Koppl, following that meeting, may have been taking steps to consider the impact of closure of the DB Plans and even to instruct Towers Perrin does not indicate that any decision had been made: indeed (i) Mr Koppl had no authority to make such a decision and (ii) clearly did not take such a decision. Moreover, if a decision to close the DB Plans had been taken, part, at least, of the Whisper deliberations would have been nothing but a charade – although for whose benefit Mr MacDonald would have intended its performance to be is difficult to fathom. In any case, even if a decision had been taken before the serious market falls and even if Mr Tennet could establish that such decision should not have been taken, it does not follow that the same decision could not properly have been taken after the falls. The same decision would, clearly I think, have been taken and I therefore see no reason why IBM should not be able to rely on that as a factor in justifying its actions. The question then is whether, even with such reliance, its actions can be justified.

1112. Those assembled by Mr MacDonald were divided into teams. Mr Koppl was on the benefits team; Mr Ferrar was on the restructuring team. On 16 October 2008, the benefits team produced its first presentation. The mission was to design the "future state of benefits to generate savings in 2009 and 2010 and satisfy longer term strategic goals" and to "improve stability" and "reduce volatility". An "opportunity score" country by country was given: for the UK that score for reducing DB benefits and capping liability was said to be medium and for reducing DB benefits and reducing liability was said to be high.

1113. The benefits team made a further presentation on 18 October 2008, a Saturday. The principles guiding decisions included "Drive actions to stop growth of DB pension liabilities" and "Propose actions to reduce DB liabilities and therefore volatility". One slide addressed three benefit scenarios. The first was in a situation of moderate economic downturn ("worldwide low growth for 1 year; flat or down in major markets"): we find "stop growth of DB liability – revisit key Soto countries…", in other words DB accrual could cease. In cases of significant or extreme economic downturn, other action could be taken in relation to DC plans.

1114. In relation to pensions, the two potential objectives identified in the course of Project Whisper sessions between 15 and 20 October 2008 were to stop the growth in DB liabilities and to reduce DB liabilities and volatility. Opportunities for capping volatility were identified, including the elimination or deduction of benefits in the UK. And DB opportunities for ending volatility included "DB Termination Opportunities". As Mr MacDonald put it in his witness statement, the proposal was that the focus should be on freezing the pensions plans accruals in Germany, the UK and Japan, three countries with the highest service cost. He noted that this was pure brainstorming in anticipation of a continuing market collapse, and it was therefore entirely confidential, even within IBM Corporation.

1115. In relation to that, Mr Tennet says this (which can only be taken as a complaint):

> "Exactly why the benefits team were determined the [sic] end DB accrual in the UK is not clear, since it would have a minimal effect on volatility. Larry Koppl's *"Pension Service Cost – Issue"* chart of 18.10.08 explained that each year UK *"service cost increases the pension liability"*, that *"The large liability is the source of pension cost volatility"* and that *"Ending service cost would cap the liability"*…….. the total liability ('PBO') at the end of 2007 was [accepting the figure] $10,765m. In other words, one year's accrual added just 1.3% to the total liability. It was the existing large PBO that was the source of the problem: ceasing DB accrual would only "*cap*" the volatility

problem. Only a change in investment strategy could address the volatility arising from existing liability."

1116. Whether an investment strategy could in fact actually succeed in addressing volatility at a sensible and, dare I use the word, proportionate cost, is a different question.

1117. I also say a little about the final *"Pension – Project Whisper"* presentation which was given to Mr MacDonald on 21 October 2008. The slides were circulated to the "team" the day before by Mr Walker; the sent-to list on the covering email included Mr Koppl and Mr Ferrar. The slides included the following:

i) Slide 2 emphasised that the aim of any changes should be to "stop the growth of DB pension liabilities" and "reduce DB liabilities and therefore volatility".

ii) Slide 4 considered ways to stabilise and reduce DB service cost in relation to Germany, Japan and the UK.

iii) Slide 6 (headed "Actions to Move Forward: Project Sapporo) referred to the creation of a work team ("Larry Koppl, Kathleen Roin, Eric Alderman, Country CFO, HR & Legal")

iv) Slide 7 designated a number of people, including Mr Koppl and Mr Ferrar as the "owner" of the task to create a "Summary of Objectives to reduce/eliminate benefit accruals in targeted DB plans by country" and other persons, including Mr Ferrar, as "owner" of the task to "Plan forward from each country – strategy/options to achieve holding flat the DB plan accruals – negotiation strategies/options". Mr Ferrar's involvement is reflected in a follow-up e-mail from Kathleen Roin on 24 October 2008, who "just wanted to touch base with you regarding next steps on Project Sapporo".

1118. On 23 October 2008, there were meetings of the Trustee's Investment Committee (in the morning) and of the TMM (in the afternoon). So far as concerns the former, the minutes record the market review from Mrs Ross. Equity markets in all regions had fallen in the third quarter and since then by over 10%, and bond yields had fallen too. As a result of the equity falls, the bond allocation had reached about 48% which was in excess of the 2010 target of 44%.

1119. Mr A MacDonald (of Watson Wyatt) recommended rebalancing around a bond policy level of 44%. After a discussion about the merits of diversification in the current volatile market conditions, Mr Scott was asked by Mr Stewart Wilson to summarise IBM's current view on risk tolerance. Mr Scott reported that IBM's views on allocation were not changed by the market conditions and that rebalancing should take place. Mr Lamb's position was recorded in the minutes in this way:

> "Mr Lamb said that the natural point for the Fund would have been a larger allocation to bonds but the request from the Company had been not to move more than 3% per annum over a 3 year period into bonds. This was acceptable to the Plan because of the guarantee and with that in mind it would not be prudent for the Committee to decide upon any action that could push the NPPC higher. The current position had not broken the agreement with the Company and he would therefore be inclined to continue with the suspension of rebalancing until the Committee had a clear position from the Company and could be sure that any action would not impact benefits to members going forward and that liquidity had returned to the bond markets".

1120. Further discussion took place: it was generally agreed that "it remained counter strategic in current conditions to sell bonds to buy equities". The minutes then record this:

> "Mr Alexander [of Watson Wyatt] said that for strategic reasons it was reasonable to retain the bond policy weight at 44% but on tactical grounds not to bring the actual weight back to 44%. It was therefore agreed that the policy benchmark for bonds be fixed at 44% and that asymmetric trigger points be set around the benchmark. The normal 3% drift range would be appropriate for the lower trigger point but there should be no upper trigger point…."

1121. The effect of that last decision was that bonds would not be sold to buy equities if the bond allocation rose above 44%, but equities would be sold to buy bonds if the bond allocation fell below 41%.

1122. So far as the TMM is concerned, it is to be noted that Mr Ferrar was in attendance in his capacity as Trustee Director. Mr Riley joined the meeting to give a presentation. There was no suggestion that Mr Riley's assessment of the state of the UK business necessitated any change to the DB pension arrangements agreed after Soto. He was aware of poor morale and that there had been major changes to the structure of the pension plans in recent years. According to the minutes, he stated that "there were currently no discussions going on as regards the IBM UK pension plans." I have no reason to think that Mr Riley thought that there were any such discussions under way.

1123. In point of fact, Project Whisper was already well under way as I have explained above. And yet Mr Ferrar made no mention of it. It would have been one thing for him to keep silent if the topic had never been raised; it is quite another for him, as a director of the Trustee, to have allowed an important statement made by the General Manager for IBM UK to go uncorrected.

1124. This was also one of the least satisfactory aspects of his oral testimony. I think it is fair to say that he was discomfited by questions about his silence at this meeting. He met that by seeking to downplay his involvement. His evidence was to the effect that he understood Project Whisper to have been no more than contingency planning of hypothetical options which might never move forward. Initially there were just thoughts, then later (at least after the time of the TMM on 23 October 2008) options were discussed and developed. His oral testimony included this:

> "…… Project Whisper was the 15th, my involvement finished on Sunday, 19th, I flew back on the 21st, night of the 21st, arrived 22nd, meetings on the 22nd, TMM 23rd. I got an email from Kathleen Roin on the 24th which indicated quite clearly that there was some action starting. I had a meeting with Stephen and Brendon on the 27th, at which I was talking about labour costs there, and we got the NDA signed on Sapporo and that is when we really -- I personally started thinking: we need to have options, we need to start this, we need to make this a UK thing."

1125. Mr Ferrar said that his involvement finished on 19 October 2008, but I do wonder if that is correct. What ever the true position, even accepting that he did not attend the meeting on 21 October 2008, I have no reason to think that he did not receive the email before his flight to the UK. I would be very surprised indeed if (i) he had not absorbed the information in the slides sent to him (which information was not new to him in any case) prior to the TMM on 23 October 2008 and (ii) he was not aware of the task being assigned to him and the ownership indicated in Slide 7. He would have known of the ongoing discussions concerning how to deal with the DB Plans.

1126. He is right, of course, to say that Sapporo/Waltz went wider than DB pension provision and that no decisions were taken at that time – 15 to 21 October 2008 – whether in relation to DB pensions or otherwise. But I am sure that, before he attended the TMM on 23 October 2008, Mr Ferrar understood that DB pension changes were firmly on the agenda; options were to be developed and decisions made. Matters were more developed than an idea in the sky that "we need to have a talk about pensions". In any event, the result of the presentation on 21 October 2008 to Mr MacDonald was that those involved went away to develop their thoughts and to produce options.

1127. It is quite clear to me that, at the TMM on 23 October 2008, in saying that there were no discussions going on as regards the IBM UK pensions plans, Mr Riley was conveying the message (which he no doubt believed to be the case) that the possibility of future changes to the DB Plans was not being considered; had he known the truth about the work that had been done and presented to Mr MacDonald, and about the decisions taken at the end of the sessions, he could not properly have made the statement which he did. Mr Ferrar, in my assessment, knew the truth and with his state of knowledge could not, himself, properly have made the statement which Mr Riley made.

1128. Ms Roin's email of 24 October 2008 was sent to Mr Ferrar no doubt to keep him up to speed with how matters

were developing. It would have come as no surprise to him that he was to lead the project (by then known as Project Sapporo) in the UK. It did, however, tell him some things which he may not have known. For instance, Ms Roin told him that Towers Perrin had been engaged to produce "initial country scans for each of the six Soto countries that we will use to develop our action items"; but in the future (what she referred to as "the second phase of the project during which we narrow down the potential action items to the actual proposals we wish to bring forward") local UK consultants (KPMG or Hewitt) would be engaged for more detailed analysis. Proposals would first be reviewed by Mr Castellanos and then by CHQ senior management. CHQ would fund the consultants. The aim was to hold initial UK workshop meetings in the week of 17 November 2008. She would send Mr Ferrar non-disclosure agreements for both internal and external use. She asked him for his initial thoughts on who he would like to be on the "core UK Sapporo team".

1129. Arrangements were already in hand to appoint independent consultants. The choice had narrowed to KPMG and Hewitt. A draft of the requirements for presentations which they were to be asked to give was prepared. It was sent to Mr Michaud by Sally Johnson (IBM UK HR Pension Benefits Leader) on 23 October 2008 with some amendment the next day. The draft was sent on that day to Mr Ferrar. Topics for inclusion could include "What you would propose as a roadmap for the next 18 months" covering a number of items but expressly excluded "investment strategy for our DB plan, buy-out and buy-in except for deferreds, and overall redesign of the DB pension for active members".

1130. Mr Ferrar received the draft requirements and made some amendments. The applicants were to "concentrate on providing a strategic agenda for pensions change in IMB [sic] UK that would help IBM to…. manage a long term change to its DB liabilities". So, overall redesign of the DB Plans, including early retirement subsidies, was on the agenda. However, "Investment strategy for the DB plan", was still expressly excluded, Mr Tennet observing that this was the key topic that might be useful to address volatility.

1131. Apart from Mr Ferrar, however, none of the UK management knew about the pension discussion going on in CHQ. Mr Ferrar first officially told Mr Riley and Mr Wilson about Project Sapporo on 27 October 2008 when sending them Non-Disclosure Agreements to sign. There followed discussions about Project Sapporo between Mr Wilson and Mr Scott over the next few days but I do not think that anything turns on the detail of that.

1132. On 31 October 2008, Towers Perrin sent Mr Koppl and Mr Hemmerling their draft statement of work for Project Sapporo. The focus of their work would be on:

- Stopping the growth of DB liabilities (stop accrual)
- Reducing the DB liabilities
- Reducing the volatility associated with DB liabilities either through plan design features or financial mechanisms.

1133. Towers Perrin would review country specific material and prepare "country scan" reports. Clearly, CHQ was continuing to take a very close and direct interest in pension issues. It was hardly likely that it would be expending all this time and effort and cost unless it was ultimately to make or guide the relevant decisions.

1134. Mr Koppl prepared a presentation for Mr MacDonald on 7 November 2008 to update him on the impact that the financial crisis was projected to have on retirement costs. In the covering email to Mr MacDonald that day, Mr Koppl set out his thinking:

> "I think of annuitization to an insurance company as a longer term action because of the time it would take to structure a deal and to comply with regulatory requirements, I would expect the other actions which focus on reducing service cost or offering lump sums to be near term."

1135. The presentation noted that such costs would be higher than the 2010 EPS Roadmap had assumed and that there would be year-on-year increases through to the end of 2012 even if the economic downturn did not last beyond 2008. Whereas the 2010 EPS Roadmap had projected a contribution of $0.90 from NPPC, this was now

projected to be only $0.27 at best.

1136. The next retirement related costs forecast was produced on 10 November 2008. The 2008 Retirement Related Cost Forecast was described as "On Track" to achieve the $950m to $1b contribution to EPS growth "communicated in Jan 2008 earnings release". The 2010 outlook was for a contribution to EPS growth from pensions projected at $0.27, the same figure as Mr Koppl had included in the briefing materials just mentioned but an increase on the projections made in October. The Forecast also included a projection in a "3-year Unfavorable" scenario: projections showed a reduction in 2010 EPS of $0.29.

1137. What all this shows is that there was considerable volatility in the projections from week to week as circumstances changed in the financial markets. CHQ could not, I think, really predict with any consistency what long term pensions costs and contributions to profits would be.

1138. On 11 November 2008 there was a meeting with Lou Noto, the chair of IBM's Audit Committee. It is not clear who was at that meeting apart from Mr Noto although it is reasonable to infer that Mr Koppl was present. He reported in an email to Mr Loughridge on 10 December 2008 that Mr Noto "liked the concept of capping the non-U.S. DB liability by ending or reducing service cost." Mr Koppl's preference was to target DB accrual first: any DC actions in the US would only be "in conjunction with the most aggressive DB actions possible".

1139. Moving away from Sapporo and Waltz for a moment, there was a process running parallel in the UK. Mr Riley had been appointed general manager of IBM UKI in April 2008. Following his appointment, he undertook a review of the IBM UKI business and identified how it needed to change in order to meet the economic circumstances. Although work on the transformation strategy began in June 2008, this project was formally launched only in January 2009 and was known as **'UKI Transformation'**.

1140. It is explained this way in IBM's opening written submissions. The principal motivations behind UKI Transformation were the need to improve the underlying competitiveness of the UK business and the need to improve its profit contribution (lest it should become less relevant to IBM Corporation within the global business and as a result receive less investment), the need to ensure that its reward structure was fair as between different groups of employees, the need to reduce the volatility of, and risk attached to, pensions liabilities, and the reduction of future pension costs (in order to assist with the business' competitiveness and profitability). Mr MacDonald described it in his witness statement: UKI Transformation addressed costs, problems and a plethora of issues with a view to turning the business around. The strategy behind the project (on which work was started a few months before its formal announcement) was centred on five areas, *viz*. (1) focus on clients; (2) creating an environment to allow IBM to succeed through its people; (3) enhancing productivity by managing operational efficiency to optimise revenue and profit performance; (4) identifying, prioritising and executing opportunities for growth; and (5) enhancing IBM's reputation. I accept that as a fair summary of the strategy. But whether that included pensions at the early stage is a matter of contention. As we will see, the RBs' position is that pensions did not feature in the UKI Transformation at the beginning and only came into consideration when CHQ began to insist on the reduction of DB costs in order to achieve the 2010 EPS Roadmap. As I have already said, Mr Riley and Mr Wilson were only told about Project Sapporo in late October 2008.

1141. IBM accepts – it could hardly do otherwise – that the impetus to make costs savings in order to meet the commitment made in the 2010 EPS Roadmap came from CHQ. But IBM submits that, in parallel with this impetus, there was the separate, UK-driven process, UKI Transformation. IBM say that the suggestion made by the RBs in the Amended Voluntary Particulars ("**AVPs**") that UKI Transformation was "a pure 'fig leaf', which IBM UK and IBM CHQ cynically used to try to 'sell' the proposals", is utterly without foundation. Again as it is put in IBM's written opening, Project Waltz was part and parcel of UKI Transformation: the cost savings sought as part of Project Waltz (for, it is accepted, reasons primarily connected with the commitments made by IBM Corporation in the 2010 EPS Roadmap) were entirely consistent with the broader attempt through the UKI Transformation to increase the profitability and competitiveness of the UK business. Therefore, whilst also assisting in meeting the commitments made by IBM Corporation in the 2010 EPS Roadmap, the proposals were also of central importance to IBM UK's business strategy under the leadership of Mr Riley and, in particular, its strategy to increase profitability (not least because the profitability and budgetary targets that UKI

Transformation sought to achieve were defined by reference to, *inter alia*, NPPC).

1142. In this context, I draw attention to Mr Ferrar's own witness statement where he said that the UKI Transformation was "Brendon's initiative". Mr Ferrar commented – quite correctly – that IBM UKI as, ultimately, a subsidiary of IBM Corporation, has to compete internally for investment (for example, in the form of increased employee compensation) by CHQ; prior to Mr Riley's arrival, IBM UKI was not in fact perceived, rightly or wrongly, as an especially attractive investment proposition. Mr Riley's mission was to bring about change to reverse that perception. And it was that which resulted in the UKI Transformation strategy.

1143. It was now time for Mr MacDonald to visit England. He did so as part of a trip to London and Munich from 10 to 12 November 2008. His timetable seems to me to have been pretty gruelling. He was in London on 11 and 12 November. He held a meeting with Mr Ferrar and Mr Wilson during the morning of 11 November 2008 to discuss Sapporo. It is clear that the topic of closure (in contrast with winding-up) of the DB Plans was discussed and that the various routes which might be taken to achieve that end were addressed. This did not come as a surprise to Mr Wilson: his own evidence records that legal advice had been, and was being taken, about the possibility of closure under the terms of the Exclusion Power. The possibility of termination as a route to closure was mentioned, but Mr Wilson considered this to be a "nuclear option" and thinks he described it as such to Mr MacDonald. He also explained (and I accept his evidence about this) to Mr MacDonald that closure would "present a very difficult Trustee and employee relations issue, particularly in the light of the changes made in 2005 and 2006. I also said that he would expect the Trustee to move more quickly into bonds."

1144. Mr MacDonald agrees that he and Mr Wilson discussed the possibility of ending DB accrual. He seems to have taken away a rather stronger message than Mr Wilson thinks he gave. In his witness statement, Mr MacDonald said this:

> "Stephen told me that such an action [closure] would not be possible in relation to the IBM UK pension plans, or that it would trigger a section 75 liability."

He also said that Mr Wilson's advice:

> "made me seriously question Stephen's judgment and commitment, as I felt that he had given me advice that did not appear to be in the best interests of the enterprise. Following this incident, I came to the conclusion that Stephen should be moved on from his role as CFO for the UKI business, and I communicated that view to Mark Loughridge."

1145. This, I think, must have been the seed of Mr Wilson's eventual removal as CFO. It confirms, in my view, the proposition that CHQ were, by this time, set on terminating DB accrual in the UK Plans and were not really prepared to listen to a message which presented any hurdles: UK management's job was either to remove or jump those hurdles. Mr MacDonald's own reaction shows that he was not himself pushing back on any proposals. Even on his own terms, that is pretty surprising since, far from communicating to others in CHQ the concerns of the UK management as concerns which needed to be addressed rather than overridden and far from challenging (his own view of what was required by the need to "push back") with CHQ the need for changes, he reacted against Mr Wilson's concerns as negativity when, had he pushed back, Mr MacDonald ought to have supported him in making his concerns heard.

The RBs' attack on Mr MacDonald's failure to "push back"

1146. Now is as convenient a time as any to deal with some of Mr Tennet's submissions in relation to what he describes as Mr MacDonald's failure to "push back".

1147. I have already dealt at some length with the statement made by Mr MacDonald at the meeting in the Marriott Hotel on 8 January 2006 (see paragraphs 813 *ff* above) that he would "push back" on anyone, including Mr Palmisano, who asked him to revisit the issue of DB pension changes "on his watch". I have already concluded that those present at the meeting were entitled to understand Mr MacDonald as saying that he would resist any further changes. At the very least, as Mr MacDonald himself accepted, he would scrutinise, test and challenge

any further proposals made for change. Mr Tennet's submission is that Mr MacDonald neither resisted or even tested and challenged the need for further changes as developed during Sapporo and Waltz. His written closing submissions state that on 8 January 2006 Mr MacDonald promised the Trustee that the UK DB Plans would receive special protection (whatever the meaning of "push back" was). I can find no reference anywhere in the evidence to "special protection": Mr MacDonald did not use those words or anything like them in his witness statement nor did Mr Tennet use those words or anything like them in the questions which he asked Mr MacDonald. The only "special protection" which I can detect from the evidence is the protection which would be afforded by Mr MacDonald's assurance that he would "push back" on any proposals for further change on his watch. I remind myself (and the reader) at this point that even that assurance must be treated as qualified in that it can only reasonably be considered to apply in the absence of any significant change of circumstance.

1148. It is clear to my mind, however, that Mr MacDonald did not resist the Sapporo/Waltz changes when they came to be formulated; I do not even consider that he did much, if anything, to test or challenge the need for them. There is no evidence that he said to his colleagues at CHQ that they simply should not contemplate further changes because of what he had said to the Trustee; he clearly did not do so. There was some discussion, however: the adverse effect of market falls on retirement related costs was discussed at a meeting on 26 August 2008 with Mr Loughridge and Mr Koppl. It is worth quoting a passage from Mr MacDonald's evidence about this issue:

> "My reaction was – and it has being very candid – is that "Oh, not again". That was my first reaction, is that "Not again", and "Do we really need to do this? Is there other ways beyond pension to get there?" All of those questions were being asked by me. Then ultimately, when they said "We got problems everywhere, with revenue, with all these other issues, we have got to focus on pension", okay, now we are at pension. Now I'm sitting in front of myself again saying "Here we go again", and I want to go and see what I can do."

1149. As to that Mr Tennet submits that it is "unthinkable that the Trustee could possibly have had such a lacklustre response in mind when Mr MacDonald made the promise he did in January 2006".

1150. What happened after that is important. Mr Tennet submits that the evidence shows that Mr MacDonald, far from resisting further changes to the UK DB Plans and was actually an advocate of precisely such changes. It is relevant to see what others involved within CHQ were thinking:

i) In his oral evidence, Mr Koppl explained why his initial presentation in August 2008 (which related to IBM worldwide, not just the UK) did not include changes to DB benefits, the menu of options being focused on US DC, US retiree medical. As he said:

> "I did not relish going back to redesign the DB Plans….. There are no legal inhibitions [to suspending DC plans], it would be pretty straightforward, and it is potentially a very large saving that we could execute quickly and without difficulty from a business standpoint. That was the basis for my thinking for why this might be a potential candidate."

ii) Mr Loughridge appears to have regarded DC changes as a perfectly acceptable route to getting back on the track of the 2010 EPS Roadmap. Mr Koppl's notes of the meeting record that Mr Loughridge preferred suspension of the US DC plan to permanent change; he was clearly open to the possibility of suspension.

iii) Mr MacDonald accepted this:

> "Q. This is at a very early stage of the process, because you can see these are all just possibilities and they are discussing them, and the view that has been attributed to you is you don't like the idea of US DC suspension or permanent change.
>
> A. That is correct. Mark preferred it and I didn't. This is -- what they are presenting to me, as I said yesterday, is a series of possibilities, which they do often."

iv) But, as Mr Koppl said in his oral evidence, there was some back and forth between Mr MacDonald and Mr Loughridge as a result of which "they both agreed that acting on US DC would not be the right strategy". Savings in relation to retirees' medical benefits were also discussed and ruled out, leaving DB cuts as the only option, including DB cuts in the UK.

1151. Mr Koppl described Mr MacDonald as "in a box, because the other two things that we looked at [DC and medical benefits] were not good choices, and it took us back to DB [including UK DB]". There is not a hint here of Mr MacDonald having pushed back or even challenged changes to DB; indeed, it appears that it was his own rejection (a challenge perhaps) to DC and medical benefit changes which left IBM with DB changes as the only route to provide pension savings.

1152. There is no evidence to show that Mr MacDonald resisted or challenged the proposal to make DB cuts in the UK at any time after the meeting on 26 August 2008.

1153. Nor is there any evidence that the need to "push back" on UK DB cuts was given any thought by Mr MacDonald once the decision to make global DB cuts had been taken. He did say that "we made trade offs. We gave more money on a compensation basis and committed to SIP programmes for two years in the UK". That does not seem to me much like "pushing back".

1154. Where do his submissions about Mr MacDonald's failure to "push back" take Mr Tennet? He says that had Mr MacDonald kept his word and resisted changes to the DB Plans, Project Waltz would not now be going ahead because:

i) Mr MacDonald himself admitted that he was the key decision maker. He had the power to veto changes in the UK.

ii) Had he kept his word, it is possible that some changes might still have been unavoidable. However, such changes would necessarily be substantially less severe than Project Waltz.

1155. I consider that it is to put matters rather too high to suggest that he had a veto. The world-wide review of pension provisions was, however very important to IBM. If other senior managers in CHQ would have disagreed seriously with Mr MacDonald had he sought to block a proposal which those other managers considered to be very important, there is nothing to suggest that Mr MacDonald would not himself have raised the matter with his own superiors. I readily accept that Mr MacDonald was an important figure in the decision-making process and I accept too that his decision would, in practice, be likely to have been the last word.

1156. I cannot speculate on what would have happened if Mr MacDonald had "pushed back" in the way in which the RBs contend he should have done if he was to keep his word: it is not self-evident that any changes would necessarily have been "substantially less severe" than Project Waltz. I should not, in any case, be taken as accepting that what Mr MacDonald actually did was to fail to keep his word. His undertaking to "push back" cannot be taken, on any view, as an absolute commitment: changed circumstances might justify Mr MacDonald in deciding that he should not "push back" at all. When he gave the commitment, he was not as fully informed as he might have been and he did not appreciate that the Soto changes would not solve a problem (NPPC volatility) different from those which he thought he was addressing (cost and funding). Nonetheless, even a change of circumstance would not have absolved him from arguing strongly the case for no further changes to the UK DB Plans. I would have expected him to say to those with whom he was discussing the future of the UK DB Plans that he had given Mr Lamb and the Trustee certain assurances and his own personal commitment so that at the least Mr Koppl and Mr Loughridge could be given the chance to come up with a solution which ameliorated the proposals eventually imposed on the UK. There is no evidence that he did anything like that.

1157. However, all this is, to my mind, beside the point. The action before me does not include a claim against Mr MacDonald that he has breached some duty to the RBs or the Trustee for which he should be liable. His statement that he would "push back" cannot be taken as casting some obligation on IBM: indeed, quite the reverse is the case because any obligation to push back would only arise when others in IBM were proposing

changes which IBM might go on to implement. At most, he was saying that he personally would resist proposals to make any further changes to the DB Plans which might be detrimental to the interests of members; in saying that, he was clearly not giving an undertaking on behalf of IBM that further changes would not be proposed or, even if proposed, implemented, "on my watch" let alone after he had ceased to have any relevant input (*eg* after leaving IBM's service).

1158. In any case, Mr MacDonald as a senior employee of IBM owed duties to IBM to act in its best interests. He could, consistently with those duties, only resist proposals for further changes to the DB Plans if he considered that to do so would be within the range of decisions which he, as a decision maker, could reasonably take. If he perceived it to be essential that further changes should be made, or if he perceived such changes as being the course of action which was in the best interests of IBM, I find it difficult to see how Mr MacDonald could properly make a decision which he did not perceive as being in the best interests of IBM simply because he had given a personal commitment not to "push back". Perhaps he should not have given such a commitment, but that is a different point.

1159. Having said that, I do not consider that Mr MacDonald's commitment to "push back" is irrelevant. On the contrary, his statement was important because it illuminated and underlined the message which he was giving to Mr Lamb on behalf of IBM which, as I have identified it in my discussion of Project Soto, was that there would be no changes in the absence of a significant change of financial and economic circumstances justifying such changes. He could hardly have given his personal commitment if he had thought it was inconsistent with what he was saying on behalf of IBM. So, when it comes to examining the business justifications for the changes which IBM relies on, it will be relevant to see whether the particular changes to the UK DB Plans were justified.

1160. There is one related point which I should address. Mr Simmonds says that the "push back" statement is irrelevant for another reason. He says it was not communicated to Mr Lamb's fellow board members: the reference to it was excised from Mr Newman's draft note of the meeting before it was sent to the board members (as appears from the witness statements of both Mr Lamb and Mr Newman) and there is no evidence that Mr Lamb mentioned it. Although it is probably right to infer that the "push back" statement was not communicated to the other board members, that does not mean that it is irrelevant. It clearly had an impact on Mr Lamb and thus on the message that he himself conveyed to the board.

The development of the Project Waltz proposals continued

1161. On 13 November 2008, Mr Ferrar sent an email to KPMG (who had been selected, finally, on 12 November 2008). He wished "to progress our strategic thoughts…. with the goal to produce a strategic pensions roadmap for IBM UK for the next 2 years+". He required a summary plan by 17 November. He identified "the ideal I'd like to progress – I'd like you[r] input to some of them…". Under the heading "Actives" he wrote "4) 2010 Early Retirement legislation changes; 5) Voluntary enticement to change to Enhanced M Plan; 6) Close plan to future accruals; 7) Restrict future salary increases to DB actives".

1162. On 17 November 2008, Mr Ferrar produced a single page summary chart, sent to Mr MacDonald, Mr Riley and Mr Wilson, setting out the various options for changes in the Plans based on a "Red, Amber, Green" or "RAG" analysis. The options included cessation of future DB accrual but covered much wider ground, including deferred/pensioner benefits and asset allocation/de-risking. It is worth noting a couple of points arising out of that chart:

i) Mr Ferrar only considered early retirement in the context of the upcoming legislative change, which would give "current 48-53 year olds a one time option to take early retirement before legislation changes to 55 year minimum early retirement". If those members left, it might trigger the Amortisation Switch. That would have provided an NPPC advantage.

ii) Mr Ferrar thought that the employee relations risk of compulsory cessation of DB accrual would be "Very High". He gave it an overall RAG rating of Red. He commented: "restriction to pensionable salary increases already implemented in SOTO… Employers duty of good faith to be considered".

iii) Mr Ferrar also thought that compulsory cessation of DB accrual might not achieve the cost and volatility objectives. On cost, his summary said there would be a curtailment loss of $60m to I&E, and that the basic savings were projected to be only $5m pa with a "Risk that trustee lowers equity mix costing up to $75m p.a.". Closure to future accrual "Removes future service liability worth 1% of total liabilities p.a.". That percentage might be thought to be of little significance in the overall scheme of a reduction in NPPC.

1163. KPMG's initial thoughts on the strategic options were sent on 17 November 2008 to Mr Ferrar, Mr Wilson, and Mr Scott. There was no consideration of changes to investment strategy (nor, indeed, of the consequences of simply doing nothing). They noted the savings of replacing DB accrual with Enhanced M Plan accrual – a modest £3m pa – and with ordinary M Plan accrual – about £17m pa. They noted that closure could result in an increase in past service liabilities "due to the changes introduced in 2006. Active members would most likely become deferred and would receive RPI revaluation in the period up to retirement (capped at 5% pa) which is expected to be higher than increases of 2/3rds of actual salary growth".

1164. Even before this presentation, Mr Loughridge and Mr MacDonald had agreed that the CHQ pension team should go to the UK to work on the details of the pension changes proposed. There was a time-pressure: actions needed to be implemented by 1 January 2009 to be part of the normal year-end pension re-measurement. The team who went to England comprised Ms Roin, Mr Michaud and Mr Koppl. They met with UK management comprising Mr Wilson, Mr Ferrar, Mr Scott and Ms Middleton. At the meeting on 20 November 2008, the options of the one-page summary to which I have referred above were gone through. This included, among other matters:

i) the difficulties of offering a voluntary move to DC accrual. Mr Koppl's note recorded: "Difficult to offer more than last time (people who took DC last time would feel cheated)".

ii) In relation to termination of DB accrual:

a) Mr Wilson pointed out that "the statutory books were not at a loss". Those are the words in Mr Koppl's note; the message is that IBM UK was running at a profit.

b) Mr Koppl referred to the Soto Changes: "last time IBM based argument on US FAS method". He was clearly concerned about applying a consistent approach this time round.

c) It was recognised that that termination of accrual would be "hugely controversial".

d) Mr Scott considered the effect of closure on NPPC. He thought that it "may not be less costly going forward" because "deferred members get 100% of inflation indexing so moving actives to deferred sooner could penalize PBO".

e) The effect of closure on asset allocation was not discussed at all: at least none is revealed by the unredacted parts of Mr Koppl's note even though this had been on Mr Ferrar's one page summary.

1165. The meeting on the next day, 21 November 2008, discussed the options again. Mr Koppl's notes of this meeting show a different ordering. What one might call the more aggressive option was considered first, namely closing the DB Plans to further accrual. For the first time, eliminating the early retirement "subsidy" *ie* changing ER policy was considered. Mr Scott was tasked with reviewing the Amortisation Switch.

1166. It is important to record at this stage what Mr Koppl and Mr Wilson said in their respective witness statements and then in cross-examination about the latter's attitude at the two meetings. It is important because Mr Koppl's actions after the meetings can be seen to have led directly to Mr Wilson's removal from the project. The relevant passages are included in the RBs' opening written submissions.

1167. Mr Koppl said that Mr Wilson refused to cooperate, and that the decision was taken to remove him from the Waltz discussions as a result:

"Stephen Wilson was assigned the task of considering the UK business justification for each

alternative, along with a consideration of the potential trustee reaction... I made no requirement as to the outcome of that analysis, but Stephen refused to even undertake performing it. I was well aware that any pension re-design is difficult for local country management and employees. However, in all my years of experience within IBM I had never come across such an outright refusal from an executive to analyse alternatives. When I returned to the US, I reported to the senior executive team on my meetings and I told them about the incident with Stephen. Subsequently, it was decided by the senior executives that Stephen would no longer be involved in the project."

1168. Mr Wilson said in essence that, whilst he did not refuse to undertake the task, he could not see how reasons other than the real reasons – projected NPPC increases – could be generated:

> "I was tasked with the creation of a Trustee negotiation strategy and business justification for each of the options being considered. I found this difficult as it was not apparent to me in the meeting what the justification would be other than the increases in NPPC IBM was facing, with the resultant effect on EPS, and the associated concern about future volatility of pensions costs. We debated for some time the potential other justifications such as IBM UKI business performance, and particularly how the business had progressed since the Soto changes. However the facts as I saw them at the time did not support a view that the business had materially deteriorated since the time of Soto…. The problem as I explained above is that I could not at that moment see what grounds there were for change other than NPPC resulting from the financial crisis. I was certainly frustrated, as I felt I was being given a task that I simply could not see at that time how to complete. My recollection is that we parked the point and Larry said he would give it further consideration and come back to me."

1169. Having heard Mr MacDonald, Mr Koppl and Mr Wilson in cross-examination, and taking account of Mr Hirst's witness statement (taking what he said with caution in the light of his non-availability for cross-examination), I am left with no real doubt that Mr Wilson's approach to the pension changes sought by CHQ formed a significant part of the decision to remove him from his role as CFO of Holdings. I do not say that it was the only reason; but I doubt that he would have been removed if the pensions issues had never arisen.

1170. The way in which pensions were perceived as part of the IBM enterprise within CHQ is perhaps encapsulated by a pensions presentation given to Mr Palmisano on 5 December 2008. The RBs' opening contains a description of the slides which I include with some comments:

i) The first slide recognised that "Most (86%) of the dollars of liability [in IBM's DB plans] are attributable to those who are no longer earning service credit under the DB plans - 70% is attributable to those who have left IBM". Similarly, slide 32 explained that "74% of participants no longer earn service cost but have 86% of liability and drive volatility". The percentages for the UK were different. The slide does not show the percentage of participants who are actives, but it shows a liability for participants no longer earning service of under 70%. Accordingly, Mr Tennet says that by making changes to the accrual of DB benefits in order to address volatility and overall cost, IBM would be placing the burden of volatility on a comparatively small percentage of (active) members. I agree with that as a matter of fact.

ii) The first slide also noted that Lazard had said "Essentially when an investor buys IBM he buys an operating unit and an investment unit". No-one has suggested that that is unrealistic. It showed that Wall Street appreciated the pensions schemes could be capable of generating income for investors: they would expect IBM to achieve returns if that were possible. Certainly, investors would take account of investor presentations so that, if such a presentation projected a contribution from the pension plans of a particular level of contribution to EPS, that would inform an investor's investment decision. Further, as a matter of fact, the size of IBM's pension funds meant that they played a significant role in IBM's performance. As slide 50 showed, IBM's pensions assets were worth 66% of its market value and its pension equity assets were worth 34% of its market value.

iii) The importance of IBM's pensions plans overall was well recognised: thus in slide 1, which relates to the then current state of affairs, one finds this: "The pronounced volatility of the massive liability and related assets has a profound impact on the financial performance of the business". And in slide 2 setting out the November

2008 forecast of retirement related costs: "DB is volatile but contributes income to earnings" in contrast with DC which has "steady cost and cash". Of course, things can change; the DB Plans could not go on producing income for ever but they could be managed in such a way that NPPC was kept to a minimum and EPS was thus maintained and increased.

iv) DB accrual would not, at that time, have played a major part in cost volatility. Slide 3 explains: "Each year service cost increases the pension liability by 0.8%. Ending service cost would cap the liability… The large liability and supporting assets is the source of pension cost volatility". What the RBs seek to draw from this is that ending DB accrual was not the rational way to address the underlying investment issues. I would not disagree that it could not be seen as the complete solution but I do not understand why it can be said to be irrational to seek to contain every element of cost not least because of the volatility in the cost of funding future DB accrual however small a percentage that may be. Subject to the impact of the statements on which the RBs rely in their case on the *Imperial* duty, it seems to me to be a perfectly rational (in contrast with fair) approach to seek to contain pension costs if there is a commercial agenda which dictates that course. Whether a rational approach would also have dictated an entirely different investment strategy is another question; but the need for a different investment strategy, if that need can be demonstrated, does not make irrational a policy of reducing the continuing cost of accrual.

1171. KPMG produced their report on 19 December 2008 and sent it to CHQ and the UK team. It considered various permutations of four changes to UK DB members' benefits: a compulsory move to DC accrual, a voluntary move to DC accrual, a cap on DB pensionable salary increases, and changes to early retirement policy. It also considered what the effect of a change in investment strategy, prompted by such measures, would be. The tables prepared show that, adding the I Plan and the Main Plan together, UK NPPC was still projected to be below IBM's service cost until 2012 and would generate a net profit for IBM up to 2012.

1172. The RBs' written opening submissions suggest that CHQ's view was that equity values would bounce back in the short term. It may have been Mr Greene's view that they would do so on the basis that "equities generally recover quickly". Given KPMG's projections about NPPC and service cost, and given the (asserted) view of CHQ about equity recovery, it is submitted that it is hard to see how CHQ could have seen the pensions costs of the UK DB Plans as unsustainable either in the short term or the longer term. I do not follow this particular submission since IBM's concerns about sustainability were more about the NPPC figure than absolute cost.

1173. It is then said that, had there been any doubt about this, IBM could have waited to see how matters developed. I will return to this "wait and see" contention later, see paragraphs 1426*ff* below.

1174. Further discussions went on within CHQ. I will not relate them all. I note, however, that on 20 January 2009 Mr Ferrar sent his "Sapporo UK Next Steps" slides to Ms Middleton, Ms Roin, Mr Koppl, Mr Michaud, Mr Wilson and Ms Duff (Dickinson Dees) for the call that day. The slide for that presentation contains a paragraph headed "Design high level road map of implementation for each option". There were only three options: (i) "Mandatory move to DC"; (ii) "Voluntary move via pensionable earnings freeze (+ ER [early retirement] subsidies + DC offered)"; and (iii) "Voluntary move via Total Comp approach (+ ER subsidies + DC offered)". Doing nothing was not an option; indeed, there was considerable pressure with "Design implementation team (20 Jan through 9 Feb) – prepare to launch formal 'Sapporo implementation' 12 Feb (HR, finance, legal, comms etc)".

1175. Whether or not a final decision had been taken by this stage is not entirely clear and it does not matter. But what is relevant to note is that the drive was towards implementation of one of the options (or a combination). The options were not tempered by any consideration of local conditions. In the UK, the drive for pension changes at this stage had nothing to do with the performance of the business of IBM UK or with any need to address IBM UK's own financial position whether in relation to its PTI, PTI margins or otherwise. Instead, according to the RBs, there was a global drive for pensions change targeted on IBM's largest DB schemes, irrespective of the performance of each of the regional businesses, in order to make global savings to meet EPS targets. The only question that remained was what IBM could in fact implement in the UK, taking into account legal and administrative considerations. Although, ultimately, I agree with that assessment, the story so far is not the end of the story and I must continue.

1176. CHQ, it is appropriate I consider to infer, did not want any dissenting person to be involved in the process after this. I have already explained CHQ's perception of Mr Wilson. He was removed from discussions relating to changes concerning the UK Pension Plans on 22 January 2009. He declined redeployment to Shanghai and left IBM on 9 April 2009.

1177. IBM then started once again (if it had not already started) to play hardball. On 28 January 2009, Mr Koppl sent an email to Mr Greene. It informed Mr Greene that Mr MacDonald had "put on hold on all compensation increases in the countries that are involved in the DB redesign work. This could make a big difference in getting the DB projects done."

1178. At the beginning of 2009, Mr Loughridge presented his "Financial Model and Roadmap" to the IBM internal Integration & Values Meeting, a gathering of the 300 or so most senior executives in IBM. The presentation demonstrated that IBM's underlying business was doing well. In particular it was "On Track to Achieve 2010 EPS Roadmap Objectives". The only real concern, as it appears to me, seemed to be that the pensions element of the 2010 EPS Roadmap might not be achieved: that concern arose not out of the operation or performance of the underlying business but out of the divergence between the actual and projected performance of financial markets.

1179. Mr MacDonald, Mr Castellanos and Mr Koppl came to the UK at the beginning of February 2009 for further meetings with the UK team. It is clear from internal communications that IBM regarded the discussions as very important. Its hard-line stance is demonstrated by Mr Michaud's "Project Waltz" charts provided to Mr MacDonald, Ms Salinaro and Mr Castellanos:

i) The "Critical outcome for CHQ team" at the earlier meetings in November 2008 had been "to agree on the menu of options to be assessed and ensure that it included the most aggressive scenarios".

ii) There were now three options on the table. A mandatory move to DC accrual was "Not cost optimal" and would be perceived as "the most aggressive" course whereas "Pensionable earnings and early retirement subsidies" had "Significant potential".

iii) Slide 6 set out the expected position of local management. The Trustee would strongly resist a mandatory move to DC accrual. The "Early retirement subsidies" (*ie* the beneficial actuarial reductions) were perceived as the most contentious with the CFO (Mr Wilson) who "resists removing consent for early retirement subsidies". It is to be remembered that he had by now been removed from the discussions.

1180. The night before the meeting, Mr Ferrar circulated a "complete presentation of UKI business background, business challenges, pension background, current demographics, financial analysis, legal input and implementation & communication considerations for the total UK Project Waltz." It is clear to me from these slides that the result of the meeting was, within certain parameters, a foregone conclusion: one or more of the three options taken forward from the November 2008 meetings would be adopted; indeed, one slide set out a timeline for the implementation of options 2 and 3.

1181. The meeting took place on 4 February 2009. According to Mr Koppl's note, it was attended by him, Mr Riley, Mr MacDonald, Mr Castellanos, Ms Salinaro, Ms Middleton, Mr Jagger (KPMG) and Ms Duff.

1182. By this time, to repeat, the options under consideration effectively fell into three broad scenarios. Mr Simmonds puts them as follows (and I record in the cases of (i) and (iii) Mr Koppl's description in his note of the meeting of the headings under which the discussions took place):

i) a mandatory move to DC accrual;

ii) freezing of pensionable salary and a restriction on early retirement (Koppl: freeze plan pay now. Effective date later. Early retire); and

iii) a total compensation approach to determine employee pay increases for pensionable salary and a restriction

on early retirement (Koppl: Increases non pensionable). [These descriptions are different: IBM was against a total compensation approach, regarding the making of salary increases, in part at least, non-pensionable as more robust for the future.]

1183. At this meeting, these three options were agreed (subject to IBM obtaining legal advice, in respect of which privilege has not been waived). Mr MacDonald also directed that an implementation plan be worked up in readiness for a further review meeting to be held on 3 March 2009. It was recognised that there were risks involved, not least the fact that the Trustee had the unilateral right to change the asset allocation (which, in turn, would affect the contributions payable by IBM).

1184. After the meeting, a presentation was produced to record the position reached and to set out the way forward. The second slide is headed "UK Pension Actions – Randy MacDonald/Brendan [sic] Riley". It refers to the "Cost reduction - 3 plays agreed". There was a separate sub-heading "Volatility Reduction", the only identified measure being deferred member voluntary buyout.

1185. The slide also set out a Work Plan. Mr Michaud and KPMG were tasked with the "Cost analysis of 3 plays combined"; Mr Ferrar and Mr Koppl were tasked with "Prepare business justification"; and Mr Ferrar alone was tasked with "Develop Trustee negotiation strategy".

1186. The RBs suggest that the second of those was an explicit recognition that to date no business justification had been formulated, despite the decision to proceed. Whether or not that was the case, I do not think that the words on the slide indicate the correct answer. The need to develop the business case does not mean that it had not been formulated and considered by CHQ. It is one thing to know in outline (or even with a fair measure of detail) the business case; it is another thing to articulate it and to prepare detailed presentations in order to inform interested persons of that case and to persuade them of its validity.

1187. Within this chronology there is an email dated 4 February 2009 from Ms Salinaro to Mr MacDonald. There has been some attempt by Mr MacDonald to distance himself from some of the things which Ms Salinaro has said on other occasions, but I have no doubt that the sentiment she expressed in this email was shared by Mr MacDonald. It really reinforces the view which Mr Koppl expressed about Mr Wilson's alleged outright refusal to analyse alternatives (see paragraph 1167 above). She wrote:

> "I briefly spoke to Jane given my amazement at the difference in mindset vs. previous pension discussions. Things that we had been told in the past were not doable are now doable. She indicated that it is the new leadership and who was in the room -- I interpreted that as the fact that it was key to remove Steven Wilson and Larry Hirst from the discussions -- I inferred that they were directing the rest of the team on what had been said. It will be important for us to limit Steven's and Larry's knowledge of what we are analyzing. I fear that they will work against this initiative behind the scenes with Jim Lamb et al.-- of course I have no facts, but I think it is a concern that we need to figure out how to protect against.
>
> Had Steven Wilson been in the room today it would have been a very different meeting."

1188. I agree with Mr Tennet when he says that this email expressly acknowledged that CHQ's approach was not to debate the need for the changes with the UK team, but to remove from the process those perceived to oppose the options CHQ were championing (thus also removing a senior member of the UK Waltz team who had experience of the Ocean and Soto Changes).

1189. On 6 February 2009, Mr Murphy (UK HR) was announced as the Project Leader for Waltz in the UK. He then took charge of driving forward the Waltz proposals.

1190. A further review meeting took place on 3 March 2009. The persons attending were Mr MacDonald, Mr Castellanos and Ms Salinaro in the US and Mr Riley, Mr Ferrar, Mr Murphy, Mr Michaud Mr Koppl, Ms Middleton, Ms Duff, Mr Jagger (KPMG) and Mr Hastie (KPMG) in the UK. At that meeting, Mr Ferrar summarised the proposals which, by that stage, were being made by the UK management. In short, they were:

i) closure of the Plans to future DB accrual on either 5 April 2011 or 5 April 2012;

ii) no further pensionable salary increases for the Plans up to closure;

iii) restriction on the approval of early retirement requests from 6 April 2010;

iv) an early retirement separation programme "window" would be opened to allow up to 600 employees to leave on the existing early retirement provisions plus a cash lump sum in the first quarter of 2010; and

v) at the time of closure of the DB section, members would be eligible to join the DC section (not the Enhanced M Plan); but

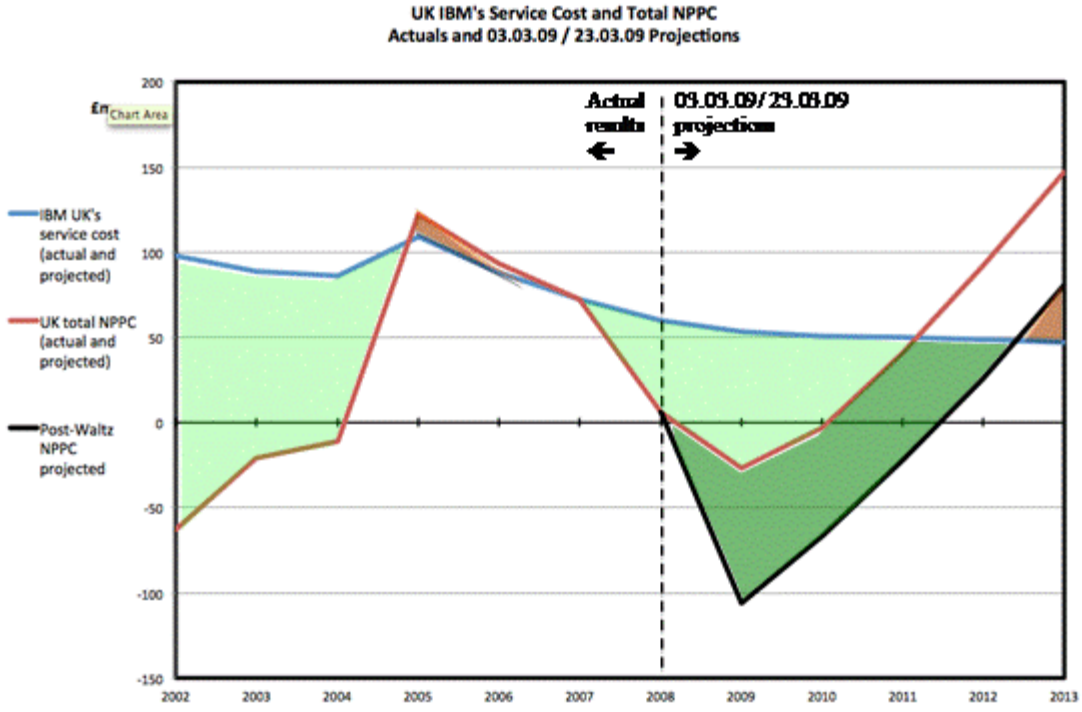
vi) it was noted that employees were entitled to leave their existing DB Plan before the planned date of Plan closure and in doing so would be entitled to statutory revaluation (*ie* pre-retirement indexing) of their deferred pension. IBM clearly did not like that: it was observed that IBM could "proactively restrict access to the IBM DC Plan for those who do this. They will also not be entitled to enhanced early retirement terms if they take this path".

vii) There were proposals relating to the employee salary programme which were intended to smooth the implementation of the proposals. These involved an increase in DC contributions to the M Plan (and also, outside the Plans, the initiation of an employee share scheme with limited coverage).

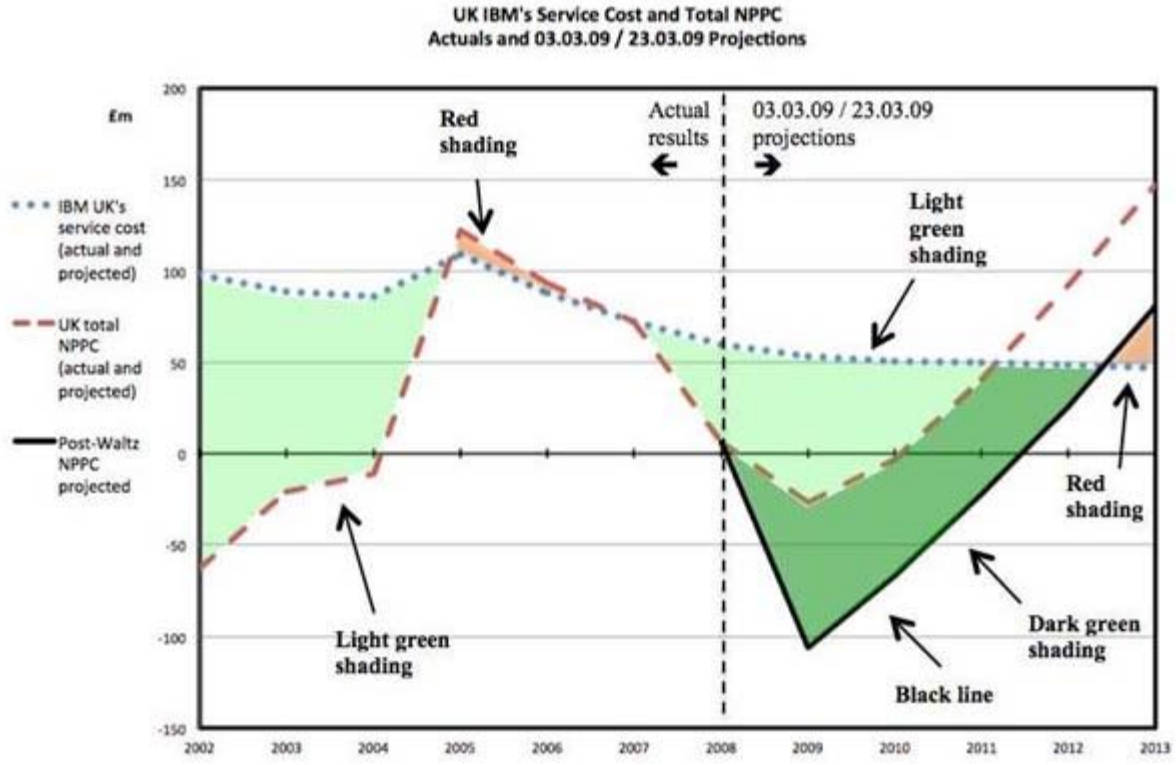
1191. The slides for the meeting considered the I&E savings which might be achieved by the changes. The figures had changed slightly since KPMG's December 2008 projections. Full year I&E savings in 2010 would be in the region of £85m. £37.5m of the savings would come from "salary cost savings" from those who were encouraged to leave through the "early retirement window". Pension costs savings (which did not include salary savings) were as follows (this chart appears in the RBs' written opening and is based on data extracted from other documents: its accuracy has not been challenged by IBM):

Main Plan and I Plan (£m)	2009	2010	2011	2012	2013	Total
IBM's service cost base case	53	51	50	49	47	250
NPPC base case	(27)	(3)	41	92	147	250
Waltz projected savings	(79)	(64)	(63)	(66)	(66)	(338)
Post-Waltz total pensions expense / (income)	(106)	(67)	(22)	26	81	(88)

1192. The RBs' written opening also includes the following chart. It is a useful presentation of the material in the presentation and is helpful in the exposition of the RBs' case concerning the need for the Project Waltz changes at all. As that opening explains, the chart, using the figures in the presentation of 3 March 2009, plots the projected post-Waltz pension income and expense as a black line (together with actual NPPC for previous years). The light green shading shows the extent to which NPPC was already lower than IBM's Service Cost (with the red shading showing those instances where IBM's Service Cost exceeded NPPC). The dark green shading shows how Waltz was projected to reduce NPPC even further below IBM's Service Cost.



(For the reader viewing this in black and white the following chart explains the colouring)



1193. There is a further point which needs to be made which indicates one element in IBM's thinking at the time. Prior to the meeting, Mr Michaud had explained (in an email dated 3 March 2009) to Mr Castellanos and Ms Salinaro that Enhanced M Plan members would not be subject to a change in contribution rates, or to the non-pensionability of their salary increases for purposes of the accrued DB rights. He said that one reason for this beneficial treatment was that "this group made a voluntary choice in support of IBM's direction for pension and that their deal was contractually agreed". He seems to have overlooked, or perhaps he did not know, that at the time of Soto IBM was careful not to express a preference for DC accrual; members were not cautioned that if

they selected to continue DB accrual they might be more likely to be subject to further change than if they selected DC accrual.

1194. It seems that a decision was made between the CHQ representatives and the UK team at the meeting on 3 March 2009 on the final shape of the Project Waltz proposals for formal approval by CHQ.

1195. On 10 March 2009, IBM received from KPMG their paper "Early retirement analysis". This showed, for the first time, the real impact of these changes on individual members of the Main Plan. One of the figures it gave was the approximate value of the expected loss (*ie* a capital value) as a percentage of income (with the loss varying significantly by individual depending of age, service, earnings and section of the Plan). Members could lose over twice as much as their annual earnings (in the case of N plan members in the upper quartile) with a minimum of 73% (in the case of C plan members in the lower quartile). This analysis does not appear to have caused CHQ to review the appropriateness of the proposed early retirement changes (although it is not difficult to conclude that it would have not led to any change in the proposals even if CHQ had done so).

1196. IBM well understood that the proposals, if implemented, could well have an effect on the Trustee's investment decisions and its approach to asset allocation. Accordingly, how to handle negotiations with the Trustee needed to be addressed. As part of that process, KPMG prepared a presentation on 11 March 2009 sent under cover of an email the following day titled "Waltz – straw man trustee engagement". Mr Tennet submits that the contents of this document provide only an *ex post facto* rationalisation for the decisions made and not the reasons for those decisions. The real reason for the change was IBM's concern over its NPPC and EPS targets. The paper, however, obscures the real reason and sought to engineer an entirely different perception. Thus the Key elements section at the beginning of the paper contains a heading "Case for change":

> "• A robust rationale for change will be needed for trustee and employee engagement/communications that demonstrates that ultimately the action being taken is in the best interests of both the business and its employees and therefore pension plan members
>
> • Develop a comprehensive story board that contains collateral supporting the case for change and is used as a reference point for consistent messaging to all stakeholders"

"Story board", Mr Spink wryly comments, is an entirely accurate description of the business case presented in this paper, a story which the RBs regard as spurious.

1197. The paper also suggested some tough negotiation tactics. There is nothing inherently wrong with that, in particular in presenting initial proposals which give room for concessions or where win/win can be achieved. However, the RBs make this submission about that approach: Planned concessions could only be a justifiable tactic if IBM actually intended, were it able to negotiate it, to implement the full extent of its initial stance. As a matter of general application in the business world, I do not think that can be right.

1198. But in the context of a situation in which duties are owed by the parties to each other – in this case the *Imperial* duties – and in the context of IBM's own Business Conduct Guidelines and Core Values, there is clearly something in the point. In fact, the proposal put to the Trustee and on which IBM consulted was to close the DB Plans in April 2010, despite the fact that IBM never had any intention to do so. It had already decided to close from April 2011. The only other date under consideration by February 2009 had been April 2012. I shall return to this point later.

1199. CHQ approval of the details of the proposals which had been under consideration was given on 23 March 2009. The meeting to obtain this approval – in practice from Mr MacDonald – was a phone call. Mr Ferrar had sent a presentation for that call to Mr MacDonald, KPMG and the UK team shortly before the meeting. A number of decisions were sought from Mr MacDonald. One of the approvals sought was to "brief the Board of Directors of IBM UK Holdings". One might think – the RBs certainly do – that this is a pretty clear indication of where the proposals were coming from and by whom they were being driven, namely CHQ.

1200. Mr Chrystie visited London for a week in late March 2009 as part of his preparation for his new role as CFO of

IBM UKI in succession to Mr Wilson, a position he formally took up on 24 April. It seems that he had had some sort of briefing about pensions at a meeting with Mr Greene in Armonk some time in mid to late February, but nothing turns on that. On 2 April 2009, he sent an email to Mr Riley thanking him for the welcome he had received in the UK and expressing his confidence in relation to his role on the operations side. I set out some of that email:

> "…. the anxiety that i feel is reserved for the pension situation....
>
> to be specific, and as we discussed the other night, i was working under the impression that i could actually speak with some folks on the team about this - at least to develop an historical perspective. given that stephen is not disclosed and david newman apparently is "conflicted", it's been a little lonely..... …..
>
> here is the reality.... pensions is a specialized skill within the finance community and i could only be considered a novice involved in a hugely important issue for the ibm company. so, i am meeting with jesse today to discuss 3 primary things....
>
> 1) help in the construction of a case for change. i mean, we can't walk into this meeting and just declare that we want to make a change because we want to - it must be framed
>
> 2) i need to understand what the negotiation strategy is and who are the players. last time, randy was directly involved. like you, i am happy to stand in front of the train but given the importance of this issue to the ibm corporation, we need to know who is going to do what to who and we might need some heavy hitters.
>
> 3) i need to better understand my "unique" role in this process. specifically, i expect that i will be on the board while also being the cfo. i am struggling to understand the balance that i am expected to have between my board role and the uki cfo
>
> in building this case for change... we will explain that the financial position of the pension has deteriorated (like every other company) and in order to support the liabilities of the plan we feel the need to reform the structure. my concern here is that the trustees could have an emotional response to this as they believe that ibm talked them into staying more heavily invested in equities and this is the reason, not the structure, that we are under funded.,… to me, it's critical that we take the conversation to a higher level and attempt to relate the changes the to the uki business model. what i mean to say is that we should articulate that the economics of the current db plan are inconsistent with a major market imt that has to deliver >10% pti growth on small single digit revenue. said another way, illustrate that the projected db growth (existing scheme) does not support our need to drive year over year productivity improvement. in point of fact, ibm is pursuing pension changes to most of the major market imts this year.... i am not certain how comfortable the chq guys will be allowing us to share the business model discussion but i think it's important.
>
> further, we should be able to develop a line of logic that points out the inequity (80% of benefit to 20% of population) that the existing db plan drives. having a fixed element of award/compensation that is this large would seem to be inconsistent with other elements of ibm pay / reward model. finally, there is nothing wrong with looking at what the team developed the last time these changes were proposed.... perhaps there are supplemental arguments we could use again."

1201. All very prescient, one might say, but it did not turn out to be the open process which Mr Chrystie there envisaged.

1202. Mr Tennet relies on this email to demonstrate that the business case had not started to be developed and formed no part of the rationale for the decision which had been made. I agree that that is so in relation to the operational aspects which formed part of UKI Transformation later sought to be relied on as part of the local strand, a conclusion reinforced by Mr Riley's reply to this email ("we can start to move into implementation mode – but

this will start probably with an all day planning meeting to start to build the case for change"). But I do not think that the same can be said in relation to the impact of CHQ's need to meet the EPS target. Although Mr Chrystie expressed it as a matter of the UK business model, he saw the need to articulate that IBM UK "has to deliver >10% pti growth on small single digit revenue": that requirement stems precisely from CHQ's need.

1203. It appears that, on 8 April 2009, there was a meeting/call between Mr Murphy, Mr Chrystie, Ms Middleton, Mr Scott, Mr Koppl, Mr Jagger, Mr Hastie and Mr Ferrar. The next day, Mr Murphy sent an email to all of those individuals thanking them for the productive meeting and setting out an action list as he had captured it. Mr Chrystie was tasked, under the section headed "Story board "Case for Change Charts"" with "Comparison of IBM market models, recent performance vs. model, 2-3 year outlook, productivity/expense issues, consequences if targets not met". His response to that task came on 16 April. His covering email said pithily "best I have for now". The response consisted of six slides which included these:

i) The first slide compared recent UKI performance with the IBM Business Model, and noted that although "UKI revenue performance has been in line with business model", "PTI growth is neither better than balanced nor in line with annual growth objectives". It did show, in any case, that both Revenue and PTI had grown since 2007.

ii) The second slide ranked IBM UKI with 10 other selected IBM regions in terms of its PTI margin, and its Business Mix Adjusted PTI Margin. Even after the mix adjustment, the UK remained in the lower quartile.

1204. Shortly after that, Mr Chrystie was informed that an even higher target was being imposed on the UK, increasing profit by $700m plus by 2012. Mr Ferrar considered that this helped UK's case for change; and Mr Chrystie thought that he might want to "use this as the backbone…so I need to develop this". This change in target came only after the UK team thought that it had reached agreement with CHQ about the Project Waltz changes. It certainly did not reflect any shortcoming in the UK business.

1205. On 22 April 2009 Mr Ferrar sent to Mr Castellanos "a final plan of the company's proposal for Waltz. This includes the decisions made, the proposal, I&E impact and implementation timeframes". A few hours later, Mr Castellanos confirmed "you are good to go. Good luck!". Mr Ferrar then announced to the UK team "To you all as the core Waltz project team, we have formal corporate approval to proceed". What of UK board approval? One is left to wonder.

1206. On 24 April 2009, Mr Murphy sent an email to a number of people including Mr Chrystie, Mr Ferrar and Mr Koppl. It recorded a list of calls/meetings over the next two weeks which had been considered at a meeting the day before. The impending meeting of the board of Holdings was referred to as "Holdings Board Briefing".

1207. On 27 April 2009, Mr Ferrar sent to Mr Riley a draft briefing paper for an upcoming discussion with Mr Lamb now fixed for 1 May 2009. It confirmed that the Project Waltz Proposals were going ahead:

> "Full approval received via Federico Castellanos on 22 April. In addition to the pension actions and the green light to initiate Trustee discussions these approvals include the DC Plan change to a matching scheme for all employees w.e.f April 2010…and approval of the early retirement window."

1208. The draft briefing note then set down a list of points to be told, and points <u>not</u> to be told, to Mr Lamb. Mr Lamb was to be told that "we intend to close the main DB Pension plans to future accrual in April 2010". It was however clear that IBM had no such intention. The RBs say that any such statement would be dishonest. The Trustee was also to be told that UK "profit is declining". The RBs say that too was untrue: even Mr Chrystie's own recent figures showed that revenue and PTI had improved since 2007.

1209. A meeting of the board of Holdings was fixed for 7.45 am on 29 April 2009. Mr Ferguson had originally put a 45 minute slot under AOB "to discuss Project Waltz".

1210. The board members were informed of the meeting on 20 April and that the purpose of the meeting was to "brief you on important changes proposed to the IBM UK pension scheme (Project Waltz)". The Agenda and Presentation (the slides were prepared by Mr Chrystie) were sent to them on 28 April, late in the afternoon. Mr

Tennet tries to make something of the fact that it refers only to a "presentation" and "discussion" of Project Waltz and does not refer to the requirement for a decision to be made. I do not attach any weight to that: it is a perfectly ordinary occurrence for an agenda of a meeting to refer to a topic for discussion in the expectation (without express mention) that a decision will be taken.

1211. Included in the slides was one showing UK DB Pension Cost/(Income). That shows a Measurement Adjustment (as to which see paragraphs 1084*ff* above) of £36m effectively increasing the cost of pension provision.

1212. The board of Holdings formally approved the proposals at the meeting. The only members of the board who in the end voted were Mr Riley, Mr Chrystie and Mr Ross. So far as the actual decision of the Board is concerned, the RBs' case is that this was simply a rubber stamp. The real decisions had been made by CHQ with the UK team, more or less reluctantly, agreeing. They rely on what was said and done before the meeting. They say that the references to "briefing" which I have mentioned above were entirely accurate. Mr MacDonald accepted that the slides and emails appeared to give that impression. And Mr Ferrar said, Mr Riley wanted "to bring them [the Board] up to speed" and:

> "….the board meeting was important to get the buy-in and the understanding of the senior management team, that is what Brendon wanted to do with the board meeting. He wanted to get them on side with aspects, and all aspects of what we had to do."

1213. Both Mr MacDonald and Mr Ferrar said in their oral evidence that they would have been "astonished" if the board had not voted in favour of the proposals and Mr Riley went as far as to say that it was inconceivable that there would have been a different result; he did not, however, accept that the decision of the board was simply a rubber stamp. Mr Ferrar, moreover, said in cross-examination:

> "I don't think it was part of the corporate decision-making process. I think Brendon wanted to do it to make sure his senior management team was on board …"

1214. Reliance is also placed on what is said to be a subsequent description of the purpose of the Holdings board meeting. By email on 28 April 2009, Mr Chrystie told Mr Riley that he was trying to arrange a meeting "to walk you through these charts that I would propose to pitch at the leadership meeting this week … it is really just advising them of the direction that we are trying to move in". So far as I can see, that did not relate to a board meeting; it related to a suggested leadership team meeting, the composition of the board and the team being different. Thus, the slides which were sent with that email for the leadership meeting were different (although there was some overlap) from the slides forming the presentation of the board meeting.

1215. Mr Tennet relies on Mr Riley's report to Mr MacDonald of the board meeting: in an email (subject line: "The dance has begun….") sent on 1 May 2009, Mr Riley wrote:

> "We had two important meetings this week. Firstly with the Directors of IBM UK where there was a robust discussion on how we communicate and manage so Walz [*sic*] is successful. We agreed to schedule an all day meeting Saturday May 16th with an agreed set of core executives to build the case for change and solicit commitment to implement….."

1216. The presentation consisted of 17 slides, in effect an "executive summary" of what had gone before and in particular of the material presented at the meeting on 23 March. It was an overview of the project and the communication strategy. It clearly had its origins in the KPMG "storyboard", adopting KPMG's suggestions on how the pensions changes might be justified.

1217. It was Mr Riley who actually presented the proposals to the board. He says that he explained the justification for Project Waltz as set out in detail in section 6 of his witness statement. In summary (taken from IBM's written opening) he explained that IBM UKI was not achieving its relative or absolute business objectives and was becoming less relevant within the worldwide business from a profitability perspective, there was an imperative to improve the profit contribution margin to 34% (from a mere 23%) by the end of 2012, there had to be sustainable improvement regardless of economic conditions, all areas of costs had to be considered, there was a

marked inequality between DB and DC members (in that DB members represented a minority of the workforce yet accounted for a disproportionate chunk of the company's pension costs), and the risk and volatility of pension costs had to be mitigated (not least through stopping the growth of DB liabilities).

1218. That is to some extent confirmed by the minutes which record the following as having been given "extensive consideration":

> "IBM UK's low (and declining) profit contribution to its ultimate shareholder IBM Corporation, the interests of IBM Corporation shareholders; IBM Corporation's requirement that IBM UK meets the business model objectives set by IBM Corporation; IBM Corporation's strategic move away from defined benefit pension scheme and towards defined contribution schemes; long term prospects for IBM's business in the UK; IBM's continued commitment to investment and employment in the UK; the interests of IBM's employees; the desirability of greater parity among IBM UK employees in terms of pension benefits; increased and increasing pension costs; risk and volatility in pensions investments and funding; general and competitive market trends and ongoing economic uncertainty."

1219. There is no record there, however, of any discussion of NPPC or of the 2010 EPS Roadmap. There is no record of any explanation having been given of how precisely the proposals before the board would achieve the objective of meeting "the business model objectives" and no record of the nature of (let alone conclusions to be drawn from) the risk and volatility which was discussed. There is no record of any mention of CHQ's direction that retirement related savings be made as a matter of urgency to safeguard the 2010 EPS Roadmap. Nothing was said about CHQ involvement in the process.

1220. Mr Riley was taken by Mr Stallworthy to the slides and acknowledged that there was no discussion on them of the EPS targets or the 2010 EPS Roadmap that had to be met and the need to make short-term cost savings to meet them. He said, however, that he certainly recalled them being discussed in the meeting; I accept that. And he said that confirmed that the UK board would have been familiar with the 2010 EPS Roadmap, a proposition which I am sure is correct. However, there was, in fact, reference on the slides to the "IBM financial model May 2007" which Mr Riley said (and I accept) was a reference to the 2010 EPS Roadmap. There was no mention of the possibility that the proposals might be inconsistent with any assurances which had been given by IBM to the Trustee or to members in the context of Project Ocean or Project Soto.

1221. Mr Tennet sees Mr Chrystie's testimony about the board meeting as incredible. In taking that view, Mr Tennet effectively rejects Mr Chrystie's evidence about his perception of the dual motivations for the pension changes, what Mr Simmonds has developed as the global strand and the local strand and the focus which he had on the UK aspect of that dual motivation.

1222. Having received oral evidence from Mr Chrystie for well over a day, I have formed the firm view that he genuinely held the view that there were two motivations and, more importantly for present purposes, that his focus was on the UK aspect. By concentrating on what he saw as the UK aspects – the business case for change which he saw as the CFO of Holdings - he may have lost sight of what was really (on one view, exclusively) driving the changes (that is the commitment to the 2010 EPS Roadmap and the need to reduce NPPC) and in doing so may have failed to question and challenge the need for CHQ to take the line which it was taking. He may be criticised by the RBs for taking the approach which he did. But in my view, it is not fair to say that his evidence was incredible. As evidence, I think it was true: it shows what Mr Chrystie did and explains why he did it. His reasoning may, to some extent, not stand up to the close scrutiny to which Mr Tennet has subjected it; but that it was genuinely believed by him at the time, I do not doubt.

1223. I should, nonetheless, deal with one particular section of his cross-examination relied on by Mr Tennet. During the course of questioning on this aspect of the case, Mr Chrystie explained that he "went ahead and presented the local strand in the way that I thought would be most identifiable to the board". At that stage, I asked a question and the cross-examination went on:

> "MR JUSTICE WARREN: Shouldn't they be informed of everything at a voting meeting? Isn't that

rather important, if it is a vote rather than simply a discussion?

A. Perhaps. Perhaps so.

MR TENNET: Surely it is kind of relevant that the country general manager has already agreed this back in February and March with CHQ?

A. I don't know that Brendon didn't discuss that with the members. I wasn't aware when he had that discussion.

Q. But it is not mentioned in this –

A. It is not. It is absolutely not.

Q. That is all completely explicable if this is a preview of a communication strategy. It is inexplicable if this is intended to be an *ab initio* board decision on whether to proceed or not. That is right, isn't it?

A. I would accept that we could have mentioned earnings per share as one of the dual motivations, yes.

Q. I suggest to you that you would have mentioned it.

A. Pardon me?

Q. I am suggesting to you that, had this been a full voting decision of the board, you would have mentioned it, not that you could have mentioned it.

A. Why would I have mentioned it?

Q. Because it is plainly relevant to their decision.

A. I should have mentioned it, yes."

1224. Mr Tennet relies on that passage to support his argument that Mr Chrystie and the board understood that what they were seeing was a communications strategy, not a document on the basis of which the Board had to decide whether to accept or veto what had already been agreed with CHQ. I do not agree with that argument. I am satisfied that Mr Chrystie was presenting what he saw as the local business case. It may have been a flawed or incomplete case; and it is, I think, correct that he ought to have mentioned EPS as one of the motivations for the proposals. But neither of those points leads to the conclusion that this was simply a meeting concerned only with a communications exercise.

1225. Mr Tennet submits that, whatever Mr Chrystie's own understanding, the Board well understood that it was receiving nothing more than a preview or 'briefing' of the communications strategy. He says that that is the only sensible explanation for why the slides made no mention whatsoever of CHQ's involvement or its directive that retirement related savings had to be made to safeguard the 2010 EPS Roadmap. The fact that the slides set out the "business justification" for the changes did not mean that the Holdings board was independently deciding to implement Project Waltz for reasons different from CHQ.

1226. I do not agree with this argument either. I do not dissent from the proposition that the communication strategy was one of the matters considered. But I am satisfied on the evidence that the board was presented with a business case. Not only was the UK business case considered, but also, in my view, the board were aware of CHQ's involvement and the need to make retirement-related savings in order to assist in meeting the 2010 EPS Roadmap. I reject the RBs' submission that the global strand was not considered by the UK board.

1227. IBM has, in any case, several responses to this. Thus, Mr Riley gave evidence, which I accept, that he had individual discussions with the board members in the lead up to the board meeting, during which he explained to them that CHQ required the changes to ensure that the 2010 EPS Roadmap was met. Mr Riley recalled that the 2010 EPS Roadmap was discussed at the meeting; in that context, as already mentioned with reference to the IBM 2010 financial model of May 2007, in the slides was a reference to the 2010 EPS Roadmap; and he confirmed that the UK board would have been familiar with that roadmap. I accept that evidence too. Finally, the minutes referred to the following as relevant considerations noted by the board:

> "…the interests of IBM Corporation shareholders; IBM Corporation's requirement that IBM UK meets the business model objectives set by IBM Corporation"

As to that, Mr Chrystie confirmed that this referred to CHQ's external EPS commitments.

1228. Although the presentation did not refer to the imperative of meeting CHQ's NPPC concerns, the board did know of the requirement of CHQ to increase profit margins from 23% to 34% by the end of 2012. The presentation showed how pension savings were to contribute to that. It may have been as certain as can be that the board would decide to adopt the proposals because that was what was required to enable Holdings to meet the profit margin requirement and because Mr Riley and Mr Chrystie (both voting at the meeting) knew the full picture and the practical impossibility of going against CHQ's decision. But this does not mean that the board meeting was nothing more than a briefing session and the occasion for developing a communications strategy.

1229. Mr Tennet notes that, after the consultation was completed, no one felt the need to bring the pension changes back before the Holdings board for a final decision about what to do in the light of the consultation and for approval of the variations to the proposals which had previously been shown to the board on 29 April 2009. In the event, and without any further involvement of the board, CHQ (in the person of Mr MacDonald) gave approval to proceed with the "plan to close Waltz" on a conference call on 9 September 2009 which I will come to. This, he submits, shows that the board had no decision-making function in the eyes of CHQ at this time and is a further demonstration that its "decision" at the board meeting on 29 April 2009 was no more than a slavish following of CHQ's directive and not, in reality, the exercise of its decision-making function at all.

1230. I do not agree. There is a real difference between the approval of the proposals at the end of April agreeing to the project going forward and the approval of the final version in September. Approval by Mr MacDonald coupled with explicit or implicit assent by Mr Chrystie and Mr Riley may have been seen as sufficient. In any event, no case is raised by the RBs that the decision on 29 April was invalid or that there was no decision at all binding on Holdings in September. This whole debate really adds nothing to the conclusion from other evidence that CHQ was in practical terms calling the shots. But I am perfectly satisfied that the board made its own decision to proceed with Project Waltz on the basis of a business case which it perceived as justifying the changes. It was not acting as a rubber stamp.

1231. The Project Waltz proposals were presented by Mr Riley and Mr Chrystie to the Trustee board at its meeting on 7 May 2009. A week earlier, on 1 May, Mr Riley had held a meeting with Mr Lamb at which he gave him advance notice of, as IBM would have it, IBM's financial position, including its desire to increase profits, and an overview of the Project Waltz proposals. It is necessary to say a little about the events leading up to the Trustee meeting.

1232. Mr Murphy prepared a briefing paper for Mr Riley to assist him with his first disclosure of the Project Waltz proposals to Mr Lamb. Mr Lamb was to be told that IBM intended to close the UK DB Plans to future accrual in April 2010, despite IBM's earlier decision in fact to cease accrual with effect from April 2011.

1233. That meeting, revealing the Project Waltz proposals to the Trustee, took place on 1 May. Mr Riley reported to Mr MacDonald:

> "Today I met with Jim Lamb. Fairly predictable, he is committed to using every means possible to evaluate options and preserve the status quo (my words). Wanted to send you one quote 'I have been deceived by Randy, it was a clear act of deceit' referring to the SOTO negotiations."

1234. Between the date of that meeting and the meeting with the Trustee board on 7 May 2009, a "brief" for the Trustee was prepared. It, too, made reference to profit: "profit performance is declining". This prompted a response from Mr McFarlane of IBM's marketing & communications team who advised that that statement:

> "is not strictly true I think... or at least it is not how we have been communicating to employees for the past 2 quarters. We have been positioning UKI performance as making some improvements, but not achieving the rate of improvement needed. I think we should major on competitiveness, the need to improve a balanced business performance to enable investment in people and the UK business."

1235. The final version was different, merely commenting that profit performance had not grown at the required rate and pace. There was, in fact, no evidence to show that, ignoring the contribution to NPPC of the Plans, profit performance had not grown in a satisfactory way.

1236. The Project Waltz proposals were presented to the Trustee on 7 May 2009 by Mr Riley and Mr Chrystie. The slides for that presentation appear under the project heading "IBM UK Transformation Case for Change – Pensions". The messages conveyed included these:

i) the purpose of the changes was to improve UKI's competitiveness;

ii) UKI PTI growth was not balanced nor in line with annual growth objectives. UKI was lagging behind other IBM regions in both absolute profit contribution and PTI margin and that in consequence IBM UKI was "becoming less relevant from a PTI perspective";

iii) UKI had a target to improve its profit contribution margin by 11 points to 34% by the end of 2012;

iv) the UKI business environment was due to be challenging at least through 2010, putting additional pressure on UKI's ability to sustain top line performance and reinforcing the need to focus on productivity;

v) there was a "significant disparity in reward between DB members and DC members" which had to be addressed;

vi) the changes had to be made "regardless of economic conditions"; and

vii) "Pension cost introduces a risk of volatility that must be mitigated." [It is not explained in the slides how the proposals were said to achieve this.]

1237. It is worth mentioning four slides and some of their contents (the highlighting is mine):

i) Executive summary slide:

> "~ UKI business is undergoing a period of transformation to improve our **competitiveness**
>
> ~ UKI is not achieving **business model objectives** (relative or absolute)
>
> ~ Change is imperative: Improve **profit contribution margin** by 11 points by end of 2012
>
> ~ Must realise sustainable/repeatable improvement **regardless of economic conditions**
>
> ~ All elements of spending are being examined
>
> < Margin/Mix improvement
>
> < Expense productivity through management of fixed/variable terms
>
> ~ Need to revitalise our reward structure so that it **supports our business model**

~ Need to create **a parity of reward** across all employee groups

~ Pension cost introduces a **risk and volatility** that must be **mitigated**"

ii) Global reward slide

"Global reward strategy

~~ Compensation and benefits structure must **support the business model**

~~ The IBM **strategy for retirement benefits is Defined Contribution (DC) plans**

~~ IBM retirement benefit financial objectives:

> Redesign DB benefits to offset rising DB costs

> Achieve **predictability** of cost by converting to DC plans

……..

> **Reduce DB financial volatility**"

iii) 2008 Defined Benefit Pension Liability slide:

"**Liability size drives pension cost, cash, and stockholders equity volatility which are a competitive disadvantage**" [This is the only reference to volatility as meaning stockholder equity volatility of which I am aware.]

iv) Summary slide:

"~:} Need to dramatically improve UKI **competitiveness** and therefore profitability

~:} Current pension costs are **not sustainable**

~:} Move to a new platform for future service benefits that:

> **fits with the business model**

> provides **parity of reward** across all employee groups

……."

1238. A number of points were made by each side as recorded in the minutes of the meeting. I record the following:

i) Mr Riley suggested that in 2006 members had received strong encouragement to move to Enhanced M Plan status. Mr Newman and Mr Lamb disagreed with that. From my review of what was said at the time, it will be apparent that I disagree with Mr Riley's suggestion. Mr Riley may have considered that the package of benefits offered to members was in itself an encouragement. But that is not the point, at least for present purposes; rather the point is that they were given no express encouragement to opt one way or the other.

ii) Mr Lamb noted that the 2006 changes had resulted in a better than expected result for IBM in terms of NPPC and that from the currently available NPPC figures it could be seen that for 2009 IBM would in effect make a 'profit'.

iii) Mr Lamb noted the position reached under which the Trustee could not effectively reduce its exposure to equities by more than 3% per annum. He stated that IBM had chosen to take a "high risk equity gamble which

had not paid off and as a result of that it now wished to reduce members' benefits".

iv) Mr Lamb identified the serious impact on members and questioned whether or not IBM really understood the effect the proposals would have on members, in particular those who were under 50 years old.

1239. The three conflicted trustee directors (Mr Greene, Mr Ferrar and Mr Chrystie) withdrew to allow the other directors of the Trustee to discuss the proposals. When they returned, Mr Lamb conveyed the Trustee's extremely negative reaction to them. The minutes record Mr Lamb saying that he felt that he had been misled by IBM 3 years previously when the Trustee had agreed to the changes proposed by IBM at that time and stated that what was now happening was different from what had been said at that time.

1240. A further meeting between IBM and the Trustee was held on 20 May 2009, which was attended by both sides and their respective legal advisers and at which the proposals were discussed in more detail.

1241. Prior to that meeting, Mr Newman had provided IBM with a detailed list of questions. That list formed the basis of the discussion at the meeting. It is not clear to me whether the Trustee had been sent IBM's responses to the list in time for the meeting: in the bundle is a response which appears to date from 20 May. But it is not clear whether it was actually sent since, on 28 May, Mr Ferrar sent Mr Newman an email attaching "a copy of our responses to your questions".

1242. In any case, it was IBM's position that it had the power to implement the proposals unilaterally if the consent of the Trustee were not forthcoming. Nevertheless, IBM sought to obtain the Trustee's acceptance of the Project Waltz proposals. It is reasonable to think that this reflected the reality that the implementation of the proposals would proceed more smoothly with Trustee agreement; and the fact that IBM had been aware throughout the whole of Project Waltz that, as we have already seen, an adverse reaction to its proposals could give rise to potential problems, for instance in relation to (1) bond allocation and (2) the bringing forward of the next actuarial valuation to 2008. Those were two key concerns which, internally, IBM continued to focus on after the 20 May meeting.

1243. IBM says that these risks were carefully addressed and the negotiating strategy was a response to them. Mr Simmonds' submission is that IBM's approach anticipated the reality, which was that the Trustee would treat any discussions over Project Waltz as an opportunity for negotiation. Therefore, IBM had given consideration to the strategy that it ought to adopt in relation to these negotiations. It is in the light of those considerations that KPMG's paper (see paragraph 1196 above), which identified in advance of the negotiations the potential concessions that IBM might offer in the course of those negotiations and its ultimate target position, is properly to be viewed. As I have already observed, there is nothing wrong in that provided that IBM does not so mis-state its position as to give rise to a breach of the *Imperial* (or perhaps some other) duty.

1244. It seems likely to me that the Trustee only received IBM's responses to the list of questions on 28 May since, on that day, an immediate response was given by the Trustee which, had IBM's answers been received earlier, would surely have provoked an earlier response. On that day, the Trustee asked under what power IBM proposed re-admitting the affected members (*ie* those excluded from the C and N Plans) to the M Plan. IBM replied the next day, arguing that the rule permitted IBM to give notice of cessation of membership "for the purposes of the DB Section". It was on that basis that IBM thereafter proceeded. But I have held, under Issue 2, that that is not correct unless the Trustee consents to readmission.

1245. On 6 June 2009 (a Saturday), a confidential briefing was held with around 40 UK executives, drawn from all sections of the Plans, who were felt to be key leaders within the UK business. In its written opening, IBM described the purpose of the meeting as being to ensure that these people understood the proposals and to receive their feedback as to the manner in which the proposals ought to be communicated and as to the likely reaction of the workforce at large.

1246. Before that meeting was held, IBM had issued an Investor Briefing on "Pension Actions". One of the slides in that briefing stated, in relation to the global position:

"• Most of liability is with participants who have left IBM or are not earning benefits.

• Volatility is primarily driven by former employees"

1247. Slide 8 identified the cost increase of the proposed changes for the UK at $115m. The I&E savings were stated at $123m in 2009 (primarily driven by the one-time curtailment gain) and $143m in 2010 (from pension & salary savings).

1248. Returning to the briefing on 6 June, the slides presented a similar message to that which the Trustee had received. It was not, however, acknowledged that the Project Waltz proposals reflected any need to meet the 2010 EPS Roadmap and the requirement to reduce NPPC or that the cause of the difficulties facing IBM in relation to its DB Plans in the UK had little to do with ongoing DB accrual and a great deal to do with past service liabilities, which I consider to be incontrovertibly established by the evidence. The RBs say that there was also an omission to explain that NPPC was not, in fact, currently rising but was falling, the rise merely being forecast for some time in the future.

1249. And so the RBs detect a lack of candour when one gets to slide 24 ("Overview of Strategy") and 29 ("Checkpoint") referring to "Objectives – Deal directly with employees in an open and honest fashion" and "Need to be open & honest with our employees".

1250. As a result of this meeting, it was decided that any announcement to the wider workforce should be delayed until after the end of the second quarter of 2009, *ie* until after the end of June. The proposals continued to be discussed with the Trustee over the summer of 2009. What was not discussed, of course, were CHQ's internal deliberations. In that context, I mention the interesting comments made by Mr Scott and Mr Koppl in the context of a presentation to be made by Watson Wyatt on investment strategy:

i) Mr Scott: "The annual service cost represents less than 1% of the PBO liability and the plan freeze does not make a material change to the liability profile for some time": see his email dated 30 April 2009 to Mr Koppl and Mr Greene.

ii) Mr Koppl: "The position that Watson Wyatt take in their charts for changing asset allocation is not demonstrated by any analysis. It could help to have KPMG work on developing the actuarial/quantitative arguments further to have a formal actuarial view which conflicts with the Watson Wyatt view. For example, how little a difference the end of benefit accruals make to the total liability".

1251. The proposals were discussed again at a TMM held on 11 June 2009. At that meeting, a summary was given of the advice which the Trustee had received from Leading Counsel raising concerns about the Exclusion Powers and the doctrine of "fraud on the power" in relation to their exercise, including concerns (according to the minutes) that:

> "as it was so close to the changes introduced in 2006 when members had to make a conscious decision to remain in the DB section of the Plan and were advised that this would then result in an affordable and sustainable arrangement for the foreseeable future, Counsel had advised that this should also be tested by the Court as it might be seen as the Company acting in bad faith".

1252. In the light of this advice, it was agreed that a further meeting between representatives of IBM and the Trustee should be held on 18 June (although, in fact, it was held on 19 June). On the day before that meeting, Mr Newman on behalf of the Trustee sent a letter to Mr Ian Ferguson (company secretary of IBM UK) setting out its formal position and its legal analysis. In particular, the letter raised challenges to the proposals based on the scope of IBM's powers and the implied duty of good faith and indicated that the Trustee would go to Court to establish the validity or otherwise of the proposals. The letter articulated the issues which have been raised in this action.

1253. At the meeting on 19 June 2009 and in the light of the Trustee's position as set out in Mr Newman's letter dated 18 June 2009, IBM put forward a revised proposal under which it offered all members (including DC members

who had never accrued DB benefits) an additional matched contribution capped at 2% on the sums contributed to the DC M Plan. At that time, the employer contribution was 8% of pensionable salary and the member contribution was 3%. Under the revised proposal, if a member made an additional 2% contribution (making a total of 5%), the employer would contribute 10%. In addition, IBM proposed deferring the cessation of DB accrual by one year to 6 April 2011. These revisions to the proposals were subject to the Trustee's agreement not to alter the asset allocations of the Plans' investments and not to bring forward the triennial actuarial valuation to 2008 (as had been threatened by the Trustee). The offers were what the RBs describe as the "pre-planned" concessions and which they say were not genuine concessions at all, at least so far as concerned the move to 6 April 2011.

1254. The revised proposal was recorded in a letter to the Trustee dated 23 June 2009. By a further letter of the same date, IBM confirmed that, after taking legal advice, it was satisfied that the proposals could be validly implemented and that it was complying with its implied duty of good faith.

1255. There then followed presentations, from 24 June onwards, to lower layers of IBM management. This was IBM's "UK – Pensions HR Leadership Briefing" given at three different locations. The slides were closely modelled on the slides for the Executives Workshop on 6 June. The slides still suggested that IBM's intention was to close the UK DB Plans to future accrual from April 2010.

1256. To illustrate what the impact of the changes would be on members, KPMG prepared a spreadsheet setting out a broad guide of the approximate financial loss to members under the Project Waltz proposals. The spreadsheet sets out, by Plan, for each member both their capitalised loss and the additional percentage contribution required to replicate their current benefits at (a) their expected retirement age and (b) their NRD. Some of the figures are startling. In their written opening submissions, the RBs record some examples. I do not propose to repeat them but they show capitalised losses in the high £100k's (over £1m in one case) in respect of pension at expected retirement age of 57 and figures of several £100k's at NRD. Whether IBM fully understood this impact of its proposals I do not know.

1257. By two letters dated 3 July 2009, the Trustee indicated that the revised proposal fell short of what it would consider acceptable and that it disagreed with the legal advice that IBM had received. Nevertheless, the Trustee stated that it was still willing to engage in discussions, with a view to reaching an agreement that would avoid the need to go to Court.

1258. On 6 July 2009, Mr Riley briefed the executives with whom the UK management had met on 6 June. The following day, he outlined the terms of the proposed changes in a call to all UK managers, which was followed up by a letter and note of the same date. A letter from Mr Riley was then circulated to all affected employees. IBM says that the proposals that were announced to the employees included a cessation of DB accrual from 6 April 2010 because the suggestion that this be deferred by a year had not been accepted by the Trustee. That seems to me to be disingenuous when (a) it was not IBM's intention in fact to cease accrual until 2011 and (b) the Trustee had only rejected the 2011 date because the "change" from 2010 to 2011 was offered by IBM only as part of a package which, taken as a whole, was not acceptable to the Trustee.

1259. Mr Riley's communication to employees included the warning (to use my own word) that there would be no further pensionable salary increases for DB members while they remained active members of their UK DB Plans. It also told employees that IBM UK would implement a new early retirement policy restricting the circumstances in which it would give its consent to early retirement on the enhanced terms set out in the Main Plan Rules. It gave no details and no indication that, in reality, consent would hardly ever be given.

1260. The reasons given for the changes were, in summary:

i) To improve IBM UK's "long-term competitiveness and productivity" and "safeguard our growth and leadership in this market"; nothing was said about the 2010 EPS Roadmap or the need to reduce NPPC.

ii) To address "rapidly-rising costs of Defined Benefit pensions". Again, nothing was said about the rising cost being mainly attributable to past-service liabilities; and nothing was said about the way those past-service

liabilities had an impact on EPS.

iii) To mitigate the impact of "external factors". The external factors were, essentially, changes in financial and investment conditions. There was no discussion of how the investment strategy adopted by the Trustee at the instigation of IBM might have been one, at least, of the causes of the impact which it sought to mitigate.

1261. It is an understatement to say that the Project Waltz proposals were not well received. I have been presented with a mass of material which demonstrates, as the RBs put it, bewilderment and outrage. I cannot, of course, say that that sort of reaction was universal but there can be no doubt that it was widespread. There were clearly strong feelings of betrayal, in particular because people made decisions based on what they had been told by Mr Hirst which they took as implied commitments, with members saying that they had been lied to. IBM was in a stronger financial position than in 2006, so why, it was asked, were the changes necessary? Some regarded IBM's behaviour as cynical opportunism. Many expressed themselves as ashamed of IBM and disgusted. In their opening written submissions, the RBs have quoted many responses from angry and disappointed employees. They are representative of the sort of comments which I have heard from the witnesses who actually gave evidence. They do not add to or detract from the strength or otherwise of the case made by the RBs on the evidence, but they do, perhaps, go to confirm the real sense of, to use the word again, betrayal. Very few of the quoted examples, however, actually address precisely what was said in relation to Ocean and Soto at the time but, instead, give an impressionistic response to an unexpected and unwelcome proposal. I must decide this case on the basis of what was actually presented, an analysis which I have already carried out in great detail.

Consultation

1262. IBM then entered into an employee consultation process. The RBs contend that the consultation was defective and itself gave rise to a breach of Holdings' *Imperial* duty. I deal with that as a distinct issue later. The relevant legislation is to be found in the Pensions Act 2004 and Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (SI 2006/349). I set out the material provisions in Annex E.

The Pensions Consultation Committee

1263. On 8 July 2009, Mr Ferrar circulated a letter setting out the arrangements for that process. A Pensions Consultation Committee ('**PCC**') was to be set up, comprising of member-elected representatives from each section, together with IBM representatives. The elections were to be held from 20 July 2009 and the consultation process was to run from 5 August to 5 October 2009. In the end, the formal process ran from 10 August to 20 October 2009 (albeit that, for practical purposes, it came to an end with the last meeting of the PCC on 8 October 2009 and that management decisions in light of the process were made on 13 October 2009). The employees were told that no final decisions would be made until this consultation period had been completed.

1264. The election for members of the PCC was run by the Electoral Reform Society. Eleven employee representatives were elected from 56 candidates on a turnout of 7,180 members. At the expense of IBM, the elected representatives were given legal and pensions training and were also advised by Pi Consulting. In total, 10 meetings were held with the employee representatives (including one before the start of the formal consultation period). At these meetings, various aspects of the proposals were discussed and the elected representatives provided feedback (based, in part, on questions forwarded to them through the pensions section of IBM's internal intranet service, known as the 'wiki', which provided members with information about the proposals and was updated regularly throughout the consultation process).

1265. Pursuant to its obligation under regulation 11(2) (see Annex E), IBM UK set out on its 'wiki' web page what it considered to be the "Legally Required Information", stating:

> "3. Listed Changes
>
> The changes on which IBM is required to consult include:

a. Cessation of accrual of DB benefits in the C, N, DSL and I Plans from April 2010, except for certain members of the I Plan (see above);

b. Restriction on increases to Pensionable Earnings / Salary for DB Plan purposes;

c. Introduction of an improved DC contribution structure for the M Plan where members choose to increase their contributions from the required minimum; and

d. Where current DB members are paying less than 3% contribution and choose to join the M Plan, such members will be required to pay at least a 3% contribution. …

……

5. Dates

All the listed changes above are intended to take effect from 6th April 2010."

1266. Further, "Factsheet 2" (uploaded to the wiki on or about 5 August 2009) for each Plan, purporting to set out the changes proposed, also stated that the Plan would close to future accrual with effect from 5 April 2010.

1267. The RBs emphasise the reference to 2010 in 3a. and 5 and in Factsheet 2. They submit that the suggestion that IBM UK genuinely intended to cease DB accrual within the UK DB Plans with effect from April 2010 was demonstrably false. They say that it was not an accurate description of the listed change nor of "the timescale on which measures giving effect to the change are proposed to be introduced" as required by regulation 11(2)(e) nor of the "relevant background information" as to the reasons for the change as required by regulation 11(2)(d). It did not comply with the letter or the spirit of the Consultation Regulations. They say that IBM had been intending since at least 16 March 2009 to close the plans with effect from April 2011 (indeed the only other choice was April 2012 not 2010). The cost implications of 2010 closure had not even been modelled by the time of the meeting on 3 March 2009 when the basic form of the Project Waltz Proposals was agreed with CHQ; modelling had been carried out only for 2011 and 2012.

1268. In their written opening, the RBs addressed in considerable detail the discussions, proposals and counter-proposals put forward in the PCC sessions which followed. I do not propose to go into that detail. The minutes show that IBM was taking an uncompromising position, although it did in the end agree to some modifications. The employee representatives for their part were consistently challenging IBM, confronting it with some very strong points to show that the proposals were unnecessary and unfair. There are, nonetheless, some aspects of the meetings which I should mention, particularly in relation to the early sessions.

1269. It is fair to say that the candidates for the PCC and the members of it after the elections were constantly pressing IBM for more information. The RBs identified a number of relevant requests in their opening written submissions. The position is encapsulated in an email from Mr Buxton, forwarded to Mr Ferrar and Mr Riley:

"There are persistent rumours that IBM has already prepared a number of sweeteners to be offered as minor concessions following the consultation to make it appear as if IBM has responded to the consultation. IBM should reveal its true proposals prior to the start of consultation, negotiate in good faith and if it announces subsequent changes it should be prepared to reopen the consultation."

1270. In the PCC session of 6 August 2009, IBM gave its justifications for Project Waltz. As previously, the slides presented an intended closure date of April 2010. IBM presented its business rationale for the Project Waltz Proposals: it was all about productivity and competitiveness. Nothing was said about the need to reduce NPPC and to keep to IBM's 2010 EPS Roadmap. IBM UK stated that "The Consultation process is intended to be a true and meaningful dialogue, and a fair exchange of views", telling PCC representatives that their role was to "Communicate in a direct, honest, clear manner".

1271. According to the minutes of that meeting, a considerable amount of information was sought from IBM including:

i) disclosure of "the full financial imperatives behind the proposals and all alternative scenarios considered as alternatives to the current proposals together with the output of their deliberations which have led to the current state of affairs".

ii) A hard copy draft of the new ER policy in order to clarify its terms and impact.

1272. These requests were addressed by IBM at the second PCC session on 12 August 2009. IBM declined to answer i), saying that it was IBM information which would not be disclosed. The RBs now contend that it is "relevant background information" within regulation 11(2)(d). In relation to ii), a draft of the new ER policy, IBM responded that an initial draft of the proposed early retirement policy would be discussed at one of the forthcoming meetings, after which a softcopy of the consultation slides would be provided. The Trustee was not having any more success in obtaining the terms of the new ER policy in spite of requests, as is revealed by emails dated 10 and 14 August 2009 from Mr Ferrar to Mr Newman and to Mr Murphy.

1273. At the fourth PCC meeting on 26 August 2009, the employee representatives gave their initial response to the Proposals. A high level summary of employee representative feedback was given:

i) The proposals were seen as highly opportunistic.

ii) IBM was perceived as highly profitable and could afford to continue as is.

iii) IBM was saving many hundreds of millions from the proposals and in effect taking all of this from a minority of long serving IBMers.

iv) The proposals were coming much too soon after 2006.

v) There were strong feelings that the decision whether to stay in the DB plans in 2006 or to move to the Enhanced M Plan was a false choice and that people were mis-sold.

vi) There was anger at a "betrayal of trust" from 2006.

vii) The IBM value of "Trust and personal responsibility in all relationships" was seen as meaning nothing.

viii) The proposals were also seen as unfairly discriminating against the DB minority that felt they made a valid choice in 2006.

1274. By the time of sixth PCC session on 9 September 2009, IBM itself had been focusing on the actions to close Project Waltz including modifications to the proposals to close the consultation process. In some slides prepared for a call with Mr MacDonald on 9 September 2009, Mr Ferrar reviewed these. They included:

i) the cessation of DB accrual on 5 April 2011

ii) agreeing to "the vast majority" (more than 95%) of requests by DB members to leave during the Early Retirement Window

iii) the creation of hybrid status to preserve ancillary ill-health and death-in-service benefits and maintaining final salary linkage for DB benefits

iv) "step down" DC contributions for former DB members (an extra 6% of salary for 2011-12 and 2% of salary 2012-13) ("**Step Down Contributions**").

1275. The slides also showed figures for the "PCC worst case scenario" (namely closing the UK DB Plans to DB accrual in April 2013 with an Early Retirement Window in the period up to April 2013). This would produce almost identical I&E savings for 2009 to 2013 as the base case ($547m as compared with $549m) but as the slide stated "this worst case scenario defers some of the savings from the earlier years to the later years". But

such deferral would not have been good for meeting the 2010 EPS Roadmap.

1276. At that session, the employee representatives put forward additional suggestions from members for consideration by IBM. Given the very serious effect that the proposals would have on some members, one might reasonably expect that IBM would give genuine consideration to any sensible proposal. Of course, there comes a time in any consultation when the time for new suggestions has passed. It is hard to think that that time had passed by the date of this session. Mr Murphy forwarded these to Mr Ferrar the next morning. He wrote in his covering email: "you may want to spend a few mins scanning them in advance of when we go back to them with our solutions". There does not appear to have been any further consideration in fact given to them. Mr Chrystie confirmed that he had not carried out any modelling although it had previously been promised by Mr Ferrar at the fifth PCC meeting.

1277. Before the seventh PCC meeting on 16 September 2009, IBM was discussing the issue of presentation of the modifications. On 14 September, Mr Murphy sent an email and some slides ("Closure Plan for discussion") to Mr Ferrar. Under the heading "Decisions" one finds this: "Which modifications are to be attributed to the Trustee, which to the PCC, and which to both". Mr Tennet describes this as a charade about attributing to the Trustee/PCC teams changes which had always been what IBM had in any event intended.

1278. The seventh session itself was concerned largely with additional suggestions from Enhanced M Plan Members. IBM was told in no uncertain terms of the reaction of those members to the new ER policy including: perceptions of breach of trust, anger, feelings of betrayal, resentment at being given no time to mitigate the impact of changes and the absence of any compensation and a conclusion that this was "No longer a company we want to work for". After this presentation, Mr Ferrar indicated that IBM was "minded to make modifications to some of the original IBM proposals", a somewhat disingenuous way of putting things, I consider, in the light of IBM's actual thinking and tactics from an early stage. Mr Ferrar said that IBM would provide detailed explanations of the modifications at the next PCC meeting.

1279. The eighth PCC meeting took place on 23 September 2009. IBM informed the members that their own proposals had been rejected. The reason given was that they were not financially viable for Holdings. IBM presented its proposed changes which included:

i) ceasing DB accrual on 5 April 2011 rather than April 2010 (as was in fact IBM's intention all along);

ii) Step Down Contributions for 2 years;

iii) creation of "hybrid deferred" status (treating DB members as active for the purposes of retaining existing ill-health & death-in-service benefits);

iv) consent for the great majority of DB members to retire during the Early Retirement Window (to the extent that this involved any concession is questionable since IBM was keen for many members to leave);

v) the introduction of a Group SIPP alternative to the M Plan for employees who wanted it;

vi) declaring a "life event" entitling DB members to modify the existing level of their Additional Voluntary Contributions for the 4-month period between December 2009 and March 2010.

As to item v), Mr Ferrar suggested that the Group SIPP proposal was a response to members' input and had not been considered previously. This was not true: Group SIPP had been raised internally in May 2008 and was still being considered when Project Whisper commenced.

1280. These modifications were duly communicated to the Trustee and to employees.

1281. The initial response of the employee representatives was one of considerable disappointment. The minutes recorded that IBM was asked for clarity about who decided that the closure of the Plans should occur in 2011 rather than 2012 or 2013: was this a UK decision or a decision of IBM Corporation (*ie* of CHQ)? The response

minuted was that "it was not financially viable for IBM UK to extend the schemes beyond 2011 or the step down to occur over a greater period than 2 years". From what I have seen, that is a highly misleading answer. It was not that it was not financially viable for IBM UK to permit that course (save, perhaps, in response to a threat from CHQ that corporate investment in the UK business would suffer); it would have been more accurate to say that it was not financially viable for IBM Corporation to permit IBM UK to take that course and an open and transparent answer would have indicated that this financial viability stemmed from the imperative of keeping to the 2010 EPS Roadmap and producing the required NPPC results. It is interesting, also, to note Mr Ferrar's statement that the employee representatives had made "a significant contribution to the process as a result of feedback and suggestions presented and the modifications constituted a significant financial move for the Corporation…." As to moving the relevant date for ending accrual to 2011, that was simply not correct. And none of these changes were, in cost terms, financially significant to IBM; they cost not a great deal. What was significant was that they allowed IBM to stick to the 2010 EPS Roadmap.

1282. At the same meeting, the employee representatives made renewed requests for details of the business rationale behind Project Waltz. The RBs' opening written submissions contain a long extract from the request. It is an important extract and bears repeating (even in this already stupendously long judgment):

> "We accept that a rationale has been set out (e.g. in Brendon Riley's call on 7 July 2009), but this is very general: identifying a number of trends, referencing the current economic climate, the increase in life expectancy, and actions by other companies. The only explicit driver appears to be that the Company's competitors tend to have defined contribution arrangements and that there is therefore a desire to 'level the playing field', but this is too vague to be of any value to the PCC in considering what alternative proposals might meet the Company's objectives.
>
> Throughout this consultation there has therefore been insufficient information available for the PCC and the employees it represents to use as the basis for generating sensible alternative proposals which would meet the Company's objectives.
>
> As the Company appreciates, it has the duty to conduct consultation in good faith and not to assume a given outcome to the consultation, but to consider other approaches which may meet its objectives. Refusing to give details of the business rationale for the proposals would suggest that the Company is determined to close the defined benefit schemes and move members to the M Plan, and is unwilling to consider alternative approaches.
>
> We therefore repeat our request for copies of the business rationale for the proposed changes. This should lay out the objectives of the proposed changes including (but not limited to) quantitative evaluation of the savings which will be achieved by the proposals, and any alternatives considered."

1283. This, it seems to me, was an eminently reasonable stance for the employee representatives to be taking.

1284. I pick up here on the reference in those minutes to the business rationale and indirectly therefore to Mr Riley's references to "long term competitiveness and productivity" and the need to "safeguard our growth and leadership in this market," and to the proposition that "rapidly rising costs……associated with the provision of Defined Beneft pensions" was "placing pressure on our long-term ability to invest for future growth and operate in an intensely competitive global market".

1285. This reference to the rapidly rising costs as a burden on Holdings is to be taken as a reference to NPPC, according to IBM's Response to the AVPs. It is not easy to reconcile IBM's position with:

> i) KPMG's Main Plan forecasts for year end 2008 which showed NPPC was projected to fall in 2009 from 2008, and would be a profit, not a loss, in 2009 and 2010.
>
> ii) The fact that KPMG's I Plan forecasts for the year end 2008 showed that for the next 3 years, IBM was projected to enjoy a profit from the I Plan.

1286. The ninth PCC session took place on 30 September 2009. IBM gave its response to the request set out above. The main objectives were stated to be to mitigate the increasing cost and volatility associated with the provision of DB pensions to an increasingly small proportion of its UK workforce. Economic conditions had put tremendous cost pressure on companies operating DB pension plans, in addition to the longer term trend of increasing life expectancy and lower interest rates which continued to increase the costs and risks associated with providing this type of pension plan. IBM declined to give financial information over and above that provided in the first PCC session in the light of its commercially sensitive nature.

1287. It was also pointed out that Mr Riley had attended the PCC on 6th August 2009 and presented on the business case for the proposed changes. IBM was thus confirming the business case to be that which had already been presented to the employee representatives: details had been given of the PTI problem, the scale of DB liability as compared with IBM's competitors and an indication of the pension dynamics over the coming years and what it was doing to IBM's cost base. Mr Riley had presented on a) cost and competitiveness b) risk and size of DB liability and c) the need to lead in the marketplace and move to DC.

1288. I would comment that, even on IBM's own case, a major driver for the Project Waltz changes was the commitment to investors in relation to EPS and the need to keep to the 2010 EPS Roadmap. But not a hint of that was given anywhere in the discussions with the Trustee or the PCC employee representatives. Further, funding and life expectancy issues had little, if anything to do, with Holdings' decisions in relation to Project Waltz. The origin of this rationale for the changes, according to Mr Tennet, seems to have come straight from the KPMG "storyboard", a proposition with which I find it hard to disagree. Moreover, in 2006, Holdings had accepted that it was responsible for, and should itself meet, the past service liabilities. It may be the case that the beneficial early retirement factors for which the Plans provided were not immutable, but members would have had good reason for disappointment and surprise to be told that they were being denied access to early retirement at all by the new ER policy. One might have expected IBM to give some sort of explanation for that. Whether this is an appropriate way of dealing with HR relations in the US, which is the culture with which CHQ, Mr Ferrar and Mr Chrystie were imbued, I do not know. I do not find it an attractive or acceptable way to deal with matters in England.

1289. Holdings also gave an overview of the new ER policy to the employee representatives on the PCC. This overview appeared on a single slide which did not reveal the essential elements. It was in vague and general terms which gave no indication of the financial impact for any individuals. Something more was said in the oral presentation. The minutes record IBM as explaining that the new early retirement policy would have significant restrictions on granting favourable early retirement terms with Holdings trying to move away from the perception that employees would be granted favourable early retirement terms in the future.

Rectification

1290. It was at this time that the concerns which led to the Rectification Action were identified. On 5 October 2009, Tony Ford, a long-serving lawyer in IBM's legal department, sent an email to Mr Ferguson (to remind the reader, he was then IBM UK Holdings Company Secretary), copied to Ms Middleton, Mr Ferrar, Mr Pinder (Chairman of the PCC) and Mr Newman. He wrote to draw attention to what he described as "a fundamental flaw or error in the drafting of one aspect of the rules of the Pensions Deed which gave effect to the C Plan ('the 1983 Definitive Trust Deed & Rules')". He considered that it affected the current consultation process in general, believing it to vitiate the process in respect of a whole class of pension beneficiaries, of whom he was one. His measured, lawyerly, letter made a number of suggestions about how IBM might properly proceed, including pausing the consultation process while it considered the facts, and adjusting any message that it planned to send to pension beneficiaries appropriately. IBM should "modify or delay the issuing of its proposals to affected recipients in the light of this new information".

1291. Moreover, he suggested that it would appear prudent to plan on making sure that any 'early retirement window' offer made to current and former C Plan members was worded so as to show clearly their freedom to retire early between 60 and 63 on the face of the communication. Importantly, he noted this:

> "Verification of the facts, legal advice and planning are likely to require some time if they are to be done properly. This may well have an impact on the PCC timescales. However, it is important to ensure that due process is followed. I am sure that we all agree that it would be morally wrong, and also practically very unwise, to put perhaps over a thousand employees (who by definition have given over a quarter of a century of service to IBM since the inception of the C Plan) under pressure quickly to make a decision affecting their future and their retirement planning, when there is a significant inaccuracy in the underlying original Trust Deed and Rules and therefore in the terms they are offered."

1292. It is not the RBs' case that the receipt of this email should have caused IBM to conclude that members had the flexible retirement right which Mr Ford had identified and which I have held in the Rectification Action that they do have. But it is their case that it required a diligent investigation before IBM gave members information designed to affect their choices which was premised on the proposition that there was nothing in Mr Ford's points.

1293. IBM's position, however, is that after being made aware of the issue, it investigated it, took legal advice in respect of it (in respect of which privilege is not waived), and on 3 December 2009 and 16 February 2010 made certain concessions (which I come to later) in respect of classes of members who might have a contractual right to early retirement from age 60 without its consent. At that time and on the evidence then available – and notwithstanding the subsequent outcome of the Rectification Action – IBM says that it did not consider that the then merely putative rectification claim had a real prospect of success. In the circumstances, it decided to proceed with the implementation of the Project Waltz proposals.

1294. Hardly surprisingly, Mr Ford's communication caused something of a stir within IBM. I do not propose to go into the several emails which the RBs have referred to. The concern of IBM is best shown in an email sent on 6 October 2009 by Mr Castellanos to Mr Ferrar where he wrote this:

> "Jonathan, I think it is extremely important and urgent that you confirm that the one time gain in 2009 is not deteriorated by this development. As of the early retirement saving impact, I understand the complexity but we need a sense of how big could it be. At the end of the day we have to solution a given number and, if this goes down, something else needs to go up."

1295. That email shows perfectly clearly that the focus of Project Waltz was at that stage on obtaining immediate 2009 gains. No doubt if the rectification claim had been acknowledged at the time as bound to succeed, the gains would have been found somewhere else and a business plan to justify the change developed. As it happens, Mr Koppl was able to give comfort. He responded on the next day to say that this development:

> "will not change the approximately $130M one time income in 4Q09 provided IBM proceeds with the decision in 4Q09 to end benefit accruals in April 2011. This one time income is not driven by the early retirement change."

1296. The issue was given further detailed consideration within IBM although, from the material available, it seems that the focus was not on the merits of the claim but on how it would be possible, notwithstanding the uncertainty, to bring closure to Project Waltz and to "book" the gains in 2009. The question which IBM clearly asked itself was how that closure could be achieved. It did not stand back and ask itself whether the issue actually had an impact on whether the Project Waltz proposals remained appropriate.

1297. Privilege not having been waived, I have no idea of the basis on which IBM asserted that the claim had no real prospect of success. Members certainly obtained no explanation of why the claim was a bad one on the evidence as it stood. Instead, the affected members were faced with making decisions about their retirement plans on very short notice (as to which see below) and on the basis of what is now known was a false position taken by IBM.

1298. The tenth (and final) PCC session took place on 8 September 2009. By this time the employee representatives had become aware of the thrust of Mr Ford's email. They asked IBM what it proposed to do about the issue in relation to the timing and communication of the Project Waltz proposals. Although IBM gave a somewhat vague

answer at that meeting, it subsequently gave a fuller response. A supplement to the minutes dated 20 October 2009 records as follows:

> "…..the Company has undertaken some preliminary work in reviewing this matter. However in order to give it the right level of consideration IBM will not be in a position to respond to the affected employees immediately. We are aware that our position on this issue will have an impact on any decision individuals may be contemplating in connection with the early retirement window which will shortly be opened. Our suggestion is that in order to have the opportunity to be considered for early retirement, individuals register their desire to do so via the early retirement tool we are launching. If they receive an offer to retire early from the Company, they have until 11th December to accept it. We confirm that by that time we expect to be in a position to respond with our view on this matter as we will use the period between now and 11th December to fully review the issues which have been raised."

1299. IBM provided the PCC with a draft of the new ER policy. Mr Riley used words, in introducing the draft, describing the existing position as one of "entitlement" to early retirement when, in IBM's view, it should not be, but should only be agreed where the business could afford it. The employee representatives wanted this recorded in the minutes but IBM refused to allow this. There is no dispute that Mr Riley actually did say what the employee representatives wanted recorded. I would only comment that I have always thought that minutes of any meeting, whether commercial, trustee, government committee or quango, were meant to be a record of discussions not a document to set out what people wish had been said or to suppress what actually had been said. Be that as it may, internal IBM emails reveal that IBM's position was "we cannot document this verbatim as it backs up their custom & practice argument against ERDFs & one which the Enhanced M plan may still use against IBM… Even if we could make some reference to 'perceived' automatic entitlement we'd be in a stronger position but documenting the quote as is puts us in a weak position." This appears from an email dated 11 October 2009 from Michelle Trinder (HR Project Lead – UK) to Andrew Pinder copied to Mr Murphy.

1300. As to the early retirement window, my perception is that IBM was not willing to be transparent. Mr Riley told the PCC that, although IBM UK had a right to amend its early retirement 'policy' with immediate effect, doing so had not been thought to be "fair" so the window was necessary to give employees an opportunity to retire early before the new ER policy came into effect. The reality is that fairness was not considered: at least, I have seen nothing in the material which suggests that it formed any part of CHQ's thinking. Rather, it was, according to the RBs, part of a strategy being pursued by IBM UK to encourage 700 or more members immediately to leave employment so as to reduce both Holdings' NPPC and its employment costs. I agree.

1301. The uncertainty about the rectification issue did not deter IBM from proceeding notwithstanding that members affected would have to make very serious decisions indeed about taking advantage of the Early Retirement Window without knowing their starting point. I have to say that I find unattractive IBM's proposition that the affected members should apply for early retirement in the way suggested in the minute set out at paragraph 1298 above. The timescale would still be short; but quite apart from that, it is questionable whether it would be right to put members already concerned about their futures to this additional stress.

1302. The decision to proceed all the same seems to have been taken on 13 October 2009 at a meeting in Bedfont Lakes attended by Mr MacDonald and Mr Koppl (along with Mr Riley, Mr Chrystie and Mr Ferrar among others) who had flown over from the US. By this time, IBM had clearly not received definitive legal advice about the rectification issue. Mr Ferrar recounts in his second witness statement that in the course of that meeting the view was reached that the implementation of Project Waltz should proceed as planned "whilst we conducted a fuller investigation into the 1983 issue". The Trustee reiterated its concerns in a letter dated 14 October 2009 noting in particular that the issue required a "speedy resolution" as it was relevant to the Trustee's consideration of the proposals and to consideration by individual members who may be considering retiring early following IBM's early retirement window.

1303. It does not appear that IBM could have had definitive advice even by 20 October. On that date, Mr Murphy responded to Mr Ford's email of 5 October. He stated that IBM had "undertaken some preliminary work in

reviewing the facts" but would not pause the consultation process and confirmed that, by 11 December (the end date of the early retirement window) IBM expected to be able to respond "as we will use the period between now and 11th December to fully review the issues you have raised…".

1304. Mr Riley had previously (in July) informed members that no final decision would be made about the proposals – this was nothing to do with the rectification issue – until the consultation period had been completed which would be on 20 October 2009. And he had stated that IBM would then take time to consider the feedback and only then make a final decision. Notwithstanding those indications, it appears that the final decision had been made on 13 October 2009 as just explained. Further, on 15 October 2009, IBM Corporation announced some results in its third quarterly earnings presentation for 2009. The presentation reported that IBM expected, in the 4th quarter "a one-time curtailment gain of over $100M due to a change we're making in our non-US plans." As Mr Ferrar explained in his second witness statement, this presentation was originally drafted to "to be even more explicit" by referring to the UK Plans rather than the non-US Plans but Mr Riley objected that UK employees would be annoyed to know that IBM Corporation was making a $100m saving from the Project Waltz proposals. As the RBs remark, indeed they would have been (had they ever been told); and the fact that IBM felt able to include this material in its quarterly presentation demonstrates, they say, the reality that the decision had already been made. Mr Simmonds has a different take on this to which I will come.

1305. Mr Riley's evidence about this was that the announcement had nothing to do with the UK management team. He says that it would have been preferable if the announcement had been delayed until after the consultation had formally closed. He was keen to stress that the announcement did not affect the outcome of the consultation. By that stage, UK management had decided in principle on the framework of the plan which was to be adopted. Their hands were not forced by the announcement: no further information became available after the announcement (or was likely to do so) and they would have come to the same conclusion whether or not the announcement had been made. Quite so: but the RBs' complaint has nothing to do with the making of the announcement but with the fact that the decision had been made before the consultation had finished and before the earliest time when Mr Riley had previously said it would be made. As to that, IBM's position is that the consultation had finished for all practical purposes at the last PCC session on 8 October 2009.

1306. The consultation officially ended on 20 October 2009. Mr Riley announced the final proposals in an All Managers call that day. His explanation for the changes rehearsed the points which were covered in the PCC meetings, principally to improve competitiveness and to be consistent with the UKI pensions marketplace. Cost and volatility were mentioned, the bottom line being "we simply cannot afford to sustain this". The end of the consultation was then announced to members by email later in the day.

1307. The final proposals as described by Mr Riley retained each of the three core elements which had been a consistent theme. They were:

i) DB accrual would cease for all DB members in the UK DB Plans (except for certain members in the I Plan for whom IBM UK was precluded by contractual or other arrangements from terminating DB accrual).

ii) For DB benefits, future salary increases would not be pensionable. Affected DB members would be asked to accept (using an online tool) that any future salary increases would not be pensionable: in default of acceptance, the member would, as stated in slide 25, receive no salary increase at all.

iii) The new ER policy would be implemented from 6 April 2010. It would provide that consent to early retirement from active status would only be granted in "exceptional circumstances", so that the 3% p.a. ERDF below age 60 prescribed by the Main Plan Rules for early leavers retiring with Holdings' consent would not be applicable and instead an ERDF stated to be approximately 6-7% p.a. would be applied for every year retirement preceded NRD (for C Plan, at age 63; for most N Plan service, at age 65).

1308. These core proposals were subject to the modifications which I have already considered, in particular the introduction of Step Down Contributions and "hybrid deferred" status for affected DB members (affording them similar ill-health & death-in-service benefits to those applicable under the UK DB Plans). These were not new

modifications: they had been under consideration within IBM since at least 8 September and had been presented to the PCC on 23 September.

1309. These changes were set out in Mr Riley's email to members, although in relation to the non-pensionability agreement it was not spelt out that, absent agreement, the member would not receive any pay increase. In addition, Mr Riley explained the early retirement window stating that IBM would consent to the vast majority of employees who requested early retirement in that window on the enhanced terms. This was presented as an opportunity for retirement planning; it of course held great advantages for IBM by ensuring that the savings from people retiring were taken as part of the Waltz proposals.

1310. At the TMM on 23 October 2009, the Trustee stated its position that it would require confirmation from the Court whether or not the Project Waltz Proposals were a breach of the Holdings' *Imperial* duty. That position was confirmed in a letter to Mr Ferguson (for Holdings) dated 23 October 2009. The members were informed of the Trustee's position by the posting of a letter on its website on 28 October.

1311. Mr Francis of Watson Wyatt, one of the Plans' investment advisers, was present at that TMM. The minutes record him as going through his presentation of risk reduction. In the course of that presentation he is recorded as describing the events of 2008 as a "1 in 60 year" event.

1312. The RBs complain that the implementation of Project Waltz involved further breaches of the *Imperal* duty. These are the subject matter of a number of claims in the Employment Tribunal which have been stayed pending these proceedings. In essence, the members complain that:

i) the new ER policy substantially reduced accrued pension rights, and was used by IBM UK as a mechanism to pressurise older members into retiring early without having to go through a redundancy process or make redundancy payments;

ii) the Early Retirement Window provided to members was unreasonably short;

iii) the threat to deprive members of all future pay rises if they did not agree to the 2009 Non-Pensionability Agreements was capricious and arbitrary.

1313. As to the Early Retirement Window, the evidence established in my view that IBM had been planning for 700 members to take early retirement. Mr Koppl had carried out assessments of what would happen if either more, or fewer, members adopted the option. A good take-up of the early retirement option was an important feature of the delivery of the Project Waltz savings and was what IBM hoped to obtain.

1314. Mr Riley's email informing members of the Final Proposals (see paragraph 1309 above) told DB members that IBM UK would implement its new ER policy with effect from 6 April 2010 which would apply in circumstances where Company consent was required to draw a pension prior to Normal Retirement Age and informed them of the intended early retirement window through which the vast majority of members would be permitted to retire before it came into effect. The next morning, Mr Ferrar told members that to be considered for early retirement through the Early Retirement Window they would have to register their interest via an online registration tool between 21 October and 16 November 2009. This was a period of less than 4 weeks to register their interest, a period which Mr Ferrar regarded as "a reasonable time that gives all people the opportunity to make a decision". The draft of the New ER Policy on the "wiki" told members that consent to early retirement would only be given in "exceptional circumstances". It is to be remembered that retirement during the early retirement window would preserve a benefit calculated on the basis of a 3% ERDF below age 60; in contrast, under the new arrangements, the ERDF would be in the order of 6-8% below NRD. Mr Ferrar might consider under 4 weeks to be a reasonable period; others might disagree with the proposition that a long-serving IBMer should have to make a life-changing decision of this nature – a decision he had not anticipated he would have to make – within that timescale. It seems more likely to my mind that IBM was being driven, again, by the imperative of achieving savings in 2009 rather than by any consideration of what would be a reasonable time within which to require members to make their decision. Sight should not be lost, either, of the fact that by this time IBM knew of the possible error in the 1983 Trust Deed and Rules having received and digested Mr Ford's email. Even at that

stage, an analysis of the issue ought to have shown that there was (i) a possibility that members had a right (*ie* without company consent) to retire without actuarial reduction between ages 60 and 63 (ii) a right to retire with company consent between ages 50 and 60 in which case actuarial reduction would be for the years under age 60 and not NRD and (iii) a possibility that, where a member had left service and was under the age of 60, the deferred pension should become payable at age 60. In the Rectification Action I held that the possibilities identified in (i) and (ii) are correct but rejected the possibility identified in (iii).

1315. I have already mentioned Mr Newman's letter dated 18 June 2009 to Holdings attaching the Trustee's formal written response to the Project Waltz proposals. The letter indicated that if the Project Waltz proposals were implemented the Trustee expected to make a substantial reduction in the allocation of the assets of the UK DB Plans to return-seeking assets on the basis that there seemed to be only limited benefit to the Trustee from continuing to invest in return seeking assets compared to the significant risks involved. Under the heading "Communications with Members" appeared the following:

> "As stated at the Trustee meeting on 11 June, the Company should take care that the information provided to Members is full, accurate and not misleading. In this regard please note that any change to asset allocation may impact on early retirement reduction factors."

1316. The point which Mr Tennet makes here, and with which I agree, is that a shift away from return seeking investments could affect the discount rate, the ERDF, to be applied when calculating the quantum of an early retirement pension. The rate would reduce from the 6-7% p.a. then applicable to a lower figure. It was therefore important that, when communicating the imposition of the new ER policy, IBM should not mislead members by an implicit threat of discount factors as high as 7% but should explain that the figure would be lower – and why. This point was never made by IBM in its communication with members, whether in written communications or at the various roadshows which were held to explain Project Waltz where ERDFs of 6%, and sometimes 6-8%, were suggested. It seems to me that this point could have been an important one to some members in making their decisions.

1317. IBM received communications from DLA Piper representing some disaffected DB members and from the Trustee during the course of November 2009. IBM can have been left in no doubt that the rectification claim had real merit. Nor can it have been left in any doubt that the Trustee, at least, regarded the actual communication exercise as defective in failing to put across to members the message which IBM itself was intending to put across. In particular, Mr Newman noted, in an email dated 12 November, that in his view a significant number of members simply did not understand precisely and completely what IBM was attempting to achieve: in particular, they were making decisions on the basis that by not signifying their agreement they were only foregoing pensionable increases for the period up to April 2011 and that "for many of them they may conclude that this is a risk well worth taking in the current low inflation/low ESP plan environment". The Trustee's legal advice was communicated to IBM by Nabarro on 13 November. Concern was again expressed that members might request early retirement during the window "in the erroneous belief that, if they do not opt for early retirement at this stage, they may not be able to retire until age 63….". IBM was asked to delay closure of the Early Retirement Window until these issues had been resolved, but it did not do so.

1318. I have already mentioned, in passing, two concessions made by IBM in relation to early retirement. The first was made on 4 December 2009 and was to the effect that those individuals who had transferred from the N Plan to the C Plan on 6 July 1983 would be granted consent to early retirement from age 60 in all but the most exceptional, business-critical circumstances. IBM sent a further email on this aspect on 9 December 2009, 2 days before the deadline for accepting any offer of early retirement through the Early Retirement Window. The concession would apply not only to those who transferred from N Plan but also to those who joined C Plan at its inception on 6 July 1983. Whether this was clarification, as the email stated, or whether it was an extension of the class, as the RBs now contend, does not much matter for the point in hand, namely that this group of people would have been uncertain about their position and would have received the clarification very late indeed in the day. As Mr Tennet puts it, these members were given 2 days in which "to change the life-changing decision with which they had been struggling". IBM has no answer to that which I find satisfactory.

1319. A further concession was made on 17 February 2010 on similar terms in relation to those individuals who had been employed by IBM in 1982 or early 1983 and who were then under the age of 25 and so could not join the C Plan in July 1983 but did so before November 1983. Some of these people would already have left IBM's service by this time.

1320. IBM says that this was a reasonable approach to take at the time (and was certainly not an approach that breached the more severe test imposed in relation to the *Imperial* duty) and the mere fact that the Court has subsequently found against IBM in the Rectification Action in this respect does not alter that conclusion: the test is not what IBM now knows but rather what it believed at the material time. That, as a proposition, has some force: but privilege not having been waived, I am in some difficulty in simply accepting an assertion that the modifications reflected IBM's assessment of the correct answer to the rectification issue rather than a solution which (it hoped) would remove the problem from the landscape and enable Project Waltz to proceed with at least one challenge removed.

1321. Mr Tennet correctly points out that, in any case, the concession was stated to be a matter only of "policy" and did not recognise that, if the rectification claim was a good one, the concession would (i) not be a concession at all and (ii) would not go nearly far enough since there would be a right to an unreduced pension if retirement took place (without consent) between ages 60 and 63. No explanation was given of what "exceptional, business critical, circumstances" were.

1322. Certainly, IBM itself seems to have recognised the damage caused overall. An example of that comes from a video of a Leadership Team Roadshow at Warwick in late October or early November 2009, in relation to which we find the following question and answer by Mr Riley:

> "Q. How will you re-build employee trust?
>
> A. Trust is a word that has been used a lot in the communication - probably the word that appears the most. Again, if I'm really honest, I think I would say that we probably won't be able to re-build trust with some employees, and, as an IBMer who has been with IBM for 25 years, I don't say that with any sense of pride at all. But I think that's a reality, not only from the changes we are talking about here but other changes that have been made in past years which have also been referenced a lot."

The 2009 Non-pensionability Agreements

1323. I need at this stage to say something more about the 2009 Non-Pensionability agreements. It was part of IBM's strategy to achieve the Project Waltz savings that members should agree, on an individual basis, that future salary increases would be non-pensionable.

1324. On 27 October 2009, Mr Ferrar emailed the affected IBM UK employees with an online tool by which employees could agree to the non-pensionability terms by a deadline of 10 November 2009 stating:

> "I am writing to you to explain that any salary increases offered as part of this and any future ESP will not be pensionable as long as you remain a member of a Defined Benefit pension plan, even if such salary increases are backdated. …
>
> If you do agree to accept that any further salary increases will be non-pensionable for Defined Benefit plan purposes (by ticking the acceptance box in the tool below), further salary increases will be included in the calculation of pensionable salary for the purposes of an IBM Defined Contribution Plan.
>
> If you do not agree to this term (either by ticking the non-acceptance box in the tool below or by not responding in accordance with the deadline set out below) you are advised that you will not be eligible to receive any salary increases.

Please find the tool below to register your acceptance or not of the terms described above which must be submitted no later than 5pm GMT on Tuesday 10th November."

1325. I think the natural reading of that is that a member who did not elect would never receive any salary increase. Some members were evidently confused as to whether they were giving up pension increases in the period up until April 2011 or for ever because, apparently, some C Plan members had been told that the exclusion from being considered for salary increases would last only until 5 April 2011. 582 members e-mailed in a standard form which had been prepared for dissatisfied members to use. They wrote to complain about the timeframe in which acceptance was demanded, to object that any acceptance would not be informed consent, to indicate that their acceptance of these 2009 Non-Pensionability Agreement terms was "under duress" and to reserve the right to revoke their acceptance in the light of the outcome of the anticipated Court proceedings to clarify the validity of what IBM UK was doing. Other members sent their own individual objections.

1326. On 9 November 2009, Mr Ferrar sent a further email to the affected employees which extended the deadline for acceptance to 16 November 2009 and explained that "the process associated with the acceptance or non-acceptance of these terms will remain in place through to 5 April 2011" (I add that in fact further agreements were made in 2011 between Holdings and many employees). It was also explained that failure to accept the terms by the deadline would result in no salary increase for 2009 but also that an employee who did not agree the terms (or failed to respond) would retain the option to change his mind after the deadline but this would be taken into account only for salary increases during 2010 and up to 5 April 2011.

1327. Of the 3,798 active DB members who were asked to accept the 2009 Non-Pensionability Agreements, 3,066 accepted, 27 rejected them and 705 did not respond. Accordingly, an employee who did not sign up would not receive a salary increase for 2009 – 2011 (with matters being reviewed thereafter) regardless of these factors identified by Mr Tennet:

i) the individual employee's ability, future performance, effort and contribution to the employer's business;

ii) Holdings' own performance and profitability;

iii) any future changes to that individual employee's responsibilities; and/or

iv) future increases in the cost of living, no matter how extreme.

1328. By letter dated 7 October 2010 IBM UK confirmed that, even if the closure of the UK DB Plans were held to be invalid (*eg* as being outside the scope of the Exclusion Powers), IBM UK would still seek to enforce the 2009 Non-Pensionability Agreements. The RBs describe the result of that as being that members would be denied any protection of their accrued pension against inflation. That is true to some extent, but only if it assumed that pay increases match inflation. Moreover, it was always open to a member to opt out of the DB Plan and thus become entitled to statutory revaluation of his accrued pension. But the downside of doing that is that the member would cease to have any further accrual of pension, whether in the DB or the DC sections.

The business case for Project Waltz

1329. IBM's case at the outset of the trial was that the Waltz changes were made for sound business reasons comprising a global strand and a local strand. Mr Simmonds submits that the evidence bears out its case. The RBs submit that the business case is spurious: IBM's real reason for Project Waltz was to meet EPS targets and that was, in effect, the be-all and end-all of the matter. For my part, I do not think that there is necessarily an inconsistency between IBM's asserted business justification and the RBs identification of the reasons, or motives, for the Waltz changes. At this point, I turn to IBM's case, making some observations as I go along. I will then consider the RBs' criticism of the business case (so far as not already dealt with) together with IBM's riposte.

1330. In summary, the two strands were:

i) The global strand of IBM Corporation requiring costs savings in all areas (including pensions). This was required in order to meet its commitment to investors to improve EPS from $6.06 in 2006 to between $10 and $11 in 2010, contained in the 2010 EPS Roadmap and in the light of the global financial crisis of 2008 which was projected to have a dramatic effect on IBM's ability to meet that commitment.

ii) The local strand of Holdings' need to address its current and future lack of competitiveness, demonstrated by its failure to meet its PTI targets and its relatively lowly position compared to other IMTs. Holdings' pensions costs were increasing by reason of the fall in asset values following the 2008 financial crisis. The answer to these problems was UKI Transformation under which it was sought to transform the UK business to increase its profit margin (and, hence, its contribution to the earnings of the global business) from 23% to 34% by the end of 2012. The Project Waltz changes served to assist in meeting the objectives of this project. Therefore, although the global and local strands of the business reasons for Project Waltz were separate they were nevertheless complementary.

1331. IBM submits that either of these strands is sufficient to justify the Project Waltz Changes. On IBM's case, all of the RBs' arguments against the business justifications reduce to one of two complaints:

i) "it's not fair", or

ii) IBM management could have looked at the matter in a different way and made a different decision.

1332. But, it is said, neither of these complaints can found a breach of the *Imperial* duty because:

i) fairness is not part of the *Imperial* duty; and

ii) the *Imperial* duty does not take responsibility for the way business decisions are made out of the hands of management and into the hands of the Court.

1333. The RBs would certainly not agree with IBM's categorisation of its complaints. The "it's not fair" argument is to mis-describe the real complaint which is that IBM's actions were such as to give rise to a breach of the *Imperial* duty even if the test which I have adumbrated, of irrationality and perversity, is applied: there was unfairness of such an egregious nature as to give rise to a breach of duty. Nor is it suggested that the court should make management decisions for IBM: the suggestion is that the decisions actually made gave rise to a breach of duty from which a remedy must flow. Decisions made may therefore need to be reversed but it is no part of the RBs' case that I should impose some other business decision on IBM.

1334. That said, IBM's case, of course, is that the decisions it actually made were rational and reasonable (indeed, it would say also fair). I must therefore examine the business case and see whether IBM's actions represented a rational response to the financial circumstances in which it found itself.

1335. But before I do that, I mention one further contention made by IBM, namely that a further reason, spanning both global and local strands, was the need to deal with the disparity of pension treatment as between DB and DC members. Dealing with that point first to get it out of the way, there was evidence from IBM that it wished to see greater parity between various groups of employees but that, as I perceive it, was because of IBM's philosophical preference for DC rather than DB provision. There was also some evidence about concern on the part of DC members that they were being penalised for a benefit accruing only to DB members. This evidence was, however, rather speculative and consisted of (i) a report (by email dated 31 August 2005) to Mr Heath by Mr Gavin Wilson of "the argument that I'm hearing on the street" and (ii) Mr Ferrar's evidence that he had a perception that there was dissatisfaction. Mr Gavin' Wilsons's email was forwarded to Mr Stephen Wilson by Mr Heath with the comment "The oher [*sic*] side of the coin". On the other side, Mr Newton, a member of the M Plan, said in his witness statement that he was not aware of any ill-feeling amongst his fellow DC members. In cross-examination, it turned out that he worked with a maximum of 25 members of the M Plan. In the light of the limited evidence each way, it can only be a matter of speculation whether or not the DC members were or were not resentful of the benefits accruing to DB members. I do not accept that concern about the disparity as a cause of dissatisfaction formed any part of IBM's thinking. I do, however, accept that a concern for parity did

feature; but, in my view, that concern was driven not so much by a desire simply to see all employees treated in the same way from an HR perspective but more by a desire that such parity should be achieved by implementation of a policy of "DC benefits for all" from a cost and predictability perspective.

The global strand

1336. I come to the global strand. IBM's case, as it has always been, is that the genesis for Project Waltz was the requirement to meet the commitment made to investors under the 2010 EPS Roadmap (announced in Mr Loughridge's investor briefing on 17 May 2007) in the light of the 2008 financial crisis. Mr Simmonds says that Mr Ferrar and Mr Riley were aware of this and saw the pension changes both as delivering savings to CHQ and as solving IBM UK issues such as profitability and parity.

1337. There is no doubt that Mr Ferrar was aware of this, and of the need to reduce the NPPC figure, at all material times. Quite what Mr Riley understood is a different matter. In his second witness statement he addressed his presentation of 29 April 2009 to the board of Holdings (see paragraphs 1217*ff* above) making reference to a number of headings including "Pension cost introduces a risk and volatility that must be mitigated". He states in his witness statement that one of the reasons for the proposed changes was that, if nothing was done, future increases in NPPC were likely to have a significant impact on the business, leaving the details to be dealt with by Mr Chrystie and Mr Koppl in their evidence. It is not entirely clear from that evidence how much Mr Riley himself knew at the time about future increases in NPPC and Mr Koppl's projections although as his oral testimony made clear he did, by then at least, appreciate that pension costs were being looked at as a way of seeking to ensure that the 2010 EPS Roadmap was kept on track. He also said that he appreciated that NPPC was an important part of what he understood to be the driver. In this context, there was an interesting interchange with Mr Stallworthy in the context of questions being asked about the selection of six countries (including the UK) as warranting particular attention in delivering NPPC savings:

> "Q. So would you accept that these six countries were selected because of their defined benefit liabilities, not because of their profitability?
>
> A. Yes, I would.
>
> Q. In the mind of CHQ, therefore, this was nothing to do with profitability, was it?
>
> A. I think in the minds of CHQ it was two things: it was moving out of defined benefit pension schemes, which it was trying to do globally; and it was about continuing to meet the EPS road map of the Company. It was about those two things together.
>
> Q. I think you have accepted that the primary motivation of the changes, the thing that started all the primary motive was meeting an EPS target by achieving some urgent DB cost savings?
>
> A. That was certainly – yes."

1338. As regards Mr Chrystie, Mr Simmonds notes he confirmed at several points during his evidence that he understood from the outset both the global and local strands of Project Waltz. That is true. But by his own account, his entire focus was on explaining the changes in the context of the UKI business model, that is to say, in the context of the local strand. He took the decision on Project Waltz as having been made. Thus in preparing for his presentations of matters to the board of Holdings on 29 April 2009 and later to the Trustee, he described his task as building the cohesive document to present to the board and the Trustee. He did not see it as his task to justify the decisions that had been taken; rather it was to communicate them. I consider this aspect of his evidence in the section below under the heading "The local strand" at paragraphs 1360*ff* below.

1339. It is part of IBM's case that the effect of the crisis was so to change the financial landscape that further changes to the DB Plans were necessary to meet the 2010 EPS Roadmap; and that to meet the 2010 EPS Roadmap was a rational and reasonable business objective. Nothing said by IBM in relation to Soto constrained IBM in its actions in relation to the DB Plans beyond the constraints which already applied (*eg* complying with the terms

of the Trust Deed and Rules) at all; still less did they constrain IBM from taking the steps which it did take in the light of the changed circumstances.

1340. Mr Simmonds contends that the global strand justified IBM's overall commercial decision. Thus he submits:

i) There is no suggestion that the NPPC assumptions underlying the 2010 EPS Roadmap – made in 2007 before the financial crisis hit – were other than reasonable, best estimate assumptions.

ii) Both Mr MacDonald and Mr Koppl testified that IBM senior management considered it vitally important not to renege on the commitment despite what had happened in the markets in 2008: this was not challenged by the RBs. In the same light, keeping to the 2010 EPS Roadmap commitment was a perfectly rational objective for management to have: whilst the members might disagree with that objective, that was a business judgment for management to take. As Mr Ferrar put it:

> "…we are running a business and we have committed to investors a certain earnings per share. I think we wanted to make sure our investors got the return of the money they put in our Company."

And similarly Mr Chrystie:

> "These are extraordinarily difficult decisions, gut-wrenching decisions that nobody likes to have to make, but we have made commitment to Wall Street, and the Corporation needs to meet those commitments."

1341. As to the first of those, I do not understand it to be challenged.

1342. As to the second matter, not reneging on commitments to Wall Street, there is obviously great force in that and I do not doubt that senior management did hold the view expressed. Other commitments could not, however, be ignored. IBM would not, for instance, have been able simply to ignore its contractual commitments. Thus if it had had in place contractual bonus schemes, it would have had to meet its contractual obligations or, if it chose, or was forced, to breach those obligations it would have to suffer the consequences in terms of damages claims. Similarly, if IBM had made statements which, contrary to its position on the facts of the present case, gave rise to Reasonable Expectations, then IBM would need to show that the commercial imperative of meeting the 2010 EPS Roadmap enabled it (on the unitary approach which I have adopted) to override those expectations and that doing so would not, objectively, destroy or seriously undermine the relationship of trust and confidence which lies at the root of the *Imperial* duty; or (on the two-pronged approach) that it was justified in acting contrary to those expectations. The issue is not whether IBM's commercial choices are of themselves open to challenge but whether those choices give rise to a breach of the *Imperial* duty, in relation to which I do not consider there is any inconsistency in a decision by IBM being at one and the same time a reasonable commercial decision (provided previous statements giving rise to expectations are ignored) and a breach of the *Imperial* duty.

1343. The parties appear to have a radically different view of market changes in 2007-08 and of what was and was not predictable. Mr Simmonds records that on IBM's case Project Waltz:

> "was played out against the backdrop of a financial crisis of almost unprecedented and unpredictable magnitude. Global stock markets fell between 30% and 40%, and the value of IBM's global pensions assets fell by 25%. It was aptly described by Watson Wyatt, one of the Plans' investment advisers, as a *1 in 60 year event.*"

1344. The RBs contend that the effects of the 2008 market falls were not unprecedented or unpredictable. They say that the overall effect of the 2008 falls was substantially less than the effect of the dot.com crash between 2000 and 2002: 2008 was easily foreseeable. I set out the thrust of their submissions in the following paragraphs, adding some comments.

1345. In their written opening submissions, the RBs referred to the dot.com crash which on their case results in Main

Plan ROA falling short of EROA by £2,052m compared with a shortfall of around £1,342m in 2008, commenting that for the purposes of US GAAP accounting, it was not just negative ROA that caused a problem, but rather a failure to meet EROA, which was around 10% at the time. They contended that the 2000-2002 crash was more severe than the 2008 falls that precipitated Project Waltz, mainly because it lasted three years, rather than just one. For the purposes of US GAAP, the following figures (which I take from the written opening which in turn took the figures from the Main Plan 2002 Survey and the UK Main FS Model 2012 March Sensitivity analysis) appear (and have not been challenged):

i) In 2000, 2001 and 2002 the Main Plan incurred actuarial losses (namely a shortfall of actual ROA from EROA) of £488m, £699m and £865m respectively, totalling £2,052m for the duration of the 2000-2002 crash. (In 2003 the Main Plan began to make actuarial gains as ROA well exceeded EROA.)

ii) Comparing that three-year window with the falls in 2008 (which was preceded and followed by years of ROA approximately meeting or exceeding EROA), in 2008 there was an actuarial loss of £1,342m.

iii) Accordingly, the actuarial losses from the 2000-2002 crash were over £700m greater than those from the 2008 falls.

1346. Matters were made worse, in 2005-6, when the effects of the asset falls in 2000-2002 were compounded by falling discount rates (and thus bond yields) which increased the liabilities of the DB Plans (the PBO under US GAAP). IBM itself described this effect as a "perfect storm": see a note prepared by Ms Roin (Director of Pension Benefits, CHQ) on 30 June 2005. The effects of market falls in 2008 were not compounded by falling discount rates in a similar way.

1347. Having experienced worse falls 6-8 years earlier, there was nothing unprecedented or unforeseeable about the 2008 crash. In fact, the dot.com crash and the falls in 2008 were, it is said, part of a long-term trend which saw very significant falls in the markets – for example, in 1974 equities fell by 57.1% in real terms. Rather than being either unexpected or unprecedented, a significant fall in asset values at some point would have been reasonably foreseen by IBM in adopting a strategy heavily weighted to equities.

1348. It is true that there was nothing unprecedented about a market crash. Whether the causes of the 2000 – 2002 crash and the 2008 crash had much, if anything, in common would be a matter for expert evidence of a nature I have not received and so I cannot make any assessment of the relevance of that part of the submission. As to the other part of the submission, it may be a fact of life that a crash occurs from time to time in an investment cycle, although markets and regulators attempt to avoid such occurrences. But to say that this particular crash, with its particular severity and unpredictable consequences, was foreseeable strikes me as a rather startling proposition. It should not be forgotten that there were real fears about a collapse of the international banking system and concerns that market falls might continue, far outstripping the actual falls which were seen. I do not believe that anyone would have regarded this sort of crash as predictable except, perhaps, in the sense that disasters of this sort might be expected to occur very rarely – Watson Wyatt's 160 year event.

1349. The next limb of the RBs' case on the predictability of the 2008 crash rests on the proposition that, by the time the decision, post-Soto, to take action in relation to DB pensions was made, the markets had not even fallen to their full extent: Waltz was a response to much more minor falls. The RBs rely on Mr Koppl's slides for the presentation on 24 July 2008 and his presentation to Mr MacDonald and Mr Loughridge on 26 August 2008 (see paragraphs 1101 and 1102 above).

1350. The highlights for present purposes of those presentations are:

i) That this was the first forecast that the 2010 EPS Roadmap target might not be met.

ii) And yet the level of projected savings was already unacceptable to IBM. For good measure, Mr Tennet adds that pension changes were back on the agenda, even though global NPPC was improving, because that improvement was not by itself enough to bring the proposals back on track.

iii) The projection by 26 August 2008 had fallen to $0.66.

iv) Mr Koppl agreed that there was not an 'unprecedented fall in stock markets' but that the shortfall from $0.90 was a 'problem'.

v) The focus was to be on making DB savings.

vi) Mr Koppl said that he started to consider DB savings more generally at this stage.

vii) And so Mr Tennet submits that it took just a shortfall of $0.24 from the EPS target, and Main Plan falls of just -7.6% (even offset by discount rate improvements), for Mr Koppl, Mr MacDonald and Mr Loughridge to decide that DB changes needed to be made on 26 August 2008.

1351. Mr Tennet describes these deliberations as resulting in a decision. But as I have explained I do not see matters that way. A decision did not come until later although it is of course obvious that options in relation to the DB Plans were under active consideration.

1352. At this time of the decision to do something, the markets had obviously fallen, but much more severe falls had not yet been experienced. Market falls were particularly bad at the start of October 2008, and on 15 October 2008, when the sudden falls prompted Mr Loughridge to ask Mr Koppl to produce an emergency update of the retirement related costs forecast overnight. I have rejected Mr Tennet's submission that a decision had already been made and thus reject, also, his submission that these falls were not causative of the decision. But I must emphasise that even if, contrary to my finding, a decision had already been taken, that should not disentitle IBM from making a renewed decision based on the new factual circumstances. It is an absurd proposition to say that by making a premature, and (assume for the sake of argument) invalid, decision in August 2008, IBM is precluded from making another decision in October 2008.

1353. Mr Simmonds describes the arguments made by the RBs which I have just addressed, as an attempt to "shrug off 2008/09 as a minor blip in the investment markets, or apply 20:20 hindsight when maintaining that the financial position improved subsequently". As to that, I accept Mr Koppl's testimony that, in 2008, people thought that the financial crisis was going to deepen, and it was only in retrospect that the collapse of Lehman Brothers represented the darkest hour of the crisis. The FTSE reached its lowest point in February 2009 (33% down on its 2008 high) and [Main Plan]asset returns for 2009 were still negative until June 2009 (facts which I do not think are challenged and which I take respectively from a slide prepared by KPMG for a presentation on 16 April 2009 and from an IBM Retirement Cost Forecast for 10 July 2009, presumably prepared by Mr Koppl).

1354. If I leave out of consideration for the moment (thus begging the major issue for the sake of the argument) the statements on which the RBs rely as giving rise to the alleged Reasonable Expectations, it seems to me that the response of IBM (by which I mean IBM Corporation/CHQ) and through it the response of group operating companies around the world to the 2008 crash made perfectly good commercial sense. I agree with Mr Simmonds' analysis that the facts demonstrate that the commitment to the 2010 EPS Roadmap was an entirely rational reason for the Project Waltz changes: it made perfect sense on the financial data available to IBM, as the savings made from the pension changes flowed into reductions in the NPPC, which in turn assisted in achieving the ultimate EPS target. But that is from the perspective of IBM Corporation. It is a different question whether Holdings could properly have implemented the Project Waltz changes given the Reasonable Expectations which have been established. Accordingly, the rationality of the commercial decision by IBM Corporation is not the end of the matter as Mr Simmonds submits that it is.

1355. Turning to Holdings position *vis a vis* the global strand, it has to be remembered that Holdings does not sit in splendid UK isolation. Not only does it have markets going beyond these shores, it is part of a far larger global business under IBM Corporation and with high-level governance in CHQ. It does not have, commercially, total independence. The "powers reserved" system is a reflection of the control retained by CHQ. Importantly, internal investment from CHQ within IBM in its regions is a matter of central significance, a point I will develop in a moment. A healthy Holdings requires a healthy IBM Corporation, and Armonk generally, with CHQ in particular, in charge of the major decisions about that corporate health. One may agree or disagree with their

business philosophy (as we have seen, less than polite comments have been made about Mr Gerstner and Mr Palmisano: see paragraph 528 above) and one may agree or disagree with particular decisions. But that is not the point: the point is that these management decisions are precisely that and so are to be made by management. The court should intervene in the present case only if there has been a breach of the *Imperial* duty which requires irrationality or perversity in the sense which I have described it.

1356. In particular, reasonable minds might differ about the importance of sticking to the 2010 EPS Roadmap - come hell or high water as the RBs might perceive it or as a rational response to market demands as CHQ might perceive it. That decision, however, lay with CHQ subject always to the impact of Holdings' *Imperial* duty.

1357. In the light of that, Mr Simmonds submits that it makes no sense for the global strand of the business justification for Project Waltz to be given any less relevance than the local strand when assessing the justification for the pension changes. I will be coming to the local strand in a moment. As to that, he submits that, although the evidence for the local strand is compelling, the Project Waltz changes would have been perfectly justified even if the global strand were the sole reason for the changes. Indeed, IBM does not deny that the Project Waltz changes would most likely have gone ahead even if the global case was the sole strand of the justification.

1358. Conversely, it is unrealistic to view the global strand and the local strand as completely distinct: the need to improve current and future profitability, which IBM says formed a critical part of the local strand for IBM UKI, was one of the headline objectives under the 2010 EPS Roadmap, as was the related domestic target of achieving double-digit annual PTI growth. That those were the objectives, I do not doubt, although whether the need to improve current and future profitability locally has anything to do with Project Waltz is a different matter. The RBs have suggested that there was no evidence that the achievement of the 2010 EPS target depended on Holdings increasing its PTI margin (in contrast with its absolute levels). But the 2010 EPS Roadmap clearly did seek a contribution to EPS increases through margin improvement. And Mr Chrystie, in his evidence, explained how margin expansion could be achieved. So I do not agree with the RBs on this point.

1359. There is one other point to make before moving on to the local strand. I have mentioned the TMM on 8 May 2008 (see paragraph 1089 above) and the presentation by Mr Wilson about NPPC. For present purposes, the relevance is that reference is made in the minutes to NPPC having been cited by Holdings in 2006 as part of the reason for the Soto changes. Mr Simmonds cross-examined Mr Lamb about this and submits that Mr Lamb's approach at the TMM was consistent only with an understanding on his part that it was an option open to Holdings to make further changes if NPPC proved to be a problem: otherwise, he, Mr Lamb, would not have said at the TMM what he did. That is not fair to Mr Lamb who has consistently acknowledged that a significant change in circumstances might mean that there was a need to revisit the DB Plans; but he was adamant that a single year's poor NPPC figures would not justify Holdings doing so. I accept that what Mr Lamb said is confirmation – which is not needed in any case in the light of the way in which the RBs put their case – that Holdings was giving no guarantees about the future. But nothing which Mr Lamb said leads me to a different conclusion about the Reasonable Expectations which I have decided are established; indeed, this evidence was taken account of by me in reaching my conclusions.

The local strand

1360. IBM stands behind the rationale for the local strand, that is to say Holdings' business case, set out by Mr Chrystie in his witness statement. Rather than reinvent the wheel, I set out almost verbatim starting at paragraph 1365 below, the summary contained in IBM's written closing submissions under this heading. Mr Simmonds' text is based on the witness statements and oral testimony of Mr Chrystie and Mr Riley. They were subjected to cross-examination on this aspect of their evidence and on UKI Transformation generally. Although the RBs did not, and do not accept, that the UK business case had anything to do with the decisions to plan and implement Project Waltz but had everything to do with an *ex post facto* rationalisation of the decision made for the sole purpose of meeting EPS targets, I am satisfied that Mr Riley was entirely sincere in his perception of the need for UKI Transformation and in embarking on that voyage of change. After all, the transformation programme (or should it be program?) got under way before Mr Riley had been told about Project Waltz; and the fact that PTI

(carrying with it in practice the imperative of NPPC savings and meeting EPS targets) came to dominate the thinking of UK management does not mean that UKI Transformation became nothing more than a fig-leaf justification for Project Waltz in the UK.

1361. Equally, I am satisfied that when Mr Chrystie came to the UK, he had a genuine concern to look at all aspects of the UK business to see how they could be improved and deliver savings to the global enterprise. He was pushed very hard by Mr Tennet to accept that his only concern was to deliver on the pensions savings and that the rest – the development of the business justification – was no more than an exercise in advocacy. He did not accept that. Mr Tennet had extracted from Mr MacDonald an acceptance (I will need to say something more about that later) of the proposition that the work-plan described in the presentation to him on 3 March 2009 was an exercise in advocacy and he attempted, without success, to get Mr Chrystie to agree with that. As he repeatedly explained in his oral testimony, he saw two motivations (sometimes he used the word "strands") for the "three plays", for the Project Waltz changes:

> "there is the motivation of solving the earnings per share problem and there is a motivation of saying: look, the UKI is not delivering in line with the corporate model, and now you have got pension headwinds that are going to be added on top of that. Again, I clearly read from that there were dual motivations."

1362. He did, however, see the second motivation as part of the first motivation. As he put it, "the need to grow 10 to 12 per cent each and every year is linked to the Corporation's commitments". I add that the need to produce NPPC savings is not merely linked to, but is required by IBM Corporation's commitment to investors.

1363. For my part, I do not see any inconsistency between (i) Mr Tennet's proposition that the decision had already been made about how to deal with pensions globally and in the UK by the time of Mr Chrystie's own appointment and (ii) Mr Chrystie himself having a perception that there was a need for other business changes in the UK as part of his role to deliver on the EPS target. Indeed, there may, in theory, have been a clear business case for making pensions changes in the UK having nothing to do with NPPC but to do with the expense of on-going accrual and other factors (the sort of factors which have led many UK businesses over the last few years to close their DB schemes to further accrual).

1364. I set out Mr Simmonds' summary of the local strand in the following paragraphs making some comments as I go along.

1365. In summary, IBM UK faced severe challenges in terms of profitability, both in terms of failing to achieve CHQ's targets, and lagging behind other regions.

i) The CHQ model required local businesses to achieve 10 to 12 percentage points of PTI growth each year: the UKI's figures were -7% in 2007 and +2% in 2008. This appears from one of the slides prepared for the presentation to the board of Holdings on 29 April 2009 (see paragraphs 1210 and 1211 above). There was no challenge to the comment on the slide that PTI growth was not in line with annual growth objectives; indeed Mr Wilson accepted that. Further, the PTI growth target for 2006 had not been met: only 93% of the profit plan was achieved. The CHQ model of 10%-12% annual PTI growth had formed part of the May 2007 roadmap presentation to investors. Holdings had serious issues with a number of its large services contracts, and urgent action was required to make its costs structures competitive. That is not to say that the UKI business had not been growing revenue successfully and slightly ahead of the other mature markets: in cross-examination, Mr Riley reiterated that there had been very positive signs of growth in the UKI business. However, the senior executives of IBM believed that IBM UK could be doing much better; the UK market generated more incremental market opportunity at this time than any other market in the world with the exception of the USA. As Mr Chrystie said in cross-examination, the definition of success in IBM is:

> "double-digit PTI growth year after year. The revenue is growing 3.7 per cent when the market is growing at a similar -- in a similar way. The global financial crisis of 2008 puts us in a situation where we can no longer depend upon that revenue growth continuing, and we have to make profit improvement through productivity."

ii) The UK business was not performing well in comparison with the other regions as was shown by the comparison chart created by Mr Chrystie for the board meeting of Holdings on 29 April 2009.

iii) This was not just a matter of brand mix: the margins for the individual brands in the UK were significantly lower than the margins achieved for the same brands in other regions. This appears from the table for UK brand margins by comparison to worldwide brand margins referred to by Mr Chrystie in cross-examination. He says, and I see no reason to doubt, that these figures had been obtained by him from CHQ so as to ensure that he was comparing like with like. Mr Wilson accepted that the comparison of regional performances was an important tool for CHQ.

iv) As to the suggestion of poor performance, Mr Simmonds refers me to one of the slides for the Holdings board meeting on 29 April 2009. This presentation was made to make out the case of "Changing our Pensions Strategy". The particular slide referred to demonstrates "UKI Performance vs Rest of World" taking account of the impact of DB costs (or perhaps more accurately, a failure of the DB Plans to deliver anticipated profits). Unless I have missed something, none of the slides in this presentation indicates relative performance of the underlying businesses of UKI and other regions. This presentation, at least, does not show a need for any significant changes to other aspects of the UK business in relation to which, as an earlier slide notes, "UKI revenue performance has been in line with business model". I do not understand, therefore, why it is said on the basis of this slide, or indeed the whole presentation, the UK business was not performing well other than as a re-statement of the proposition that NPPC costs had to be reduced if the Plans were to deliver the necessary contribution to the EPS target.

1366. IBM UK's share in the higher-margin software market was well below that of other mature markets like Germany or the USA, and in the services sector there was a proliferation of new entrants, including many Indian-based firms and large local UK-based companies. This was the evidence of Mr Chrystie and Mr Riley which I see no reason to doubt.

1367. As a consequence, it is said that the UK was experiencing difficulties in attracting investment from CHQ and the various business units into the UK business, which had an effect on salary increases and job creation. Each region competed with the others for investment from CHQ and the business units, which naturally invested money in regions that produced the best returns. Decisions may have been linked to returns after taking account of NPPC but that does not detract from the point.

1368. IBM submits that there is nothing irrational or arbitrary about UK management seeking pensions savings, especially in the context of the UKI Transformation programme that was seeking improvements in all areas of the business: obtaining investment from within IBM Corporation was dependant to a large extent on meeting corporate objectives. There can, I think, be no doubt about that last proposition; indeed the RBs rely on it in the sense that they say the objective of CHQ was NPPC reduction and meeting EPS targets. The threats to CHQ investment were they say not driven by operational issues and profits derived from the core business but were driven by that objective alone. The equation was simple: "Insufficient contribution to NPPC cost = No investment". CHQ saw that contribution as being boosted by the Project Waltz proposals.

1369. Mr Simmonds says that as a result of CHQ's approach to investment, UK employees received no salary increases in the 4th quarter of 2008; and in early 2009, clear indications were being given that IBM UK was unlikely to see a salary increase programme from CHQ for 2009 without changes to its cost structure. Thus, in his 29 April 2009 presentation to the UK board, Mr Chrystie raised the prospect of needing to consider unpaid leave or reduced working patterns for employees if UK profitability could not be improved. A slide to which Mr Simmonds refers asks "What are the implications if we do not make this change?", the change referred to being a change to the DB Plans. In other words, the prospect to which Mr Chrystie was referring would be eliminated if actions were taken in relation to DB pensions. But that does not detract, I consider, from the fact that the main driver for change was the need to reduce NPPC. And the same goes for the salary freeze.

1370. In this context, I should refer again to the email sent on 28 January 2009 by Mr Koppl to Mr Greene informing

him that Mr MacDonald had "put a hold on all compensation increases in the countries that are involved in the DB redesign work. This could make a big difference in getting the DB projects done." That is a clear demonstration, to my mind, that the salary restrictions for 2009 to which Mr Simmonds refers were themselves driven by concerns about DB costs and designed to put pressure on UK management (and the management of other countries with DB schemes). That decision reflects, to my mind, the same view of the DB Plans by Mr MacDonald as that held by Ms Salinaro and expressed in her email dated 30 August 2005 (see paragraph 760 above).

1371. Returning to Mr Simmonds' submissions, he says that, in addition to this, IBM UK was facing financial conditions where it could not depend upon revenue growth to fuel growth in PTI. Mr Simmonds has referred to a part of Mr Chrystie's cross-examination on this point. He described Mr Tennet as being reduced to second-guessing the market analysis of IBM globally and the business analysis of one of its senior executives, *ie* Mr Chrystie. I do not think that that is wholly fair since Mr Chrystie and Mr Tennet were not on quite the same territory. Mr Tennet was trying to get Mr Chrystie to accept that he had not carried out an appropriate analysis of the profitability of IBM UK's businesses and that there was a prospect for growth. Mr Chrystie's point was that there was no prospect for growth which would provide enough profit to meet CHQ's requirements. Thus it may be that some PTI growth could be fuelled by revenue growth but not to the extent of satisfying CHQ. Mr Chrystie's position can be seen in this interchange in which he was addressing one of the slides ("IBM Global Market View – UKI") for the presentation to the board which I have just mentioned. The slide states "GMV suggests that business environment will be challenged at least through 2010" putting additional pressure on the ability to sustain top line performance and reinforcing the need to focus on productivity. The interchange was this:

> "A…….. What this is telling us is back in 2007 and 2008, just if you stay in the upper left [of the chart], the prospects for revenue growth in the market were very good. But because of the financial crisis of 2008, we are now speculating that for 2009 all the way through 2010 we cannot depend upon revenue growth as a way to help us drive our additional profit.
>
> Q. You are speculating. The fact is UKI revenue growth did continue to grow, didn't it?
>
> A. I don't believe in 2009 -- we were given a plan that was minus 2, okay, it is possible it could have, but at the time we were putting this together, this was the information we were looking at; it was a huge valley, and no reasonable person could have expected to be able to get PTI leverage out of revenue growth when this is happening in the markets."

1372. And later on he described his approach this way:

> "The way I approach this, okay, is that we have a desire to -- we have an imperative to improve our performance by over 700 million through four years. While we are doing that, we have a pension headwind in that time period that can be -- and we have said the numbers -- £116 million to £235 million. The way I looked at that is that would have been -- that would have had me solving, not a $700 million problem, that would have had me solving up to a $1 billion problem. The way I approached this was it was necessary to make those changes to the pension plans to help neutralise the effect of the growing year over year NPPC to allow us to go drill into 20 plus other things that we had to do to improve business performance. That was my thought process." [By "headwind" he meant, in effect, the impact of the year on year increase in NPPC cost on the improvement expected by CHQ in profitability performance.]

1373. Mr Simmonds says that, in practice, a significant part of growth in PTI (whether absolute PTI or PTI margin) had to come from cutting costs to produce a leaner business. This was one of the stated objectives of the UKI Transformation project. In that context, he refers me to a number of slides (out of many examples):

i) Two slides prepared for the Trustee meeting on 7 May 2009. I have described the presentation at paragraph 1237 above. Relevant for present purposes is the identification in the Executive Summary of the need to examine all elements of spending including Margin/Mix improvement. But the "Executive Summary – Proposal" slide

was concerned only with pensions. And pensions were clearly the focus of the presentation and, hardly surprisingly, the meeting since this was a meeting of the board of the Trustee. The presentation did, however, note that both GP Margin and E/R [expense to revenue] were behind the worldwide average. And it is right to say, as Mr Simmonds does, that the wide range of UKI Transformation is identified in the slide headed "Areas of Focus".

ii) A slide in the presentation to executives on 6 June 2009 (see paragraph 1248 above) headed "The Change Required" contained reference to "Multiple Focus Areas":

> "• Go To Market efficiencies
>
> • Brand specific initiatives
>
> • Revenue plays that also drive mix or margin expansion
>
> • Labour & Infrastructure reductions"

iii) A slide in the presentation to the leadership team roadshow on 2 November 2009 referring to "a detailed plan within UKI Transformation" giving further sub-headings under each of the four headings which I have just set out in the preceding paragraph.

1374. No doubt Holdings was giving consideration to these aspects of its business. I am sure that both Mr Riley (who instigated UKI Transformation) and Mr Chrystie (who continued it) were genuine in their operational concerns. They wished to find a way of cutting costs to make the UK business more efficient. Mr Chrystie, however, was faced with delivering the level of contribution demanded by CHQ. He could not achieve that through revenue growth and had to find it through cutting costs. Nothing in any of the presentations demonstrates how a significant part of the growth in PTI was going to come from cutting costs (other than NPPC costs) to produce a leaner business. Indeed, the decision to find those cuts through changes in DB provision had come from CHQ and he had no choice in the matter.

1375. The next part of Mr Simmonds' submissions looks to the future after 2008. IBM was faced with the pensions headwind which Mr Chrystie described (see paragraph 1361 above). The economic crisis beginning in 2008 had a massive adverse impact on the value of pension plan assets and the effects of this were yet to be felt because of the way pension costs were accounted for under US GAAP. They would be felt in coming years, however, and this would add significantly to the challenges which the UK business faced and would directly affect its ability to achieve its objectives. I am satisfied that Mr Chrystie did believe that there would be this headwind, relying on the materials with which he had been provided by CHQ, and that he saw it as a problem both globally and in the UK. The relevant material, in turn, is to be found in the modelling for this problem, produced by Mr Koppl and his team. It is shown on one of the slides created by Mr Chrystie for the UK board meeting on 29 April 2009 and described in paragraphs 6.21*ff* of his witness statement, the contents of which I accept.

1376. As Mr Chrystie and Mr MacDonald explained in their evidence, this headwind was the reason why CHQ saw the need to cut pension costs even in countries that were meeting their PTI targets, such as Germany. That is an explanation which I accept. Whether all this should have been foreseen or whether it is a sufficient justification for Project Waltz are different matters.

1377. IBM contends that the need to improve Holdings' profit margins was not a new phenomenon in 2009: its problems in this respect had been identified by both Mr Hirst in 2007 and Mr Riley in 2008, when delivering UK business updates to the Trustee. In that context, Mr Simmonds relies on these matters:

i) The minutes of the TMM on 3 May 2007 record the following during Mr Hirst's presentation:

> "The discussion then focused on the UK's revenue growth and PTI margin and Mr Hirst referred to the data on chart 2 of his presentation which covered the period 2004 to 2006. He noted that in 2006 revenue had only grown by 1.5 per cent whilst the

> marketplace had grown by 4.1 per cent. It was noted the PTI margin had increased from 9.1 in 2005 to 10 in 2006 and that the changes to the IBM pension plans had in fact avoided a decrease of 1.6% in PTI. Mr Hirst stated that over the last 5 years the PTI margin had grown from 5% to 10% and noted that for the last 2 years the UK had made its profit plan. He advised the TMM Members that despite this the UK still had to fight to have mission sourced [*ie* investment] in the UK by the corporation. Mr Hirst noted that the corporate model targeted double-digit PTI growth and a 15% PTI margin over the coming years. "

ii) The minutes of the TMM of 23 October 2008 record the following during the corresponding presentation by Mr Riley:

> "Mr Riley opened the discussion by noting that IBM's business in the UK was skewed towards services. He noted that, as shown on page 2 of his presentation, although there had been some revenue growth during the first half of 2008, it had been a struggle to generate profit margins."

1378. The point is made that Mr Lamb, as a former CFO of IBM UK and then as Chairman of the Trustee board, well understood the nature of the business difficulties being experienced by IBM UK at the time of Project Waltz, although he was clearly opposed to the proposed changes. The basis of that assessment (which I think is fair) of Mr Lamb's understanding is to be found in the following:

i) As regards Mr Riley's 23 October 2008 presentation in which he had indicated that there were problems with the UK business, and in particular problems relating to profit margins, Mr Lamb stated in cross-examination as follows:

> "…The situation with regard to revenue and profits is, from my own experience, and has always been difficult in the UK because of the structure of the market; the very high level of competition that IBM faces in this country; the fact that the IBM business in the UK is more developed towards services, which have lower margins than hardware, and particularly software. So I'm not surprised by what Mr Riley told me. It was always my experience that it was a struggle..."

ii) As is recorded in the minutes of the TMM of 7 May 2009, when the Project Waltz Changes were presented by Mr Riley and Mr Chrystie:

> "He [Mr Lamb] stated that he understood the need to make changes and having held the position of UK CFO, he understood the points made by Mr Chrystie in his presentation."

iii) Mr Lamb's answers in cross-examination by Mr Simmonds are really only consistent with the view that he understood the business case being made by Mr Riley for Holdings to make changes and get out of the DB Plans. He did not, however, agree with the conclusion that this was the right business case to follow, particularly in the light of his perception of the commitments made by Holdings in relation to Soto.

1379. It is said that the problems with the UK business were generally understood by the workforce. An example is taken by Mr Simmonds from a witness statement of one of the RBs' own witnesses, Mrs Harrison who said this:

> "During the years leading up to 2009, I was aware that IBM UK was seen to be underperforming in relation to other countries. I would see quarterly reports which continued to stress the need for cost-saving drives and in particular for individuals to reduce their expenses. "

1380. Next it is said that Holdings' problems in this regard were exacerbated by the need to meet the requirement imposed in April 2009 under proposals brought forward in April 2009 (described in a presentation entitled European Productivity Exercise – Overview schedule proposals) for an 11% increase in profit contribution

margin by the end of 2012 from 23% to 34%. Whether or not this moving of the goalposts is open to criticism, Mr Simmonds says that the fact is that CHQ sets financial objectives for the local businesses, and it is perfectly entitled to demand greater productivity from them. That may be so. But it has to consider the consequences of its demands. It is not necessarily the case that, because a demand is made, Holdings is absolved from compliance with obligations which would otherwise rest on it, in particular compliance with its *Imperial* duty.

1381. It is, however, only right for Mr Simmonds to point out that these new demands/objectives were not limited to UKI, but applied to all members of the Northeast Europe IOT. The UK was not singled out for special treatment.

1382. Returning to mid-2008, the need to boost Holdings' profitability and competitiveness led Mr Riley, on becoming Country General Manager in June 2008, to begin the development of the UKI Transformation programme as I have already explained. In his second witness statement, Mr Riley gave a detailed account of the transformation programme both before and after its launch as UKI Transformation. He said in his second witness statement that pension costs were always an obvious target for scrutiny and from the outset of the UKI Transformation program, he knew that they were a difficult issue and that they would need to be looked at. IBM accepts that Project Waltz was not initially part of the UKI Transformation process. Thus, in cross-examination, Mr Riley admitted that pensions were not a major element of UKI Transformation at the beginning of the exercise and in mid-2008, but that pensions became more prominent later in 2008 and before the launch of UKI Transformation in 2009.

1383. Mr Riley thought that Project Waltz would dovetail neatly with the aims of the UKI Transformation strategy; it was seen as the type of programme that would assist in changing the profitability of IBM UK. He says that with the inception of Project Waltz, pension costs were explicitly added as an item to the productivity programme. He was aware of caution on the part of Mr Wilson in initiating further changes to pensions whom he thought felt that the Project Soto changes were such that any further changes should be resisted. Mr Riley's own view was that the severity of the situation meant that all options for potential cost savings had to be looked at. I accept that evidence of what Mr Riley believed.

1384. IBM's position is that UK management – that is to say for this purpose Mr Riley, Mr Chrystie and Mr Ferrar – *bona fide* believed in the local business case for the Project Waltz Changes. I accept that all of them did believe in that case. But that is because they accepted the need to meet the targets which were being imposed on them. I do not accept that they believed there would have been a business case for these changes if they had been looking only at Holdings' business and its operational costs including pension costs impacting on its own, UK, profit rather than on IBM Corporation's NPPC line in its accounts. Indeed, I doubt that they ever considered matters from that perspective since CHQ had in fact imposed targets which made consideration of such a scenario irrelevant. Mr Wilson had, of course, considered that scenario and was unable to detect any business case from that perspective.

1385. I have to say that I find the division of the business case in the way that it is presented by IBM into the two strands unsatisfactory. Or perhaps I am just confused. Mr Chrystie identified the two motivations which appear in the quote at paragraph 1361 above.

1386. I did not understand what he said and queried why the second motivation was not simply part of the first; to which Mr Chrystie replied that it was, for the reason explained in paragraph 1362 above. I can understand that a business case for improvements in operational efficiency and matters of that sort within the UK can be described as a local case; there is always a case for such improvements quite apart from the demands of CHQ for such improvements to be made to increase local profitability. I can also understand the business case for Holdings to make changes to the DB Plans when CHQ demands it; and in that context, it must be remembered that CHQ was not simply demanding an increase in operating profit, it was demanding a contribution to PTI improvement and to NPPC which could only be achieved by making changes to the DB Plans. The reason, I would suggest the only reason, why UK management went along with CHQ's plan was because it saw no alternative. It must be questionable, to say the least, whether UKI Transformation by itself would have resulted in the sort of changes imposed by Project Waltz if CHQ had not been insisting on the contribution from Holdings to NPPC. I can, again, see that the case for improving operating profitability can be described as "local" but if one adds the word

"strand" to that, the question immediately arises: "local strand of what?". It is difficult to see how the need to address operational matters, even if that is in order to help meet the EPS target, can be said to be a strand of any sort in relation to pension changes. And it is difficult to see how a purely local strand of pensions would take account of NPPC implications for IBM Corporation.

RBs' alleged absence of justification for Project Waltz changes and IBM's riposte

1387. The RBs have a number of reasons for saying that it was unreasonable to rely on the 2010 EPS Roadmap or any other kind of implied investor commitment as a justification for Project Waltz. These submissions are made principally in the context of Mr Tennet's two-pronged approach to the *Imperial* duty and are focused on the second prong – the need for justification of conduct which destroys or seriously damages the relationship of trust and confidence which lies at the root of the duty. The arguments which he makes apply equally, in my view, when it comes to examination of the *Imperial* duty adopting the unitary approach which I have held to be correct. Thus, factors which would, on the two-pronged approach, support the case that there was no justification for the changes will also go to support the case that, on the unitary approach, the overall conduct of IBM, even taking account of the elements of justification relied on by IBM, gives rise to a breach of the *Imperial* duty.

1388. The RBs address their submissions under seven main headings which I take in turn along with IBM's ripostes. They draw very different conclusions from IBM from the evidence (mainly documentary) about Holdings' profitability and in particular its PTI growth and PTI Margins, and where Holdings stands, in terms of its financial success, with the IBM group. I will resolve those, insofar as I need to do so, once I have addressed all of the RBs' submissions and IBM's response to them.

i) IBM's desire to meet EPS targets is not a reasonable justification for breach.

ii) IBM UK's performance targets and PTI were no justification to implement Project Waltz.

iii) Headwinds & IBM's concerns as to the future: Project Waltz was premature.

iv) The Proposal to make I Plan changes was <u>even less</u> justifiable.

v) The other reasons IBM have cited are also not reasonable justifications for Project Waltz.

vi) Parity.

vii) Preference for DC as a matter of principle/policy.

IBM's desire to meet EPS targets is not a reasonable justification for Breach

1389. This breaks down into four sub-headings:

i) The EPS "commitment" was not, or need not have been, made in the first place: it was IBM's own choice to make it.

ii) Adherence to the EPS "commitment" warped retirement provision into a profit generation centre.

iii) Adherence to the EPS "commitment" only carried risk for members, and only the possibility of reward for IBM and its top executives.

iv) Adherence to the EPS "commitment" crippled IBM's ability to take a long-term view of pensions costs and volatility.

Commitment to investors

1390. As to IBM's commitment to investors, it is perfectly true that IBM did not have to give any commitment. However, it seems to me that the decision to give a commitment ("commitment" is the word which has been

used: I will explain in a moment in more detail precisely what it was that IBM committed itself to) was a business decision for IBM. I do not doubt that those in senior management considered that a strong company required strong performance in order to encourage investor confidence. Nor do I doubt that they saw the presentation of a firm target in EPS growth as the way to achieve those aims. A target, of course, is only a target; no company can ever properly promise a particular level of growth but it can make commitments about the priority which it gives to a target in comparison with other *desiderata* of the conduct of its business.

1391. Such commitments may need, however, to compete with other commitments. Suppose, for example, that Holdings had, with CHQ's knowledge and approval, made the clearest possible commitment (not amounting to a contractual promise or giving rise to an estoppel) giving rise to Reasonable Expectations that it would not, during the currency of the Funding Agreement, close the Plans to future accrual or alter the ER policy. Adopting the test in relation to the *Imperial* duty which I have explained, the question would be whether making changes to the terms of pension provision would be within the range of decisions which a reasonable employer could take. In this example, if IBM sought to close the Plans or change the ER policy on the basis that it needed to do so in order to achieve savings required to meet its commitment to investors, a close examination would be required of precisely what it had committed to investors and whether, in the light of its *Imperial* duty, it could properly have committed to what it did commit. Even if that commitment had been properly given, a close examination would also be required to see whether IBM could meet that commitment whilst at the same time acting in compliance with the Reasonable Expectations which it had engendered. Only if it could not do so, it seems to me, would IBM have an argument for saying that the commitment to investors trumped its obligations to members.

1392. This is not to say that a significant change in financial conditions would not be capable of justifying changes to the Plans: but that is a different question. The point is that a deterioration in financial conditions which produces problems for IBM in meeting its commitment to investors would not necessarily be a sufficient justification for changing the terms of pension provision. It will all depend on the precise circumstances.

1393. On the facts, the 2010 EPS Roadmap was first presented to investors in 2007. This was after the date of the events said to give rise to the Reasonable Expectations relied on by the RBs. Since certain Reasonable Expectations are, as explained, established, it follows, in my view, that IBM must do more than demonstrate that meeting the 2010 EPS Roadmap was a rational, commercially sensible, course but must show why the confounding of those Reasonable Expectations was within the range of decisions which a reasonable employer would take.

1394. In contrast, had the RBs failed to establish any Reasonable Expectations, there would be no competition between meeting the Roadmap and giving effect to such Reasonable Expectations. In order to establish a breach of the *Imperial* duty, the RBs would need to show that the Project Waltz changes standing alone were ones which no reasonable employer in IBM's position would have adopted, alternatively that the ways in which those changes were consulted on or implemented were ways which no reasonable employer in IBM's position would have adopted. But as I have explained, Mr Tennet does not present such a case of a freestanding breach by Holdings of its *Imperial* duty.

1395. The RBs say that there was no need to have made the commitment to investors in the first place. It would have been possible for IBM to have excluded pensions costs (other than current Service Cost) from the 2010 EPS Roadmap. That is true. Indeed, Mr Koppl accepted as much; and it is what is now done. And see further at paragraphs 1497 and 1498 below. However, he also explained that it was not done because no-one had thought of it at the time. Mr Tennet makes the forensic point that the reason no-one thought of it was because in 2007, pensions "were doing extremely well" as he puts it and IBM wanted to take credit for pensions in the Roadmap; but I do not think that takes the debate any further.

1396. Next, the RBs say that there was not, in fact, any commitment to investors at all. Rather, IBM decided to treat itself as having made a commitment when it later came to making the various changes (worldwide, it should be noted, not just in the UK and not just in relation to DB plans) required in order to meet the 2010 EPS Roadmap. Thus:

i) The retirement related element of the 2010 EPS Roadmap warned investors "A wide range of outcomes for 2008-2010 is possible. Actual results will be dependent upon several factors…" and included a sensitivity analysis for the US. The last page of the presentation contained a general warning that the presentation included statements that "involve a number of factors that could cause actual results to differ materially".

ii) Mr MacDonald accepted that there was no mention of a commitment in the Roadmap presentation. Nonetheless, he said in cross-examination that he thought that investors would have obtained "reasonable expectations as to what was going to happen in future" and that 'IBM will deliver on those targets'. He regarded it as "a commitment to investors". This can be compared with his approach to what was said to the Trustee and the members at the time of Ocean and Soto where he saw no commitment at all, notwithstanding the actual use of the word "commitment" (*eg* "this series of initiatives demonstrates IBM's commitment to underpin the sustainability of the defined benefit plans in the UK": see the Webcast).

iii) The retirement related forecast and Roadmap was properly explicable as a projection and not a commitment. There was no need for IBM to treat it as an unbreakable promise. By treating it as such, IBM made changes to DB Plans inevitable.

1397. Paragraphs i) and ii) of the preceding paragraph are both accurate. Each supports the proposition that there was no commitment to investors. Just as the severe financial conditions of 2008 led to the need, in IBM's eyes, to change the terms of the DB Plans, so too one might have thought that they would have led to a revision of the 2010 EPS Roadmap. But Mr Simmonds submits that the way in which IBM in fact responded was a reasonable business decision: it was one which IBM and Holdings could reasonably take and it is neither here nor there that a different decision might have been made by different decision makers. That is a submission which I deal with in detail later.

1398. As to paragraph iii), I do not think that it is correct to say that IBM treated the forecast as a promise. It did, of course, regard it as a very important statement. IBM's business, commercial, decision was that the target should be adhered to; that was a matter of judgment for CHQ/Holdings. It is not suggested by the RBs (subject to one point I will mention in a moment) that the decision was taken in bad faith. The decision may or may not have amounted to a breach of the *Imperial* duty. But it does not assist, in my judgement, in assessing whether there was such a breach of duty to argue that IBM treated the commitment to investors as a promise and that therefore inevitably changes to the DB Plans would follow. The issue is not whether IBM treated it as a promise but whether making the choice in the way it did was a breach of the *Imperial* duty, because it went against the Reasonable Expectations of members and because no reasonable employer could have acted in the way in which Holdings did.

Adherence to the EPS "commitment" warped retirement provision into a profit generation centre

1399. Mr Tennet finds support from Lazard (see paragraph 1170 (ii) above) when he submits that the DB Funds were seen as (to use my words) a profit centre for IBM; as they said, investors in IBM were buying into an operation and into an investment fund. He says that the Project Waltz changes were not driven by a concern that the DB Plans had become too expensive; rather they were driven by a concern that the Plans should produce (greater) profits in order to reduce NPPC, with the profit being used to meet future DB Service Cost and to subsidise future DC cost. One might expect, he suggests, that the ongoing cost of the DB Plans should approximate to the Service Cost. Instead, IBM was using the DB Plans as an instrument to achieve EPS targets and in doing so was expecting members to pay to achieve that objective. And, as Mr MacDonald acknowledged, the annual costs of pension accrual were effectively the annual cost of employing staff; an employer could not expect to employ people for nothing.

1400. I do not think that future accrual costs have much, if anything, to do with the point which Mr Tennet is making. The comparatively small annual cost of future accrual forms the basis of a different submission which I will come to later. The real complaint here is that the profit is being generated at the expense of members principally as a result of the changes to early retirement. Underlying that is the implicit proposition that IBM's early retirement policy had become so entrenched that members were entitled to expect that they could retire without

consent or, if consent was required, it would be refused for special reasons (*eg* the need to retain key personnel). It seems to me that it is for IBM to decide whether to change its early retirement policy subject, of course, to any restraints imposed by the *Imperial* duty or otherwise. If there is such a constraint, the RBs do not need to rely on the alleged "warping" of the function of the DB Plans. In contrast, if there is no such constraint, I do not see how the alleged "warping" turns something which would not be a breach of duty into such a breach.

1401. It is convenient here to say something about Service Cost. Mr Tennet has made frequent reference to Service Cost in comparison with NPPC. The suggestion that comes through is that somehow Service Cost and NPPC ought to stand in a relationship to each other whereby NPPC should not be lower than service cost and that IBM Corporation should therefore expect, and plan on the basis that the NPPC line in its accounts should not be less than Service Cost. On that basis Mr Tennet makes submissions which effectively come to this: it is offensive that actions should be taken in relation to the Plans to reduce the amount of an accounting concept (NPPC) to produce a profit when the real cost of the Plans to IBM was the Service Cost: it is wrong that an accounting profit should be used to reduce the payment which one might expect to be made to meet the actual cost.

1402. I do not agree with this line of argument. EPS is affected significantly by NPPC (of which Service Cost is part of the equation). That is the reality of US GAAP principles. If it is proper to arrange the business in perfectly legal ways in order to improve EPS (which it is) there is nothing objectionable in principle in attempting to reduce NPPC even if that means that the cost in any particular year of supporting the DB Plans is less than the Service Cost.

1403. Mr Tennet adds that if IBM really had been genuinely committed to investors, the strength of the commitment made to members, on its terms, was no less. By making the Waltz Changes, IBM effectively put the interests of its investors ahead of its members. On that logic any changes to employee compensation could be made, simply because IBM wanted to return a greater profit to investors. The point depends critically on the existence of a competition between competing expressed commitments. If the RBs are unable to establish any Reasonable Expectations engendered by IBM, there is no competition.

Adherence to the EPS "commitment" only carried risk for members, and only the possibility of reward for IBM and its top executives

1404. Mr Tennet describes the commitment to investors as a "heads I win tails you lose" scenario. If market performance was good, IBM (and thus the investors) stood to gain, with NPPC falling (or rising less fast than would otherwise be the case) and the required money contributions to the DB Plans being reduced. In contrast, a poor market performance would lead, as it did under Project Waltz, to changes detrimental to the members in order to keep the 2010 EPS Roadmap on route. This is true susbstituting "might" for "would". But it is true of any attempt to stick to a target, whether it is a commitment to a third party or not. I do not consider it carries anything but the slightest weight in favour of the RBs' case.

1405. Mr Tennet says that "It is hard to avoid the inference that the Roadmap was designed to allow IBM top executives to take credit for the greatest overall EPS improvement possible, leading to even more lucrative remuneration and bonuses" and that "IBM senior executives would keep their bonuses, but members would lose out sorely." There is no evidential basis for the assertion that bonuses would be retained. But even assuming they would be maintained, there is no evidence at all to suggest that any senior executive involved in the decision-making process gave any weight at all to his or her personal position. These points were not put to IBM's witnesses in cross-examination. At the end of Mr Riley's oral evidence, he was asked by me whether he or any other of the senior executives had a financial interest in the outcome of Project Waltz. His response indicated that there was no direct interest relating to Project Waltz; his only interest was in a long-term incentive scheme based on overall improvements in the performance of IBM Corporation. I reject Mr Tennet's suggestions and whatever it might have been justifiable to speculate before the hearing, I do not consider that this suggestion should have been maintained in closing submissions.

Adherence to the EPS "commitment" crippled IBM's ability to take a long-term view of pensions costs and volatility

1406. Here, Mr Tennet submits, by reference to some graphs and tables, that in the long term, higher levels of costs incurred now are likely to be offset by lower levels of costs in the past and in the future. He submits that the Main Plan has in fact done spectacularly well if a long-term view is taken. I agree with him that the evidence shows that, from 2009, NPPC was set to rise, but the likelihood is that it would fall again in due course. This is because, following market falls, the expected return on equities in the future takes account of those large falls: it is then expected that in later years there will be significant (positive) out-performance of EROA, which, together with the previous falls, would provide an overall return broadly in line with EROA. Mr Tennet's proposition is that, by taking 2010 as an arbitrary target date for pensions returns, IBM was effectively shutting its eyes to the natural rise and fall of pensions costs, and it was making itself susceptible to short term movements, when it had adopted an investment strategy that needed to be viewed in the long term. As Mr Clare said "….what can be positive over the long term can be negative over the short term and it is important that all these factors are taken into account when setting and monitoring investment strategy."

1407. Mr Simmonds' overarching response to those submissions is that, in effect, all that the RBs are demonstrating is that a different set of management entrusted with running the business could have done things differently which is something IBM accepts. The fact of the matter is that IBM's management did what it did. That may or may not be seen as unfair or unreasonable by the RBs. It may or may not have been what they would have done if they had found themselves (or, indeed, what the Court would have done if it had found itself) in the position of a senior IBM executive at the relevant time. So it may be true, as the RBs assert, that IBM put the interests of its investors ahead of those of the members of the Plans. But that was the business decision that was reached and it is not part of the court's function when considering the *Imperial* duty to second-guess that decision. In that last context, he says that the prioritising of the interests of IBM's shareholders as compared with the interests of its employees is pre-eminently a decision for IBM.

1408. In any event, Mr Simmonds observes that the implicit suggestion that the interests of IBM's employees were entirely sacrificed on the altar of shareholder interests is simply wrong: the forecast contribution from retirement plans to the 2010 EPS Roadmap target was $0.90 and, in the event, even following Project Waltz that figure was never achieved. The savings contributed from retirement plans was in the event only $0.55, with the result that the EPS target was met only by achieving additional contributions from other areas of the business. Thus, in terms of the 2010 EPS Roadmap forecast, the pain was shared. I do not know the source of the figures. If the source was identified during the hearing, I have been unable to track it down. I shall simply assume Mr Simmonds is correct.

1409. Mr Simmonds may well be right to say what he does about management decisions being left to management and not interfered with by the court if, as is IBM's case, nothing had been said in relation to Ocean and Soto to give rise to the Reasonable Expectations. But since there is a competition between competing commitments, then IBM's decision must at least take full account of the competition. By that I mean that IBM had to recognise that the members did indeed have legal rights arising from their Reasonable Expectations as a result of the *Imperial* duty owed to them, and not simply to recognise that members would be disappointed, angry, feel betrayed – choose whatever words or phrases you will. Manifestly, neither Holdings nor IBM did recognise that the members had Reasonable Expectations. That is, in my judgement a factor to be brought into account in deciding whether Holdings acted in breach of its *Imperial* duty in promoting Project Waltz.

IBM UK's performance targets and PTI were no justification to implement Project Waltz

1410. Under this heading and the next heading (Headwinds etc), Mr Tennet has made some lengthy detailed submissions in his written closing. Although it is not easy to see the relevance of some of them as one goes along, it is possible to see at the end of them that they are important in identifying some of the matters which ought, at least in the RBs' case, to have featured in any business assessment of the justification case. I must therefore, however reluctantly, go into this detail myself. I do so unashamedly by taking many of the submissions verbatim into this judgment, and certainly by adopting Mr Tennet's structure of the argument.

1411. His submission is that Holdings' performance was not the reason for Project Waltz. If it had been a reason, it would not have been a reasonable justification for acting contrary to members' Reasonable Expectations. I

address the following sub-headings of Mr Tennet's argument:

i) The principle of performance as a justification for change.

ii) IBM UK was performing reasonably well in any event.

iii) The pensions changes would have been very different if PTI were the justification.

The principle of performance as a justification for change

1412. Holdings' issue with the performance of UKI is identified by Mr Tennet as a failure to meet CHQ targets and failing to keep pace with other ITMs. It was not that the UK business was failing to produce profits or that its productivity had declined since Soto. I agree that this failure to meet targets was one concern of UK management. But it was not all: Mr Riley had introduced UKI Transformation to address what was perceived as under-performance. But as several witnesses, including Mr Wilson, said, CHQ was always setting tough targets even in the good times and certainly before the NPPC problem, leading to Project Waltz, arose. The fact that attempts to achieve improvements in performance were driven by (perhaps unreasonable) targets does not mean that the only reason to achieve improvements is to meet targets: even in the absence of any target, UK management would surely be seeking to run as efficient a business as possible.

1413. Mr Tennet nonetheless submits that arguments based on the need to meet targets and to compete with other IBM entities cannot, in principle, form a reasonable justification for Project Waltz. He gives four reasons for that which I set out verbatim from the RB's closing written submissions:

i) A target set by CHQ is simply a demand that the UK business makes more money. If the existence of a target can be a good reason for change then IBM could justify any changes by setting increasingly tough targets.

ii) How IBM performs relative to other IBM entities is also not a good justification. Just because the UK 'could do better' in comparison to other entities (where the Group as a whole was doing very well) does not mean that its DB members should be punished with pensions cuts.

iii) Moreover, there was no suggestion in 2006 that the DB Plans might be closed if IBM UK were outpaced by other IBM entities in future. If there had been such a possibility, in order for IBM to act consistently with its assurances that the DB Plans were sustainable, it was incumbent upon it to carry out analysis as to how likely it was that IBM UK might be outpaced in future. There is no evidence, as far as the RBs are aware, that any such analysis ever took place.

iv) The only rational, objective, way to consider UK business performance is to compare its performance at the end of 2008 with its performance at the time of Soto. If performance had tumbled, it might be arguable that there was a business need to recover. However, since 2006, UK performance had in fact improved slightly, and pensions were contributing to the UK's PTI.

1414. Taking those in turn, I think it is putting matters too high to say that the setting of a target could be used to justify any change. I come back to the competing commitments. A target imposed by IBM as it were out of the blue would not be likely to be a good justification for acting contrary to Reasonable Expectations. But a target imposed to meet a commitment to investors cannot be ruled out of the picture *a priori* as a possible justification; it all depends on the facts.

1415. As to the second reason, I do not understand why relative performance should not be taken into account (subject to the third reason) in assessing the justification of a particular business case for the changes. In order to obtain internal investment, CHQ takes into account many factors, including relative performance. Emotive language such as being "punished with pensions cuts" does not really assist the debate.

1416. The third reason depends on the proposition that the statements about sustainability gave rise to an expectation that Holdings had carried out the analysis referred to. In the light of my discussion concerning the difference

between expectations as to the future and what it is reasonable to consider (*ie* "expect" in a different sense) Holdings had done, this point does not preclude reliance on targets as an element of the business case raised in justification of the change. But it is a factor to be brought into account in assessing whether there has been a breach of the *Imperial* duty. I do not consider that, in the present case, this point carries any significant weight.

1417. As to the fourth reason, see under the next heading.

Holdings was performing reasonably well in any event

1418. The RBs closing written submissions contain a section under this heading. The submissions are seen to be relevant because, on the RBs' approach, the only rational, objective, way to consider UK business performance is to compare its performance at the end of 2008 with its performance at the time of Soto. If performance had tumbled, it might be arguable that there was a business need to recover. However, since 2006, UK performance had in fact improved slightly, and pensions were contributing to the UK's PTI. The starting point, therefore, is that there was nothing for the business to recover from, no need for a recovery plan and *ergo* no business justification for Project Waltz.

1419. IBM takes issue with that for reasons that will become apparent.

1420. I need to deal in more detail with the RBs' submissions under this heading. I set out virtually verbatim the relevant paragraphs with some comments and findings. I accept as correct the figures set out (having referred to the source material referred to in the submissions). But as a preliminary matter, I should address the general criticism about the quality or integrity of the data on which Mr Chrystie relied. I do not consider there is anything in the particular criticisms made. It is clear from Mr Chrystie's evidence which I accept that he pulled all of the data from IBM's central systems. He attempted to compare like with like and I accept his evidence that his attempt was successful. The documents which he used and generated were, I am satisfied, internally consistent. That is not to say that all documents presented the same figures in the same context, so there may be inconsistency between documents.

1421. Turning to Mr Tennet's more detailed submissions in relation to Holdings' performance in 2008, compared with 2006:

i) The UK figures available for the period 2006-8, which were shown to Mr Chrystie at his meeting with Mr Koppl and Mr Greene on 19 February 2009, show that UK PTI in 2006 was $588m (obtained by a calculation from the 2007 growth figure of -3%) and that it had grown slightly to $594m by 2008. These figures conform broadly with Mr Wilson's recollection.

ii) Mr Chrystie's data did not separate out the UK from UKI. For that reason the RBs' position is that it cannot be relevant to the assessment of whether changes should be made to the UK Plans. I disagree with that. As Mr Legge (for IBM) submits, Ireland accounted for only 3% of the total for UKI. This is not material to the overall picture.

iii) Mr Chrystie's data is not adequately explained. It is apparent that there are other ways PTI data could be calculated: that is what Mr Wilson said in his witness statement. I accept that there are different ways in which PTI could be calculated. But it is not suggested that Mr Chrystie's method was an inadmissible method. I have no reason to conclude that it was an inadmissible method. And this is so notwithstanding the next criticism which **is that** Mr Chrystie's data did not match the figures reported to investors, or any of the previous PTI data.

iv) Mr Wilson explained to me that the new basis of measuring PTI after 2006, including the Measurement Adjustment, had particularly harsh consequences for Holdings, as it retrospectively burdened the UK with the "cross we had to carry" of its strong software performance in 2006, although such performance was not reflected in the 2006 results at the time. Mr Chrystie's analysis did not reflect the Measurement Adjustment; perhaps this was, to use his own words, because he "did not understand" it. He accepted that "what appears to have made a potentially very significant difference in the PTI trend is as a result of an internal policy decision on transfer pricing after the event". In the circumstances, Mr Tennet says it is unsurprising that his data therefore did not

provide a clear picture of Holdings' actual performance: I agree that the picture would not be accurate, but whether the inaccuracy is material is a different matter.

v) Mr Chrystie did admit that, had the UK not been subjected to the pensions Measurement Adjustment, UKI PTI would have been around $55m greater in 2008. By its very nature the Measurement Adjustment, the RBs say, treated the UK unfairly by artificially deflating PTI. If that artificial loss to UKI PTI were factored back in, Mr Chrystie's own data would show that UKI PTI grew from $760m in 2006 to $775m in 2008.

vi) IBM's response to that is to say that this adjustment really makes no difference: Mr Chrystie's own view was that it was not material making only a 1% (or thereabouts) difference. Although the figures for 2008 produced an 8·5% increase in PTI between 2007 and 2008, the correct way of looking at matters is that between 2006 and 2008 (the relevant period) the Measurement Adjustment does not make much difference. That is, as Mr Legge points out, the evidence of Mr Chrystie which I accept.

vii) On its face Mr Chrystie's data showed UKI PTI declining from $760m in 2006 to $720m in 2008. In the light of the matters set out above, the RBs submit that these figures cannot be relied on. However, they go on to say that even that order of decline was by no means sufficient to justify change and a decision to make the drastic changes under Waltz in response to a small fall in PTI would be wholly disproportionate. Mr Wilson's view was that such a decline was not "material".

1422. The RBs also say that properly understood, the UK was performing well relative to other IBM entities in terms of PTI margins:

i) IBM UKI's PTI margin, on Mr Chrystie's figures, was 13.8% in 2008.

ii) Mr Chrystie's own business mix adjustment showed that, for a fair comparison with other entities, the UKI PTI margin for 2008 should be 15.5% in 2008.

iii) Mr Chrystie said that PTI margin would improve by 1% if the pensions Measurement Adjustment had not been applied leaving UKI adjusted PTI margin for 2008 at 16.5%.

iv) Such a margin would rank IBM UKI in the middle of the cluster of Major Markets in Europe, ahead of Nordic, France, Italy and the Alps.

v) Mr Chrystie's figures show that IBM average PTI margin was 21.3%. However, the RBs says that that figure appears to be wildly unrealistic.

vi) For those reasons, even on Mr Chrystie's data, it appears that the UK was managing to keep up with the other IBM entities.

1423. My conclusion is to reject the assertion that the UK was performing well. Rather it is more accurate to describe it as keeping up with someregions. Further I do not consider Mr Chrystie's figure of 21·3% to be wildly unrealistic. I do not consider it correct to take from his cross-examination overall (particularly as found on pages 81-104 of the Transcript of day 21) a conclusion that this particular figure of 21·3% cannot be correct.

1424. IBM UKI was, properly considered, also above average in terms of PTI growth:

i) Holdings' PTI growth for 2008 would be 9.5% if the Measurement Adjustment were removed.

ii) In 2008 average Major Market PTI growth was 8.7% and IBM average PTI growth was 8.8%.

This is correct for 2008, but says nothing about the future.

1425. The RBs have a fall-back submission. If, which they deny, some pension changes could be justified on the basis of UK performance, the particular changes making up Project Waltz were not justified and would not have been

implemented. For that reason UK performance cannot be a justification for making the Project Waltz changes. This is a topic which will feature in my discussion later.

Headwinds & IBM's concerns as to the future: Project Waltz was premature

1426. One of the "headwinds" about which IBM was concerned was its 'long term' concerns about NPPC, that is to say from 2012 onwards (in contrast with its concern about the immediate year to year increases which IBM was projecting). On the RBs' case, at the time the decision to proceed with Project Waltz was taken, the projection was that NPPC would exceed IBM's Service Cost in the UK only in 2012. The RBs have addressed this aspect of "headwinds" in their written closing under three headings: (i) What long term projections did IBM actually rely on? (ii) Watson Wyatt's 2008 projections (iii) IBM's fears of further falls. They also suggest that Project Waltz was premature.

What long-term projections did IBM actually rely upon?

1427. Under this heading, the RBs seek to show that IBM had no material on which to found a business case by reference to concerns about a pensions headwind in the long term. So far as the evidence discloses, the projections on which IBM relied were those prepared by KPMG which went only as far as 2013. These were the projections on which the presentations on 3 March 2009 and 23 March 2009 (see paragraphs 1190*ff* and 1199*ff* above) were prepared and delivered. The point is made that NPPC would exceed Service Cost in 2013 by only £100m which, in context, is not a huge sum of money and is described by Mr Tennet as "scarcely disastrous". Moreover, for 2008 to 2011, NPPC was projected to total £17m with a Service Cost of £214m. And for the whole period 2008 to 2013, NPPC was projected to be £256m, and IBM's Service Cost was to be £310m. Thus, over the whole of that period, IBM would, on those projections, still not have to pay the full operational costs of DB accrual. I do not understand those figures to be challenged.

1428. Mr Tennet then submits that the long-term projections IBM actually relied upon indicated that future NPPC was going to be well within what a rational employer would consider to be acceptable levels. That, if I may say so, seems to me to be no more than an assertion of the result for which he contends. It may be that other managers in CHQ and Holdings would have considered that NPPC was within acceptable levels (whatever those words may mean). But that does not mean that even those managers would consider that anyone who disagreed with them was irrational. There is, I think, no absolute level of what is or is not rationally acceptable: it all depends on the facts. In any case, the question is not what any rational employer may consider to be within acceptable levels; the question is whether the decision which IBM actually made fell outside what a reasonable employer could properly decide.

1429. There is more force in the point that, as well as being unreliable, projections beyond 2013 were not of interest to CHQ. 2010 was the target date for the 2010 EPS Roadmap and what happened after that was not at the forefront of the minds of those planning how to get back onto the map. In this context, it is worth noting that although Mr Michaud had projections from KPMG up to 2013, he did not include the data for that year in his presentation on 4 February 2009 (see paragraphs 1179-1183 above).

Watson Wyatt's November 2008 projections

1430. The only available NPPC projections that go beyond 2013 were Watson Wyatt's projections of 28 November 2008. They show a more gloomy NPPC projection beyond 2013. However, the RBs contend that the evidence is that they were never relied upon, and it is unclear how reliable they are. This it seems to me, lends support to the view, favourable to IBM, that the members' Reasonable Expectations could not be projected into the long-term.

1431. As to the reliance that was placed on them:

i) It appears that they were only ever sent to Mr Scott and Mr Wilson; this was on 1 December 2008. There is no evidence of them being considered by anyone else involved in Waltz. I have no way of knowing whether the contents of these projections were taken into account in any presentations or, if so, how.

ii) In fact, Mr Wilson suggested sending them to KPMG to use as the baseline for the Sapporo analysis, but Mr Scott said that he was concerned about them because "they don't use constant assumptions". Rather than using a fixed long-term EROA assumption as required under US GAAP, the Watson Wyatt EROA assumptions reduced over a 10 year period. Mr Scott considered that:

> "for the base case in Soto we should use a projection which keeps the assumptions constant, particularly as in some cases we will be modelling the impact of changing the asset allocation."

1432. The projections themselves show Main Plan and I Plan combined NPPC in 2013 as £266m (compared with KPMG's figure of £147m). 2014 was projected to have the greatest NPPC (of £272m) before it began to fall again. This is in the context, on Mr Chrystie's figures, of absolute PTI for 2008 of $720m, or £465m (at Plan Rates). The RBs accept that, had any attention been paid to these projections, they would have generated greater concern.

1433. As to reliability, there are said to be a number of problems with Watson Wyatt's projections:

i) The assumed market value of assets as at 31 December 2008 was too low. Year-end 2008 assets were assumed to be £4,113m, but in fact by year-end had risen to £4,244m.

ii) The assumed PBO was too high. The projections expressly assumed that there would be no change to the actuarial assumptions as at 31 December 2008 from the year before. In fact, owing to changes in the assumptions, PBO at 31 December 2008 was reduced by £207m.

iii) IBM's own accountancy expert Mr Robbins examined the Watson Wyatt figures. He amended them to take account of "IBM actual investment strategy", resulting in a lower (that is to say more favourable) NPPC projection than Watson Wyatt's figures.

IBM's fear of further falls

1434. The notion of "headwinds" (*ie* long-term problems) was not unique to the UK. Mr Koppl's oral testimony was in November 2008:

> "…we did a three-year unfavourable case as well. And I will just say for my part that we didn't know how long the crisis would last, we didn't know the depth or the duration…One can look back in retrospect and say that we were at the darkest days after Lehman Brothers, and that wasn't our sense of it. We didn't know"

1435. Mr Tennet fairly remarks that, in essence, this concern was about the fear of the unknown: what could happen, as opposed to what IBM knew would happen, or was projecting was most likely to happen.

1436. But then he goes on to say that to the extent that IBM's fear of the unknown contributed to their decision to make changes to the DB Plans, such reasoning was flawed and unjustifiable. First, he says that, as a matter of principle, the fear of the unknown cannot be used to justify changes.

i) Just because some falls have occurred, it does not mean that further falls are necessarily going to happen.

ii) '3 year unfavourable' assumptions are, by definition, not the 'most likely' or 'best estimate' projections. It is the best estimate projections (with a margin for prudence if necessary) that ought to drive decision-making. If unfavourable assumptions could be relied upon to justify changes, then any changes could be justified on the basis of increasingly pessimistic assumptions.

iii) There can be a fear of market falls at any time – falls are, as IBM well understood, inherent to the nature of the markets, particularly when there is a very high allocation to equities. Therefore, this nebulous fear was no more of a factor in late 2008 than on the day after the Soto changes were implemented.

1437. Secondly, Mr Tennet says that IBM was expecting the markets to bounce back. It is counterfactual to suggest that IBM was actually fearful of further falls.

i) At the Trustee's Investment Committee on 11 December 2008 Mr Greene tried to persuade the Trustee not to de-risk. He pointed out that "equities generally recover quickly" at the end of a recession. Had IBM thought that the markets would not bounce back Mr Greene would have suggested the opposite.

ii) Mr Koppl was of the same view. On 17 November 2008 he produced slides that considered the question "Heading out of a recession – when would you have wanted to get back in [to equities]?" He reviewed recessions in the past, and concluded that the markets almost always improved within 12 months of the recession: "Moral: once the economy has reached bottom, much of the return has been experienced." The apparent moral was to stick with equities, riding out the volatility, and they would recover.

iii) Equities are by their nature, long-term assets, which do better in the long term but suffer periodic dips. There was nothing to suggest that what was happening in 2008 was in any way out of line with the type of fluctuations that were to be expected.

1438. As to the first of these points, I do not consider that a fear of the unknown cannot be taken into account. It seems to me to be entirely rational to seek to avoid the risk of an occurrence that is not thought likely to happen. Nor do I accept that the best-estimate projections ought to drive decision making if it is suggested that other considerations are left out of account. Indeed, to fail to consider the possibly catastrophic effects of an unlikely event might itself be seen as irresponsible. The whole of the second submission is, it seems to me, founded upon the unstated proposition that double-guessing management (with the benefit of hindsight at that) is precisely what I should be doing.

Project Waltz was premature

1439. The RBs say that, whatever its concerns, IBM had some breathing space to wait and see how markets did in fact perform. Announcing changes in 2009 was a premature response. I do not propose to go into the detailed submissions on this point. In my view they all suffer from the same flaws in that they fail to address the fact that any changes which did turn out to be necessary could not have retrospective effect. The first point to make is that, if markets did not recover or deteriorated so that the changes had to be made at the end of the "wait and see" period, benefits would have had to be provided in the interim on the current basis. Perhaps not much turns on that point because the absolute sums involved would be likely to be small in the context of the Plans' liabilities. The second point is that whatever may have happened, IBM needed to book the savings in 2009. If Project Waltz was justified at all, it was justified in 2009.

1440. Mr Tennet suggests that this is not really the position with IBM waiting (as Mr Simmonds put it, Micawber-like) for something to turn up. Mr Tennet says that delaying matters until 2012, and certainly until 2011 would have been a credible strategy to meet the concern about headwinds (but not, of course, to meet the only real reason for the change, namely to meet the EPS target). It is said that it was always within IBM's power to take the measures it did to cut costs. This could have been timed for 2012 just as easily as 2009, and so fas as headwinds were concerned, 2012 would have been the more obvious time. I think that similar points can be made about how changes might have looked if the concern had been PTI rather than the EPS target.

1441. There is force in those arguments focused on headwinds. I take account of them in reaching my conclusions in relation to the *Imperial* duty. There are, however, a number of points concerning the allegedly premature nature of the proposals made in IBM's written and oral closing submissions which I find compelling. The fact is that Holdings was falling behind on its PTI objectives in 2007 and 2008, and that action was needed immediately to address the situation if those objectives were to be met. Thus, in 2008, although the really serious DB costs consequences were in the future, Holdings had a problem that needed to be dealt with there and then. Further the new targets had to be met by the end of 2012. As Mr Simmonds says "You don't start doing that in 2012, you try and achieve the target by the end of 2012". The changes as Mr Chrystie and Mr Ferrar explained (an explanation which I accept) were intended to do a number of things at the same time for both the long term and the short

term and take account of CHQ's agenda on EPS. Mr Ferrar summed up IBM UK's position on the Project Waltz Changes in the light of the then financial position of the DB Plans in this way:

> "…I was fully aware that we were taking away an immediate profitability to change a long-term future cost problem. "

1442. Mr Chrystie made the same point:

> "…We have a requirement to go from 23 per cent to 34 per cent, and the part that you haven't noted in that the NPPC year over year growth is huge as it moves into the out years, right at the same time when I have a requirement to go from 23 per cent contribution margin to 34 per cent. So I will grant you that this wasn't a reason for our poor profit performance in 2008, and in fact 2009, but we were solving the problem moving forward."

1443. Mr Chrystie said that, at the time, IBM did not know what was going to happen in the markets, and wanted to take action in the face of the unknowns going forward. Mr Simmonds says (correctly I believe) that the case that IBM should have waited to see if the asset position would improve was not put to any of the witnesses and cannot now be relied upon.

1444. Further, the suggestion that IBM should have waited for the NPPC effect of the asset falls of 2008 to reverse before implementing Project Waltz was not put to the factual witnesses. In any event Mr Simmonds, correctly in my view, observes that this suggestion is belied by the magnitude of the rises that would have been necessary to achieve that effect. He has demonstrated to my satisfaction (the detailed submissions can be found in the written closing submissions at paragraph 291 and the footnotes to it) that, based on the 31 December 2008 funding survey, the required asset gains would have been as follows:

Years to make	2009	2009/10	2009/10/11
gain	(i.e. in 1 year)	(i.e. in 2 years)	(i.e. in 3 years)
Amount of gain (£,000s)	1,713,926	2,086,658	2,428,734
Yield (over one, two and three years)	40%	49%	57%

1445. These asset returns were to be made on a portfolio with 52% return seeking assets, limited to 56% in the event that any increase in the value of equities significantly altered the asset allocation of the fund. It is unrealistic to think that these returns could have been achieved.

1446. My view is that there is nothing in the argument that Project Waltz was premature in the sense of addressing concerns which IBM had. But that is not necessarily an answer to the claim that by taking those commercially rational steps but taking no account of Reasonable Expectations, Holdings was in breach of its *Imperial* duty.

The proposal to make I Plan changes was even less justifiable

1447. On KPMG's projections, the I Plan was performing very solidly. 2009-2011 NPPC was negative (a profit), and at all times, including in 2013, NPPC was less than IBM's Service Cost. Mr Koppl said that KPMG had given separate consideration to the I Plan:

> "…in some of the earlier KPMG analysis I know the I Plan was broken out; but from my standpoint, both the Main Plan and the I Plan were adversely affected in terms of the asset impact of 2008, and we were seeking to save costs, and from a financial standpoint I would have intended to include both plans for that reason."

1448. He agreed that the I Plan was still going to be profitable in 2009-2011, but said that:

> "The issue we were concerned about was the EPS Roadmap…I don't have that on this page, but I am imagining that after…the events of 2008, that this is worse than where it would have been in the EPS Roadmap….The rationale that we started with for all of these was relative to the EPS Roadmap."

1449. There is one other answer which I think sums it up. This was the exchange:

> "Q. Isn't it simply the case that the poor old I Plan got lumped together with the M plan, and at that point no one gave it any thought, it was just part of the UK figures?
>
> A. I would say I didn't focus on it individually as part of the decision process, no."

1450. Mr Tennet submits that the thrust of this evidence is that the I Plan was not making enough profit, because it was failing to meet the 2010 EPS Roadmap target. I agree with that in the sense that, taking the UK DB Plans together, they were failing to produce enough between them.

1451. However Mr Tennet says that the I Plan was in fact exceeding its performance under the projections which underlay the 2010 EPS Roadmap:

i) IBM's NPPC projections of August 2007, shortly after the 2010 EPS Roadmap was presented in May 2007, show that I Plan NPPC was projected to fall a little, and then flat-line at a cost of £8.4m.

ii) KPMG's December 2008 NPPC projections, which took the market crash into effect, showed that I Plan NPPC was now due to fall much faster, so that it turned negative in 2009, and stayed negative in 2010 and 2011.

iii) Accordingly, KPMG's projections were that I Plan NPPC would be consistently less than projected at the time of the 2010 EPS Roadmap, despite the market falls.

1452. And so the RBs conclude that IBM did not give any proper consideration to the I Plan at all (as confirmed by Mr Koppl: see the last quotation above). Had IBM considered the I Plan properly, it would have realised that, even on its own reasoning that the 2010 EPS Roadmap had to be adhered to at all costs, there was, even so, no case to make any I Plan changes at all. And so Mr Tennet suggests that IBM's case is bizarre since it would have to be explained to members of the I Plan that it was sustainable given the 2007 NPPC projections but not sustainable given the more favourable 2008 NPPC projections. As he put it in his closing speech:

> "…..what is really happening in 2009 is that IBM has moved the goalposts. The scheme is performing better than it had been expected to perform, and IBM has actually just changed its mind as to what it regards as a sustainable level of cost in relation to this scheme. It has changed its mind despite, in fact, members of this plan having already made choices based on IBM's earlier pronouncements as to sustainability and commitment. We say that behaviour can fairly be described as perverse and it can fairly be expected to undermine trust and confidence."

1453. There would be considerable force in that point if the assumption is made that each of the world-wide DB schemes should contribute to the shortfall in NPPC saving only that part of it for which it is responsible in the sense that its NPPC projection is worse that its 2007 NPPC projection. That would be one fair approach, but that is not where Mr Koppl and CHQ were coming from. Mr Koppl was focusing on projections to deliver the required savings from the DB Plans and was not concerned with whether the different Plans should have been treated differently. There is, accordingly, less force in the point which Mr Tennet makes, but it is not without merit and it is certainly to be brought into account in assessing the validity of Project Waltz in relation to the I Plan. The corollary, of course is that Plans performing less well should bear a greater part of the additional burden.

1454. Mr Simmonds rejects that reasoning. The criticism of the lack of separate consideration of the I Plan should, he suggests, be judged in the context of the business reasons to which I have just referred (as described by Mr Chrystie and Mr Ferrar). IBM accept that, after a point in time, there was no separate consideration of the I Plan

during Project Waltz, but Mr Simmonds submits that that fact gets the RBs nowhere because:

i) even though the financial case for closure of the I Plan was less pressing than for the Main Plan, the reasoning underlying the closure of the latter applied to the former, that is to say:

a) Cost: KPMG's analysis projected the I Plan's NPPC to be £1.8m in 2012 and £7.8m in 2013 – a modest cost, reflecting the smaller size of the I Plan, but a cost nonetheless – but this was based on year-end 2008 projections that were not necessarily the worst case that IBM was faced with: the same unknowns which affected the Main Plan equally affected the I Plan.

b) Parity (1): the desire to align DB and DC employees pointed to the closure of all DB accrual. As already explained, I do consider that it was really any part of IBM's agenda that all employees needed to be treated the same. There was a desire for alignment, but this was only a reflection of IBM's commercial preference for DC schemes which fitted better with its business model.

c) Parity (2): the desire to treat all DB members in the same way. As Mr Koppl observed when asked if the I Plan could have been treated differently:

> "Could have been. I'm just -- from my standpoint, and I will set aside how the members might regard it, of some members being treated one way and another, that wasn't my domain, but from a financial standpoint, this plan was adversely affected just like the Main Plan was. So yes, it is a lot smaller, you could make a materiality argument and say these numbers aren't very material to the whole of the UK."

Or, as Mr Simmonds puts it, if the I Plan had been treated differently, there could have been complaints that there was no rational basis to discriminate between the Plans because the same trends applied equally to them both.

ii) This all leads to the submission that, whilst the small size of the I Plan could have justified not closing it due to lack of materiality, a rational business case existed for its closure; although a different management could have come to a different decision, that does not entitle the Court to substitute its own decision for that of IBM management.

1455. I shall express my conclusions on this disagreement concerning the I Plan as part of my wider decision later in this judgment.

Parity

1456. The RBs address parity in the context of reneging on Reasonable Expectations. Parity does not appear to feature as part of the submission that there was no business case for the Project Waltz changes even in the absence of Reasonable Expectations generated by IBM under Ocean and Soto. It is said that a wish to increase parity of pension provision amongst employees would not justify reneging on the Reasonable Expectations engendered in 2004-2006. The UK DB Plans had been closed to new entrants since 1997 (save to the extent that admission to I Plan was required on acquisitions), with DC pensions being provided under M Plan. The disparity between different groups of employee – some with DB benefits and some with DC benefits – was created by IBM, no doubt for perfectly good business reasons.

1457. When it came to the Project Soto changes, IBM created a new status, that of Enhanced M Plan Membership, again no doubt for perfectly good business reasons. But this exacerbated the disparity which already existed.

1458. In those circumstances, I regard it as a bit rich for IBM to seek to rely on the disparity which it had deliberately reinforced by the Soto changes to act contrary to the Reasonable Expectations engendered in the course of those very same changes.

1459. I have already addressed the question whether there was any resentment by DC members against DB members: see paragraph 1335 above. I concluded that the evidence each way was so tenuous that I could not conclude that there was any such resentment, let alone of such significance as would form any part of a justification for departing from any Reasonable Expectations.

1460. IBM's case on this aspect therefore comes down to its preference, as a matter of policy, to have DC provision rather than DB provision across its whole worldwide operation. That policy preference cannot, I consider, justify a departure from Reasonable Expectations. In any case, it is now clear that CHQ had that preference in 2006; nothing had changed by the time of Project Waltz.

Other reasons given by IBM do not justify the Project Waltz changes

Competitiveness

1461. IBM sought to justify the Project Waltz pensions changes on the basis that its competitors did not have such large (or any) DB liabilities and that having such DB liabilities made IBM UK uncompetitive. This reason appears, for instance, in the initial email announcing the Project Waltz proposals and the slides for the first PCC session on 6 August 2009.

1462. But the fact of a large accrued liability was not something new since the time of Soto nor was the fact that such liability was larger than most of its competitors. Indeed, competiveness was one of the factors which Project Soto was supposed to have addressed.

1463. It is right to say that the UK DB Plans were providing the same benefits that had been said by IBM to be sustainable under Project Soto. It is also established that there had been no increase in the service cost of future accrual as was accepted by IBM in its Response to Voluntary Particulars. Even if there had been an increase in service cost, the Evergreen Agreement envisaged the increase being shared equally between IBM and the members by way of additional contributions.

1464. Further, and more significantly I think, the UK DB Plans were predicted to produce NPPC contributions or income for the next 2-3 years and to abate service cost at least into 2011: they would be 'cheaper' than DC provision during this period. It is not easy to see, therefore, how the DB Plans were making Holdings uncompetitive in terms of shareholder returns. There may be a point to be made that, from a purely UK perspective, there was a deficit to be plugged in the long-term. But that aspect does not appear to have featured in anyone's analysis of competitiveness and I say no more about it.

IBM's riposte to RB's criticism of the local strand

No UK business justification at the time of the 4 February 2009 meeting

1465. According to IBM, the RBs' principal criticism of the UK business case boils down to a matter of timing: the business case cannot have been a proper reason for the Project Waltz changes because the detailed work on the business justification post-dated the making of the decision in principle to proceed with Project Waltz on 4 February 2009. That is certainly one of the RBs' criticisms, but it is an equally important criticism that the alleged business case had no firm foundation. With no business justification, there was no reason to disappoint the Reasonable Expectations which the members were entitled to have, the extent of which I have already decided. In his written closing submissions, Mr Simmonds has devoted some pages to a rebuttal of the RBs' criticism of the local strand including timing and substance.

1466. Mr Simmonds says that the RBs confuse the question of whether the analysis for the UK business justification had been done with the question of whether there was such a justification in the first place. I agree that the two are distinct: but the RBs have not confused the two, they have simply relied on the distinct strands as separate criticisms.

1467. For IBM, the timing point is not relevant. It submits that there is only one relevant question: was there a UK

business justification for the Project Waltz changes? If the answer to that question is yes, it is irrelevant whether the detailed analysis to build up the UK business reasons for the changes was actually done after the decision in principle was taken. I do not think that that is quite the right question. The question is whether the conduct of Holdings in deciding to make the Project Waltz proposals and then implementing the proposals gave rise to a breach of the *Imperial* duty. It comes to much the same thing, but not precisely.

1468. Thus, consider this case: suppose that IBM had put forward the proposals and implemented them without any thought of the local strand. Suppose that the changes were then challenged but that Holdings was then able to formulate a UK business case which would have justified the proposals had it been articulated before the decision had been made and the proposals implemented. In order to succeed in their challenge, the RBs would then have to establish conduct on the part of Holdings contrary to the members' Reasonable Expectations. The conduct relied on – the decision to make the proposals and their implementation – is either such as to destroy or seriously undermine the relationship of trust and confidence or it is not. On one view, the answer to the question whether the conduct is that serious cannot depend on whether Holdings might subsequently be able to formulate a justification for the changes which it had not previously thought of. On another view, an assessment of the seriousness of the conduct can only be made in the light of the subsequent justification: members may have a justifiable complaint that Holdings had made a decision which was not justified by what it did know, but that is not enough, of itself, to give rise to a breach of the *Imperial* duty.

1469. Even if the first of those views is correct, it does not follow that the consequences of the conduct is the same as they would be in the absence of any business justification at all. In the latter case, it is quite possible that the changes implemented pursuant to the decision would be set aside. But in the former case, a lesser remedy may be more appropriate. Part of the enquiry into the appropriate remedy would be what detriment the members have suffered as the result of the implementation of changes which, on the hypothesis under consideration, could have been justified when they were made. Assuming, without deciding, that it is in principle possible to award damages or equitable compensation for breach of the *Imperial* duty, the result might be only a nominal award.

1470. On the facts of the present case, however, I do not consider that I need to resolve these issues. This is because, before the time when the final decision to make the changes was made (by Mr MacDonald in September 2009) and thus before the consultation had been concluded and before any changes were implemented, the UK business case, such as it was, had been formulated. Until that time, IBM could have withdrawn the proposals or have confirmed its decision by a further express resolution. It did not do so but I see no reason in principle why it should not be entitled to rely on the business case which it had developed by then as justification for proceeding. Further, even if the decision in principle on 4 February 2009 (not communicated to members) to make the Project Waltz changes had given rise to a breach of some duty, it is not easy to see how the members would have suffered any detriment and thus why that breach should carry any substantive remedy. I accept, of course, that the position might be different – and this particular reasoning would not apply – if the UK business case had not been addressed until after this litigation had started.

1471. Having reached that conclusion in favour of IBM, I ought nonetheless to record some of Mr Simmonds' concessions and arguments. In the course of doing so, I say some things about the substantive business case.

1472. IBM accepts that the detailed business analysis had not been prepared by February 2009, but the reason for that is said to be plain: the non-involvement in Project Waltz of Mr Wilson following his meetings with Mr MacDonald and Mr Koppl in November 2008. Without any sense of irony, IBM says that, were it not for the absence of Mr Wilson's involvement, the business case would have been prepared earlier and would not have had to await the appointment of Mr Chrystie. It is suggested that it is clear from the slides and the notes of the meetings in November 2008 that the intention was that the UK business case would be developed in parallel with the global strand, before any firm decisions had been taken on the Project Waltz changes. If one replaces "firm" with "formal", I would agree. But the reality is that by this time CHQ had developed its thinking to such an extent that there was no realistic prospect of it or Holdings concluding other than that the worldwide DB changes should be made. The CFO's job was to find the reasons for going to the chosen destination not to challenge the direction of travel. If Mr Wilson would not do it, then someone else would have to take on the role. Mr Chrystie took on the role but only in April 2009; IBM accepts that this meant that there was no detailed analysis of that

case until then.

1473. According to IBM it was quite clear to everyone by February 2009 that Holdings was not meeting its performance targets. Mr Simmonds relies on Mr Riley's oral testimony:

> "I think we had – I certainly had – more confidence on some of the things that we were doing around profitability, but you have to understand that we are still (a) a long way behind in terms of our rank to other units and (b) we weren't growing our PTI at double-digits, so relative to the other units you are falling behind…"

1474. That was in response to a question whether there was a need to make pension changes to fix operational productivity which, as Mr Stallworthy suggested to Mr Riley was a "yes or no question" (not eliciting, as we can see, a yes or no answer). It is interesting to see how that line of questioning then proceeded:

> "Q. But your answer as to how you were going to do it was driving to fix with the transformation strategy, that we have already looked at, wasn't it?
>
> A. Yes, transformation was one of the key strategies, yes.
>
> Q. So it wasn't to do with pension changes, was it?
>
> A. I think we were starting to see at that point in this meeting the pension changes being discussed, the requirement for corporate to move and change on pensions, and then following this meeting and other meetings it became a bigger issue for us to deal with."

1475. I accept the proposition that everyone knew that IBM was not meeting its performance targets *ie* the targets set by CHQ. I am sure that Mr Wilson was well aware of that and that PTI was a real concern for Holdings. But his point, in taking the view that a business case had not been identified, was that the changes were being driven by IBM's NPPC concerns. Essentially, it was only because of those concerns (and the impact of NPPC on EPS) that Holdings was being required to find a business case not for UKI Transformation but for the pension changes. It has to be recognised that CHQ were driving this all along, as the following exchange between Mr Riley and Mr Stallworthy shows:

> "Q. But at this point in time [as early as November 2008] wasn't the reality that it was all being driven by CHQ? They were insisting upon the changes, weren't they?
>
> A. Yes, yes, CHQ were very strong on wanting to make the changes on pensions. We have still got -- I have still got a role -- at that time, had a role to play in leading the continued growth and success of the business, and growing PTI at double-digit, so ...
>
> Q. But doesn't it follow from what you have said before that but for CHQ's insistence on these changes being made, there wouldn't have been pension changes implemented?
>
> A. Not necessarily. Not necessarily.
>
> Q. You had worked up your transformation strategy –
>
> A. Yes.
>
> Q. -- by 23rd October 2008 and there were no changes to pensions there. We have been through that. You have accepted that the primary motivation for these changes was CHQ's insistence on fixing NPPC?
>
> A. Uh-huh
>
> ……..

Q. But the primary motivation was fixing the NPPC problem. You have accepted that.

A. Yes.

Q. Isn't it right that it was inevitable that the changes were going to be made from the point at which CHQ required them of you? Isn't that right?

A. Yes, there was a lot of pressure from CHQ to make the changes and implement the changes, yes.

…..

Q. Let's look at it in two different ways then. Even if there had been no productivity -- we looked at Germany and Canada, and the fact that they were hugely profitable and that they still had these changes imposed on them because of their DB liabilities.

A. Yes.

Q. So it is right, isn't it, these changes would have been required by CHQ even if there had been no productivity problem with the UK?

A. Yes, CHQ would have definitely pushed for those changes."

1476. Nonetheless, Mr Riley denied that none of the business justification had been done by 4 February 2009, and stated that there was justification for the work to be completed. In this part of his cross-examination, Mr Riley did, however, accept that "in terms of the detailed work that was going to be required, that was not really commenced and kicked off at that time". I asked him about the non-detailed work and where the evidence which demonstrated that work was to be found. His answer was this:

"…….I guess, my Lord, it was the fact that we were at -- the business at that time was severely challenged from a profit perspective, and we had done a lot of work and analysis on the profitability of the business, and that's more my reference to that."

1477. Mr Simmonds says that Mr Riley developed this point, stating that:

"UK had a bit of a crisis, because we were going to fall off a cliff from a PTI perspective"

and

"We certainly had all the PTI analysis at the time. We could see what was happening with PTI and where the Company was headed with PTI. That was patently obvious."

1478. There is a risk of some confusion here about what is meant by the business case. For Mr Riley, the business case depended on meeting PTI targets, targets which, it must be remembered, had been imposed by CHQ. Those targets themselves could only be met in practice by making the proposed changes to the DB Plans; there was no way in which the other matters addressed in UKI Transformation could, by themselves, have produced the necessary contribution to PTI. In contrast, what Mr Wilson meant by a business justification was one which did not depend on meeting the increases in NPPC which IBM was facing. If NPPC was taken out of the equation, he was unable to see a business case to justify the pension changes under Project Waltz, and that was why he found it difficult to have been tasked with the creation of a business justification for the options being considered. See further at paragraphs 1486*ff* below.

1479. So Mr Riley's focus was on PTI whereas Mr Wilson's focus was on NPPC. Although the two are not the same, in the situation in which IBM found itself at the time, containing NPPC cost, not simply increasing PTI, was the critical factor in achieving the EPS commitment. This was not the message CHQ wanted presented which was

why its concern was to build up the local business case.

1480. Had it not been for that pressure from CHQ, it seems to me more likely than not that the changes would not have been made. I think that the best evidence on this comes from Mr Riley. In the course of cross-examination, Mr Stallworthy questioned him about the risks to profitability which had been set out in the slides for the conference call on 3 March 2009. The risks included (i) loss of critical skill (ii) negative employee response (iii) adverse Trustee reaction and (iv) adverse press reaction with a business impact on brand reputation and a financial impact due to loss of future business. Mr Riley acknowledged that he was extremely concerned that the pension changes would have an operational risk to revenue. This exchange took place:

> "Bearing in mind that these risks to operational effectiveness and productivity were entirely antithetic contrary to the objectives of the transformation strategy and your concerns about profit, doesn't it indicate that you would not have made the changes but for CHQ's insistence? You said that it shows you had thought about the risks. You didn't entirely answer the question, Mr Riley. Doesn't it indicate that you wouldn't have made these changes but for CHQ's insistence?
>
> A. Yes, CHQ had a very strong influence on where we were up to that point of time.
>
> Q. Is the answer "yes"? It's a "yes" or "no" question.
>
> A. Yes, most likely yes."

1481. Mr Simmonds submits that Mr Chrystie was firm in his view that no further detailed business analysis was necessary to make the fact of a profitability problem plain. It was also clear to him that anyone in the UK who had seen the figures (which he rather assumed I think would include the entire UK pensions team) would understand the profitability problems prior to the building of the business case. His role, when he took up his position as CFO in April 2009, was to pull together the existing elements of the case for change and to produce a coherent package for the presentations to the board of Holdings. That is all true, but Mr Chrystie was taking the targets as a given. He was not looking for a purely operational justification for the changes which might call those targets into question. In this context, see further paragraphs 1361*ff* above.

1482. Then it is said by IBM that the UK business case was also appreciated by Mr MacDonald at the 4 February 2009 meeting: Mr Koppl's notes of that meeting record Mr MacDonald addressing the effect of the Project Waltz Changes on the UK PTI problems: "Randy – what is impact of $100 million pension savings on closing PTI growth gap". That is all perfectly true, but the PTI problem was itself driven by US GAAP not by anything local to the UK. If there was a problem about the profitability of the underlying business, it was one which Mr Riley had initiated UKI Transformation to address; and it is clear from his own evidence that Project Waltz was not an appropriate means of addressing any operational deficiency which there may have been.

1483. That is not to say that the local strand was an *ex post facto* rationalisation after February 2009. Rather, as I see it and as I understand Mr Chrystie to have seen it, the local strand was really part of the global strand both ultimately deriving from the need to meet the NPPC reduction. But even if it was an *ex post facto* rationalisation, IBM submits that there is nothing at all wrong with that as a matter of principle, provided that the rationalisation was real and not concocted, a proposition with which I agree.

1484. Put in this context, the advent of the Spring Plan in early April 2009, which imposed greater profitability requirements on IBM UK, also provided a legitimate fortification of the UK business justification for the Project Waltz changes, although the problems with the lack of profitability of IBM UK were seen by UK management long before the Spring Plan.

1485. IBM therefore submits that, provided the business case for Project Waltz was genuine, and the view was *bona fide* held by UK management, there is ultimately nothing in the RBs' timing issue. I agree with that conclusion.

Mr Wilson saw no business justification

1486. Mr Simmonds addresses the reliance placed by the RBs on the fact that Mr Wilson did not see a UK business justification for the Project Waltz changes as demonstrating that there was no such justification. He says that, just because Mr Wilson did not agree that there was such a case, does not mean that there was not such a case. I agree with that, of course, since Mr Wilson is not the arbiter of such a question. I have attempted earlier in this judgment to explain what Mr Wilson considered a UK business case to be and how and why it differed from Mr Chrystie's perception. The significant difference comes down to a simple point.

1487. Mr Chrystie started with the targets which he had been given (and then the increased targets under the Spring Plan). He saw meeting those targets as his objective; the Project Waltz changes were the appropriate way of meeting those targets (and realistically, I would add, there was no way in which the targets could have been met without serious changes to the DB Plans). He did, however, see the pensions aspect of the local strand as effectively part of the global plan.

1488. In contrast, Mr Wilson did not see CHQ's need to reduce NPPC in order to meet its EPS target as part of any UK business justification for the Project Waltz changes. As he put it:

> "the facts as I saw them at the time did not support a view that the business had materially deteriorated since the time of Soto."

1489. In that context, he confirmed that he did not see any material deterioration. There had actually been a slight deterioration in revenue growth between 2007 and 2008, but that was not enough, in his view, to support any changes. Further, in his evidence, Mr Wilson confirmed that:

> "I felt at the time that a justification for the pension changes, if it was to rest on factors other than the increase in NPPC, ought to consider changes in the achieved business performance over the time period since Soto."

1490. Mr Simmonds agrees that, had material deterioration of the business been the sole criterion, Mr Wilson would have had a point. But the fact is that material deterioration was not the only business justification for the Project Waltz changes. He suggests that Mr Wilson himself admitted that others could have discerned a business justification where he himself could not, and reasonable people could potentially have differed as to whether or not there was a business justification. That is not quite what Mr Wilson said. Let me set out some of the relevant questions and answers:

> "A…….I am trying to describe here that we did have a substantive debate in the meeting for quite some period, I would say, around about an hour, back and forth, about what the possible grounds for justification could be. It may be that there were smarter people who could think of different reasons. What I am describing is that at that time, in that meeting, I was not coming up with those grounds.
>
> Q. That is a fair point. This is a matter on which reasonable people could disagree……
>
> A. Well, I think that depends on the data that one has, as to whether reasonable people can disagree or not.
>
> Q. I think the evidence you gave a few moments ago was that you accepted there had been a deterioration in terms of profits but you didn't consider it to be material. That is a question of judgment, isn't it?
>
> A. Yes, of course it's a question of judgment as to what you regard as being material.
>
> Q. That is -- sorry to interrupt. That is why I said that is a subject on which reasonable people could disagree.
>
> A. Potentially that may be the case.

Q. The other thing is you are looking in terms of deterioration of the business. Whether there is potentially a business case to support change or not may depend on how one frames the scope of the inquiry. You decided that that is where you set the bar, if I can put it like that.

A. We had a debate where we talked about a lot of different angles that one could take, which could form a possible basis of justification. I can't recall all of the details of every angle that we discussed, but there was, as I say, quite a substantive discussion back and forth about what the potential rationale for further changes could be after the 2006 Soto changes. What I have recorded in my witness statement is that, at that time, in that meeting, I was having difficulty coming up with a reason that I found intellectually satisfying as a justification. That is not to say that there couldn't be such grounds; I am just saying that is the position that I found myself in, in that meeting.

Q. That is really the point I was probing. Because, clearly, when one looks at Mr Chrystie's charts from April of the following year, clearly one of the things that he considered to be important was the fact that UKI had not been meeting targets. We saw that from slide 4 and the conclusion drawn from it.

A. …… I would point out that, of course, the pension costs number within those performance figures was actually the frozen capped amount, not the actual pension cost that the Corporation was booking. Which was just one of the many factors that, for example, we did debate in that meeting, as to what was the right standard for measuring PTI when you are suggesting a change in pension provision but measuring the business against a number that is not the actual NPPC being recorded by the Corporation..…….. I did not come to a point of being able to clearly see a rationale that did not just go back to the fact that we had an NPPC problem that was going to come at us because of the falling financial markets. If others have come up with better analysis since then, then that is for them to speak to."

1491. Mr Wilson's position there tallies with Mr Koppl's evidence on the reasons for the dispute between them at the 20 and 21 November 2008 meetings. Mr Wilson had decided that there was no business case because there was no material deterioration in the business since the time of Project Soto; Mr Koppl wanted him to look at how UK profitability was measuring against CHQ's targets, including in relation to the future. It is the issue of the relevance, if any, of targets and NPPC to a purely local business case.

CHQ was responsible for the decision to proceed with the Project Waltz Changes: the UK Holdings board meeting was irrelevant

1492. Mr Simmonds has addressed several pages of his written closing to this topic. I think that I have dealt with the board meeting in sufficient detail at paragraphs 1209*ff* above. The board meeting was not irrelevant.

1493. As to the suggestion that there was no reference to the global strand at the board meeting, Mr Simmonds submits that this does not invalidate or demote the relevance of the UK board decision to proceed with the Project Waltz changes. He records my question during the hearing:

> "[the RBs] are saying there is a breach of an *Imperial* duty of good faith which lay on the company, which through its decision makers was acting in perfectly good faith, albeit ignorant of some material factors. But if they took the view that it was in the interests of IBM UK to make these changes, for the reasons that they thought were good reasons, how does one go behind that?"

IBM's answer is that, unless it can be argued that the decision of the board was invalid (which is not suggested by the RBs) or that the minutes of the meeting were a sham (which is not suggested) one cannot go behind the decision.

1494. I went on to say this:

> "When we have heard all the evidence things will be clearer, but if the scenario were different from the one that you perceive, IBM Corporation might have thought 'we want to do this for NPPC reasons. Unfortunately we can't do it. Ah, but there is a very good business reason for doing this, so we can actually validly achieve what we want to achieve by reference to some perfectly valid justifications which would have been sufficient reason as if NPPC weren't a problem at all. So we can have a win/win for us'."

1495. I summarised it this way: if the decision was a good decision (*ie* on the UK case), what has NPPC got to do with it? This remains a critical question, my answer to which will become apparent later.

The causation argument

1496. Allied to the previous argument is the contention that the local strand cannot be relied upon because (as IBM accepts) it was most likely that the changes would have gone ahead in any event because of the global strand. Mr Simmonds submits that this contention is misconceived. There is no reason as a matter of principle why the local strand has to be treated as the *causa sine qua non* of the Project Waltz changes: such a conclusion would be contrary to the fact that, in the real world, business decisions are taken for multiple reasons. I agree.

The EPS target in the 2010 EPS Roadmap could have excluded retirement-related costs

1497. I have mentioned briefly (see paragraph 1395 above) the point that the 2010 EPS Roadmap could have concentrated solely on the operational performance of the business, and excluded retirement-related costs, thereby excluding the need to reduce pension costs in order to assist in meeting the 2010 EPS Roadmap commitment. As Mr Koppl explained:

> "Q. But there was nothing stopping you doing this in 2007?
>
> A. Only that we hadn't thought of it. It was like asking Thomas Edison, if he had invented the light bulb earlier, would the world be different?"
>
> [I am grateful to someone on the IBM team for this historical footnote: Whether Mr Koppl was correct that Thomas Edison (an American) invented the light bulb is open to debate: many believe it to have been Joseph Swan (an Englishman).]

1498. It is perhaps worth pointing out that Mr Koppl explained that actually doing this (as IBM now does: the basis on which it projects EPS from January 2011 is to strip out the effect of non-operational elements, including DB pension costs) necessarily involved the undertaking of some very careful analysis. As he said and I accept:

> "The risk was that, if the Company switches over for purposes of this long-term commitment on earnings and the investors don't accept it, that they feel it is manipulative or not a fair representation of the Company's results, the Company could lose credibility with investors. So there was a great deal of work to try and get the Company comfortable that this approach would be acceptable, and we announced it in 2010, in May of 2010."

1499. It is easy to say that what was done in 2011 should have been done in 2007 but I do not consider that the fact that it was not done is relevant in any way to the issue of breach of the *Imperial* duty in the present case. And so, given that the 2010 EPS Roadmap did incorporate pension cost, IBM could only operate *vis a vis* investors with NPPC figures that were dragging down the EPS away from that target.

De-risking

1500. There is an important point to be made at this stage. It relates to the suggestion that IBM ought, given that the 2010 EPS Roadmap did include retirement related cost, to have de-risked by moving out of equities and into bonds. IBM's answer is that, in respect of the US plans, in 2006 Mr Koppl prepared a statistical simulation

analysis with the assistance of Watson Wyatt, modelling the volatility of NPPC under a range of asset allocations of scheme funds (including 90% allocation to fixed income) and with a range of investment outcomes: the analysis demonstrated that volatility of NPPC for the IBM schemes was not proportionately reduced by changing asset allocations, including changing to allocations heavily weighted to fixed income, although the median cost was significantly increased. That, I suppose, might also be relied on as some evidence about the effect of a move into bonds in the UK DB Plans.

1501. I can have some confidence that that is so from the modelling carried out by Mr Robbins of equivalent changes in the Main Plan. As that modelling demonstrates, the high levels of NPPC forecast after 2008/09 would have occurred had the Trustee's target asset allocation policy been adopted on 1 January in 2003, 2004, 2005, 2006, 2008 or 2009. The only different outcome arises if the policy had been adopted during the "sweet spot" for switching in 2007. I agree with the way it is put in IBM's written closing submissions (see at paragraph 288) and by Mr Legge in his closing oral submissions: the modelling shows that the high levels of NPPC cannot properly be attributed to IBM's preferred asset allocation and that the true reasons for there being a high NPPC after the date of the asset falls was because there had not been a switch at the critical time in 2007.

1502. I have revisited the modelling and the analyses prepared by Mr Robbins and I have taken account of Mr Clare's and Mr E Bradley Wilson's comments. Mr Simmonds submits (and I agree) that the following conclusions can be drawn:

i) The actual asset allocation strategy always produces a lower NPPC median outcome and a much lower NPPC best outcome than the target strategy or the 100% corporate bond strategy.

ii) Although the 'breadth of variance' volatility of the NPPC produced by the target or 100% bond strategies is less than that of the actual strategy, the bond-based strategies nonetheless preserve a significant degree of breadth of variance volatility.

iii) Notwithstanding the fact that the breadth of variance volatility of the actual strategy increases over time, it is many years (estimated by Mr Clare at thirteen years) before the highest NPPC under the actual strategy is higher than the highest outcome under the bond-based strategy.

iv) In some years, it is possible that NPPC would be lower under the bond-based strategy than the actual strategy.

v) One inference which I am invited to draw (and which I do draw) from this evidence is that the volatility of NPPC under the bond-based strategy on a breadth of variance basis would be significant – *ie* NPPC would remain unpredictable even if the bond-based strategy were adopted.

1503. Viewed from a funding perspective (rather than an NPPC perspective), the asset allocation of the funds was not unusual for comparable UK funds. In Mr Bowie's words:

> "the proportion of growth assets held by the IBM Main Plan was at all times within the spectrum adopted by other UK DB schemes."

1504. It is not an understatement on the part of Mr Simmonds to say that this issue involved an enormous amount of detailed analysis as to the exact status of the various surveys referred to by Mr Bowie in his report. However, both experts accepted:

i) that maturity had a part to play in the adoption of an investment strategy;

ii) that the data showed that there was a not particularly strong correlation between maturity and asset allocation; and

iii) that the asset allocation of the Main Plan was not an outlier by comparison with comparably mature UK schemes.

1505. In my judgement, Mr Bowie's contention set out in paragraph 1503 above is correct.

Discussion and conclusions

1506. I have now completed my very lengthy consideration of the facts following Soto and of the arguments of the parties. During the course of that, I have expressed some conclusions relevant to Project Waltz in addition to the conclusions already stated in relation to Ocean and Soto. It is now time to draw the threads together.

1507. So far as concerns the law, I have addressed the nature of the *Imperial* duty as it applies to the exercise of discretionary powers by an employer and reached the conclusion that the test is one of irrationality and perversity in the sense that no reasonable employer could act in the way that Holdings has acted in the present case. The contractual duty can be expressed differently: an employer must treat his employees fairly in his conduct of his business, and in his treatment of his employees, an employer must act responsibly and in good faith; he must act with due regard to trust and confidence (or fairness): see paragraph 407 above. But as I have explained, to confound a Reasonable Expectation may, on the facts, be something that no reasonable employer would do in the way that is has been done. There may, accordingly, be no significant difference in the application of the two different tests to a particular set of closely related facts.

1508. The *Imperial* duty is the focus of attention in relation to the closure of the DB Plans to future accrual by an exercise of the Exclusion Powers and in relation to the change of early retirement policy. The contractual duty is the focus of attention in relation to the alleged failure properly to consult. So far as the 2009 Non-Pensionability Agreements are concerned, it seems to me that the focus ought to be on the contractual duty. Those Agreements do not involve any exercise by Holdings of its powers under the DB Plans. Indeed the Agreements, if effective, are as relevant to hybrid deferred members as they are to members remaining (until exercise of the Exclusion Power in 2011) in the DB Plans: hybrid deferred status conferred a final salary link in respect of the earlier period of service during which the member was accruing benefits under the DB Plans. Although the Agreements relate to pensions, they are nonetheless purely contractual arrangements between Holdings and the members concerned; the entering into of those Agreements could not, it seems to me, engage the *Imperial* duty rather than the contractual duty as a matter of employment law.

1509. I have addressed at paragraphs 1002*ff* above the different approaches of IBM and the RBs to the issue of how the actions and statements of IBM Corporation and CHQ are to be taken into account in assessing whether Holdings has been in breach of its *Imperial* duty and whether it is an answer to the RBs' complaints that Holdings was simply acting in any entirely appropriate way to the requirements of CHQ in relation to which it had, in reality, no choice. I have identified the question to ask as being whether Project Waltz was an appropriate response to the combination of problems facing both IBM Corporation (including in particular the requirement to meet the 2010 EPS Roadmap) and Holdings (including the need to improve competitiveness) taking into account the Reasonable Expectations of members. It is not possible, for Holdings to shelter behind a business case based on the need to meet targets imposed by CHQ unless, in turn, a business case can be demonstrated justifying the imposition of the targets.

1510. The Reasonable Expectations which I have held the members were entitled to hold after the implementation of the Soto changes were, to recap, as follows:

i) In relation to future service, an expectation that benefit accrual (in accordance with the Soto changes) would continue into the future; but such an expectation would be subject to an appreciation that a significant change in financial and economic circumstances (including trading and competitiveness) might cause Holdings to make further changes to the Plans and that to do so might be a decision which Holdings could reasonably take. Subject to that qualification, the expectation would last until at least the operative date, 6 April 2011, of the cessation of benefit accrual as a result of the service of the notices under the Exclusion Power.

ii) In relation to past service up to the time of the implementation of the Ocean proposals, an expectation that a member would be able to take advantage of Holdings' then current early retirement policy until 2014 unless there was a relevant justification for a change in policy.

1511. There can be no doubt that the Project Waltz changes conflicted with those Reasonable Expectations. Active members of the DB Plans would (i) cease to accrue further DB benefits from 6 April 2011 (ii) obtain no salary increases in the future (notwithstanding that Mr Riley had announced increases for 2009) unless they entered into the 2009 Non-Pensionability Agreements albeit that, after the initial announcement, the "future" in this context was limited to 2009 to 2011 with a review thereafter and (iii) be subject to the detrimental change in ER policy. Enhanced M Plan members would also be subject to (iii). In relation to (ii), this was focused as a result of the limitation just mentioned, on 2009 to 2011. IBM thought that the effect of the exercise of the Exclusion Power would be to break the final salary link for accrued benefits. I have held that to be incorrect; but the 2009 Non-Pensionability Agreements would achieve the same result.

1512. The Project Waltz changes were, on any view, very significant and clearly capable of giving rise to a breach of Holdings' *Imperial* duty and of its contractual duty of trust and confidence. It is right, in my view and as Mr Tennet submits, to view the changes as a whole in addressing the issue of a breach of duty. Indeed one of his submissions is that the severity of the changes taken as a whole is a factor demonstrating a breach of duty. Having said that, the individual elements of the changes must be considered separately. That is for two, related reasons. The first is that one or more of the individual elements may of themselves give rise to a breach of duty. It is important to know whether that is so. The second is that it is important, when it comes to considering any remedy, to know what Holdings could properly have done to avoid a breach of duty if it has committed one, and in that context it is important to know what, if any, individual element would have given rise to a breach of duty taken by itself. I will say a little about remedies later, but that whole aspect of the case is raised by issues which were not dealt with at the trial and which can only be properly addressed once my decision in principle is known.

1513. I have considered exhaustively the many statements made in relation to Ocean and Soto (including the Webcast) and have stated my conclusions about the Reasonable Expectations which the members were entitled to take from those communications, as I have just summarised them. They were not simply statements and communications; they were intended to be, and were, acted upon by the members in making the choices which they did.

1514. Although I do not believe Mr Simmonds has actually conceded this, it seems to me that, were it not for the business case which IBM presents, with its global and local strands, the two elements of the Project Waltz changes (cessation of accrual of DB benefits and change to ER policy) relevant to the *Imperial* duty would, in the light of those conclusions, have given rise to a breach of Holdings' *Imperial* duty. He has argued forcefully that the RBs were not entitled to hold any relevant Reasonable Expectations as a result of the Ocean and Soto communications. But he has not submitted, if he is wrong on that, that IBM Corporation and CHQ could simply set whatever targets they liked leaving Holdings with no real choice about whether to take steps to achieve those targets. And so he has not suggested that, even applying his own approach to the interaction between IBM Corporation's actions and Holdings' response in the context of Holdings' *Imperial* duty, Holdings' actions in implementing Project Waltz in the absence of any business case on the part of IBM Corporation would not have been perverse or irrational in the sense which I have used those words as the test for breach of duty. I ought to make it clear, in case what I have just said might give a contrary impression, that Mr Simmonds did submit that, assuming that IBM Corporation had a good business case from its perspective for imposing the targets on Holdings which it did impose then, applying IBM's approach to that interaction, Holdings was not acting in breach of its *Imperial* duty or its contractual duty of trust and confidence in implementing the Project Waltz proposals.

1515. I also consider that Holdings' conduct in relation to the 2009 Non-Pensionability Agreements would, in the absence of the global and local strands, have given rise to a breach of the contractual duty of trust and confidence in the context of Project Waltz as a whole. It is unrealistic to separate these Agreements from the other elements of Project Waltz and to suggest that, because members made their own decision to sign the Agreement, there can be no breach of duty. The 2009 Non-Pensionability Agreements have been described as "no-brainers" both by IBM and by some of the RBs' representatives. It was, of course, a "no-brainer" in the sense that a non-pensionable pay increase was better than no pay increase at all. But that is not an answer to the question whether, by presenting the choice which it did in the context of Project Waltz and on the hypothesis of

there being no global or local strand, Holdings would have been acting in breach of its duty of trust and confidence.

1516. However, if one looks at the 2009 Non-Pensionability Agreements in isolation, the picture is different. It must be noted that the Ocean and Soto communications did not say anything expressly about salary increases. Those communications did not, I consider, give rise to any expectation that salary increases would be awarded in the future (although employees may have held expectations – probably no more than "mere" expectations to use Mr Tennet's terminology – that salary increases would be awarded in the future as they had been in the past).

1517. It should also be noted that there was not a hint in any of the communications that members might be treated differently, so far as concerns salary increases, in the future depending on whether they elected to remain in the DB Plans or to join the Enhanced M Plan. Mr Tennet submits that, whilst there was n expectation of any particular increase in pay, there was a Reasonable Expectation that members would not be denied pay rises which would otherwise be applicable to them by reference to what election they had made in 2006 under Project Soto: there would be no discrimination by reference to the different status.

1518. That is the essence of his submission which he developed at some length. I do not agree with it. If members of the DB Plans are to be entitled to the same pay increases as members of the DC Plans, that will be as a result of IBM's breach of its *Imperial* duty and its contractual duty of trust and confidence based on the other Reasonable Expectations which I have identified: in other words, what Mr Tennet submits is a separate Reasonable Expectation is, in my view, properly to be seen as the result of other Reasonable Expectations. I do not consider that what was said in connection with Ocean and Soto was capable of giving rise to an expectation concerning pay increases as a separate Reasonable Expectation. I make clear that I am not saying that the members of the DB Plans do in fact have such an entitlement in the light of the Reasonable Expectations which are established. That is an issue which will fall to be dealt with, if it arises at all, in a further hearing dealing with remedies.

1519. That conclusion is, I think, consistent with the remainder of Mr Tennet's own submissions. He accepted in his oral closing submissions that, had it not been for the Reasonable Expectations on which he relies, Project Waltz would not have given rise to a breach of duty on the part of Holdings. It necessarily follows from that that the 2009 Non-Pensionability Agreements, in the absence of any Reasonable Expectations at all, would not have given rise to a breach of duty; and this is so whether the 2009 Non-Pensionability Agreements are viewed as part of the overall changes or viewed in isolation. Given my rejection of Mr Tennet's submission relating to the further Reasonable Expectation for which he contended (that DB members would not be denied pay increases which would otherwise be applicable to them), it follows that there is no basis on which to assert that the 2009 Non-Pensionability Agreements, taken in isolation, gave rise to a breach of duty.

1520. That conclusion is, I think, consistent with Mr Tennet's own submissions. He accepted in his oral closing submissions that, had it not been for the Reasonable Expectations on which he relies, Project Waltz would not have given rise to a breach of duty on the part of Holdings. It necessarily follows from that that the 2009 Non-Pensionability Agreements would not, whether as part of the overall changes or viewed in isolation, have given rise to a breach of duty. Given that the Reasonable Expectations on which he does rely do not include one to the effect that pay increases would be the same for all classes of member, it follows that there is no basis on which to assert that the 2009 Non-Pensionability Agreements, taken in isolation, gave rise to a breach of duty.

1521. The caveat is this. As the proposals for a non-pensionability agreement were originally presented, members could reasonably have thought – and clearly many did think – that a failure to sign the agreement would result in there being no pay increases at all in the future. A threat of that sort, I think, could well amount by itself to a breach of the implied contractual duty of trust and confidence. Although Mr Ferrar subsequently modified the communication so that the agreement would operate only in relation to 2009 to 2011, some members made their decisions and elected via the online tool to accept the agreement before he did so. I must leave the caveat hanging there at the moment. I will return to it later.

1522. In the preceding few paragraphs I have looked at the position on the counterfactual scenario that there was no global strand and no local strand. I considered it helpful to do so if only to eliminate any suggestion that the

global strand and the local strand were somehow irrelevant and only make-weights in IBM's case.

1523. I now want to look at another scenario contrary to the actual position as I have held it to be. This is the scenario described in paragraph 1012 above, applying IBM's approach to the way in which Holdings was entitled to take into account the targets set by CHQ. On that approach, the global strand starts with the position that IBM Corporation/CHQ's decision and conduct in deciding to put forward and promote the Project Waltz changes was not constrained in any way by any Reasonable Expectations. And in assessing whether Holdings itself is in breach of its *Imperial* duty, the question is whether, given that the changes were required by CHQ, Holdings would be acting perversely and irrationally (in the sense which I have described) by agreeing to the changes (to which IBM says, of course, that the answer is obviously that Holdings would not be acting in that way) notwithstanding that the changes would disappoint the RBs' Reasonable Expectations. In my judgement, it cannot be said that Holdings would have been acting perversely or irrationally in those circumstances. Given that UK management, and in particular Mr Wilson, Mr Heath and Mr Hirst were all acting in good faith and believing what they said in promulgating the Ocean and Soto communications, it is not possible, on the approach now under consideration, to say that Holdings itself was acting other than in good faith and in the belief that the communications were true. Accordingly, when new targets were set by CHQ, even if those targets were set in order to remain on the course of the 2010 EPS Roadmap, it cannot be said that the adoption of the Project Waltz changes by Holdings was a course which no reasonable employer would have taken. Project Waltz would not, therefore, have given rise to any breach of duty on the part of Holdings.

1524. From consideration of these two counterfactual or hypothetical scenarios (*ie* (i) no global or local strands and (ii) CHQ's ability to impose targets without thereby risking Holdings being put in breach of its *Imperial* and contractual duties), I must now address the actual position under which (i) the global and local strands are relied on and (ii) Holdings is unable to shelter behind CHQ's targets but must instead address the validity of the business case. The central question is whether the global strand and the local strand lead to the result that Project Waltz did not give rise to a breach of Holdings' *Imperial* duty or of its contractual duty of trust and confidence. I avoid putting the question as whether the global strand and the local strand justify the breach of duty since that would be to adopt the "two-pronged" approach which I have rejected.

1525. Just as I have considered exhaustively the many communications made in relation to Ocean and Soto, I have done the same with the financial material and internal deliberations (so far as revealed in the evidence) relevant to Ocean and Soto and, more importantly, in relation to Project Waltz. The ultimate question is one of judgment, taking into account all of the factors which I have identified and addressed at length, and the submissions (many of which I have already dealt with) made. My judgment is that Holdings was in breach of its *Imperial* duty and of its contractual duty of trust and confidence in imposing the Project Waltz changes and in presenting the members with the choice of signing non-pensionability agreements or receiving no pay increases in the future.

1526. My principal reasons for reaching this conclusion are these:

i) Project Waltz was clearly inconsistent with the Reasonable Expectations which are established.

ii) The disappointment of those Reasonable Expectations was a very serious matter going to the heart of the relationship between Holdings and its employees.

iii) The communications giving rise to the Reasonable Expectations were not simply expressions of intent; they were communications on the basis of which the affected members were to take decisions as part of the implementation of Ocean and Soto of great importance relating to their careers and retirement. members made decisions accordingly.

iv) The local strand, insofar as it is based on the need for operational improvements and savings unrelated to the requirement by CHQ to deliver pension savings in a manner designed to improve NPPC, would not render unobjectionable Holdings' decision to adopt Project Waltz. In the light of the Reasonable Expectations, Holdings could be expected to adopt proposals to meet such concerns as there were about the operational cost (including the cost, from a UK accounting and scheme-funding perspective, of meeting any UK DB Plan deficit) in ways which, so far as reasonably possible, were consistent with those Reasonable Expectations. I have little doubt

that, had the only need been to meet local objectives of that sort, proposals of far less severity could and would have been devised. Indeed, Mr Riley effectively accepted that proposition.

v) Insofar as the local strand contained an element which required Holdings to meet CHQ's targets for PTI and NPPC delivery, I do not perceive the local strand as adding anything to the global strand when it comes to assessing whether the Project Waltz proposals gave rise to a breach of duty on the part of Holdings. And this is so whichever approach is taken to how the actions and statements of IBM Corporation and CHQ are to be taken into account in assessing whether Holdings has been in breach of its *Imperial* duty and contractual duty of trust and confidence.

vi) As to the global strand, the most important element of that strand was the requirement for operating units around the world to deliver NPPC improvements to meet the pensions-related requirements of the 2010 EPS Roadmap in relation to which it will be remembered that the evidence is that it was a requirement of CHQ that each element of the Roadmap had to be met. The target set for the UK DB Plans was, in my judgement, the principal driver for the Project Waltz changes in the UK.

vii) The 2010 EPS Roadmap was itself a reflection of IBM Corporation's commitment to Wall Street. Although the language which gave rise to that commitment was, as Mr Tennet submits, weaker than the language which, according to IBM, did not give rise to a commitment to members concerning their pensions, I do not doubt that the senior managers in Armonk perceived what has been said to investors as a commitment and considered that to breach that commitment would not be good for the share price. But two reminders need to be given and one additional point needs to be made:

a) The first reminder is that the commitment to investors was given after the relevant communications to members had been made and the Reasonable Expectations engendered. To prefer investors is not, of course, of itself a breach of duty. That said, it does seem to me, however, that this is a factor which can be taken account of in deciding whether Holdings' actions were such that no reasonable employer could take.

b) The second reminder is that since 2011, retirement-related costs no longer feature as a performance indicator. Again, as Mr Simmonds has said, it is not possible to derive a breach of the *Imperial* duty from a failure to adopt this course earlier than 2011. As he put it in his closing written submissions:

> "With perfect hindsight, it is easy to say that what was done in 2011 should have been done in 2007; indeed, IBM may even be criticised as having been unimaginative in that respect, but that is a far cry from a finding of perversity or irrationality on the part of IBM."

c) The relevance of that is not whether this failure gave rise to a breach of duty – it clearly did not – or even whether it is to be taken account of as a relevant factor in the same way as the fact that the commitment to investors was given after the Ocean and Soto communications had been made. The relevance is that the argument, and how Mr Simmonds approached it, is consistent with, and lends support, to the proposition that the actual Project Waltz proposals were critically dependent on the need to book NPPC savings for 2009.

d) The additional point is that the commitment to investors – or at least the one they cared about – was the delivery of the EPS target. I am not persuaded that CHQ's own requirement that the EPS target be delivered in accordance with the route set out in the 2010 EPS Roadmap was viewed as essential by investors. Indeed, I have heard no suggestion that investors complained that when the contribution of pension profit/savings to the EPS was insufficient, CHQ found the necessary contribution in other ways.

viii) Had CHQ acknowledged that the members had the Reasonable Expectations which I have held they were entitled to hold and had CHQ recognised the need for Holdings to act, so far as possible, consistently with those

Reasonable Expectations (and its own need, therefore, to enable Holdings to do so), CHQ should have given consideration to developing proposals which would meet the twin objectives of (i) meeting the EPS target in the 2010 EPS Roadmap and (ii) allowing effect to be given to the members' Reasonable Expectations.

ix) The evidence demonstrates that this was not done. Instead, CHQ determined that delivery of NPPC savings and increases to PTI were to be effected in certain ways. For the UK, that included pension savings of such a scale and having such attributes that the target set for the UK would be met. I am wholly unconvinced that proposals could not have been developed which would have met those twin objectives; indeed, I am satisfied on a balance of probabilities that they could have been. In the first place, the necessary savings to meet the EPS target (in contrast with the savings in NPPC cost) did not need to come from DB Pension plans, let alone from the UK DB Plans. If pension cost was an essential element, DC Plans could have been targeted: as the evidence (particularly from Mr Koppl) shows, that was an option and would have provided an easier solution. Another option might have been to impose heavier burdens on other DB Plans in countries where members had no similar Reasonable Expectations or no remedies arising out of them.

x) Mr Simmonds would say that this sort of decision was one for management to make and that the court should not second-guess management. But that would be to miss the point. I am certainly not second-guessing management. If they had a free hand, they may well have been entitled to act as they did; even Mr Tennet accepts that, absent Reasonable Expectations, the Project Waltz changes would not have given rise to a breach of duty even though many people would regard them as unfair. The point is that they did not have a free hand; so that if they went beyond such freedom as they did have, the court can say that there has been a breach of duty. I am guilty of some slightly truncated language there: IBM Corporation and CHQ did, of course, have a free hand in the sense that this court cannot control their actions; but they did not have a free hand in the sense (see paragraphs 1007*ff* above) that their actions and decisions can have no impact on Holdings' own position and whether it has acted in breach of its duties.

xi) Mr Chrystie was concerned about "headwinds" in the context of the UK DB Plans, and it is probably fair to assume that CHQ would have had similar concerns. But for the same reasons as I have just given in relation to the 2010 EPS Roadmap, I am not satisfied that CHQ was unable to develop proposals consistent with (i) meeting its concerns about headwinds and (ii) acting consistently with the members' Reasonable Expectations.

xii) The change in ER policy before 2014 was a breach of a Reasonable Expectation. But even if that were not so, against the background of the totality of the communications to members during the course of Ocean and Soto, the early retirement window was unreasonably short. Even if Holdings was entitled to change its ER policy, it could not do so overnight; it seems to have recognised that by providing, as it did, for an early retirement window. But to expect members to make such an important decision under the sort of pressure which was put on them was not, in my view, consonant with Holding's *Imperial* duty or its contractual duty of trust and confidence. The fact that members were being asked to make their decisions in the context of those communications meant that they needed more time than might otherwise have been sufficient to consider their positions. This is especially the case given that the communications gave rise, as I have held, to Reasonable Expectations.

xiii) At paragraph 1060 above, I referred to the message being given by CHQ in the context of Soto as being in all likelihood disingenuous. Where a Reasonable Expectation has been engendered by disingenuous statements which were misleading (whether or not deliberately so), the Court is entitled to take that into account in assessing whether Holdings' conduct in acting contrary to those Reasonable Expectations is irrational or perverse. When asking whether Holdings has acted in a way in which no reasonable employer would act, it is, in my view, relevant and counts against Holdings that some of the statements it made were disingenuous and misleading

1527. It will not have gone unnoticed that, in that summary of my reasons, I have not mentioned the RBs' arguments based on the proposition that IBM has been the author of its own misfortunes as a result of the investment policy which it persuaded the Trustee to adopt. There are two reasons for this:

i) The first is that I am satisfied, as already explained, that the result of the Trustee's actual investment policy was a fund invested within the range of a permissible and proper spread of investments. The Trustee was content with that from an investment perspective in the light of the guarantees first from IBM WTC and then from IBM Corporation. This makes it very difficult, I consider, to suggest that by CHQ procuring this investment policy, Holdings was in breach of any duty; and, more importantly, it makes it very difficult to suggest, too, that Holdings was in breach of duty in implementing Project Waltz simply because that investment policy had not produced the expected returns or returns as good as those which would have been achieved under the Trustee's preferred policy.

ii) Secondly, I accept the evidence relied on by Mr Simmonds (see paragraphs 1501*ff* above) which establishes that, apart from the short "sweet spot" period in 2007/08 for de-risking, NPPC would not have been any less in the relevant years under the Trustee's bond strategy than under IBM's return-seeking asset policy. This means that the principal driver for the targets imposed on Holdings in 2009 in order to contribute to NPPC cost reduction would have remained so that Project Waltz may not have looked at all different.

1528. In the light of all the evidence, and in particular in the light of the factors to which I have referred in the last few paragraphs, it is my view that no reasonable employer in the position of Holdings in 2009 would have adopted the Project Waltz proposals in the form which they took. Accordingly, I hold that Holdings was in breach of its *Imperial* duty so far as concerns accrual of benefits and change in ER policy and of its contractual duty of trust and confidence so far as concerns the 2009 Non-Pensionability Agreements.

1529. I have not, so far, referred to certain mistakes in the basis on which the Project Waltz proposals were formulated. These are (i) Holdings' understanding about the right of members to retire after age 60 without actuarial reduction as established in the Rectification Action and (ii) the retention of the final salary link when it came to the exercise of the Exclusion Powers. These are both factors which may have an impact on the appropriate remedy to be granted in respect of the breach of duty which I have held to be established since the remedy ought (I am inclined to think, although this will be a matter for argument at the subsequent hearing dealing with remedies) to reflect what is known today rather than what was known at the time of Project Waltz.

1530. As to the first of those factors, it is also the case that the RBs complain that no adequate account was taken of Mr Ford's identification of the rectification issue and of the strength of the case as it developed. I do not need to rely on that point as supporting the conclusion that there has been a breach of duty and, in the light of IBM's case on that, I do not do so.

1531. There is one other matter I should mention which has an impact on the issue of breach of duty. It reinforces the conclusion which I have already reached. It is this: Holdings' case before me (and I am entitled to assume, and do assume, that this was the view of IBM Corporation and CHQ too) was that the RBs were not entitled to hold any Reasonable Expectations. I have rejected that view. Holdings clearly knew of its duties (both its *Imperial* duty and its contractual duty) to employees and members. But equally clearly, it did not take into account any Reasonable Expectations held by members when implementing Project Waltz just as it did not take account of – perhaps no-one at CHQ other than Mr MacDonald himself knew – the "push-back" promise. I say "equally clearly" because it would be entirely inconsistent for Holdings to say that it took into account Reasonable Expectations which it argued before me did not exist (and, I might add, not only inconsistent but probably further conduct designed to destroy its relationship of trust and confidence with the members). To fail to take into account such an important matter is, I consider, itself a factor which falls to be taken into account when considering whether Holdings has acted perversely or irrationally. I do not need to rely on that factor to reach the conclusion which I have; and the point not having been relied on by Mr Tennet, I do not do so. But I am entitled to derive a degree of comfort from the point.

1532. It is important that, at this stage, I make one point about remedies. My conclusion that Holdings has acted in breach of its duties does not necessarily mean that the Project Waltz changes are swept away. Still less does it say anything about how Holdings is able to act in the future. The issue of remedies for breach of duty are to be addressed in a further hearing so at this stage I limit myself to the following comments:

i) The Reasonable Expectation concerning future accrual was not, as I have explained, that accrual would continue for ever absent a change of circumstances. It might therefore be argued that the correct remedy would be to achieve a situation under which accrual continued until the appropriate long-stop date which might be 2014 or perhaps even earlier. How this might affect members who transferred to the Hybid M Plan (or to the IBM UK PPPor to pension arrangements outside IBM) under Waltz who might otherwise have elected to remain in the DB Plan is a matter for debate.

ii) The Reasonable Expectations relating to the change of ER policy was that, absent a change in circumstances, there would be no change until 2014. It may therefore be that members who left service under NRD after the closure of the early retirement window in 2009, will be able to claim, retrospectively, early retirement pensions rather than early leaver benefits. For those with accrued C Plan benefits, the result of my decision in the Rectification Action is that such persons were entitled to (unreduced) early retirement pensions in respect of those benefits.

iii) Unless there is a remedy in damages or by way of financial compensation for breach of the *Imperial* duty (a question I decline to decide at this stage since it has not been argued), it is not easy to see what remedy a member taking advantage of the early retirement window would have even if he can show he would have remained in service if he had known that the ER policy would not change until 2014 absent a change in circumstances.

iv) One available remedy for breach of the contractual duty of trust and confidence is damages. Another remedy might be to set aside – on a member by member basis - the 2009 Non-Pensionability Agreements. Given my conclusion that, in isolation, the 2009 Non-Pensionability Agreements are unobjectionable, it must be well-arguable that it would be disproportionate to set them aside; and also well-arguable that damages should be nominal. A more difficult issue might relate to members who could establish that they signed the 2009 Non-Pensionability Agreements on the basis of the original statement that no future pay increases would be pensionable and that they would not have done so had they known that this would apply only to years 2009-11 with the matter being reviewed in 2011. That might well be a vanishingly small class.

Answers to Issue 4

1533.

1534. In the light of all the above, my answers to the various questions raised under Issue 4 are set out in the following paragraphs.

1535. Viewed as a whole, the Project Waltz changes give rise to a breach by Holdings of its *Imperial* duty and of its contractual duty of trust and confidence.

1536. If each element of Project Waltz is viewed in isolation, and regardless of the other elements, the position is as follows:

i) Holdings acted contrary to its *Imperial* duty in exercising the Exclusion Powers and/or any other relevant powers as mentioned in the manner envisaged by Holdings in the Exclusion Notices. This is because the exercise of that power was inconsistent with the Reasonable Expectation concerning continued benefit accrual, a matter of sufficient seriousness to give rise to a breach of duty. The break with the final salary link in the I Plan as a result of the exercise of the Exclusion Power is an additional factor indicating a breach of the *Imperial* duty.

ii) Holdings acted contrary to its contractual duty of trust and confidence in indicating (or as the RBs would say threatening) that there would be no salary increase at all in the future for those members who did not sign non-pensionability agreements. However, Mr Ferrar subsequently informed members that this would apply only to 2009 to 2011 after which the position would be reviewed, and the 2009 Non-Pensionability Agreements themselves did not go beyond 2011. Members who made their election prior to becoming aware of Mr Ferrar's qualification of the original announcement may have a claim for breach of duty which may well be restricted to a damages claim. Members who made their election after knowing that the non-pensionability would subsist only

until 2011 may have felt disappointed or even aggrieved: for those members, however, I do not consider that Holdings' conduct in relation to the 2009 Non-Pensionability Agreements was such as to breach the implied contractual duty of trust and confidence. Still less would it breach the *Imperial* duty if it is correct (as to which I express no view) to treat this aspect of the case as arising under that heading.

iii) As to the 2011 Non-Pensionability Agreements, I do not consider that I have received sufficient (or indeed any) information and argument to provide an answer to the question whether those agreements involved any breach of duty on the part of Holdings. If the parties wish me to do so, I will hear the arguments at the adjourned hearing which will need to be held to deal with remedies.

iv) Holdings acted contrary to its *Imperial* duty in introducing a new ER policy with effect from 6 April 2010. This was inconsistent with the Reasonable Expectation that the policy would not change until 2014. This was clearly a very serious matter for the affected members and capable of giving rise to a breach of the *Imperial* duty under the test which I have identified. In all the circumstances, and for the reasons given at length in this judgment, the change in policy did, in my judgement, give rise to a breach of duty.

v) It follows that Holdings was also in breach of its *Imperial* duty in implementing the early retirement window in November to December 2009: given that a change in ER policy should not have occurred, members should not have been forced to choose between retiring and continuing in service by the threat of losing the valuable benefit of early retirement on the terms of the pre-existing policy. Further, in context, the early retirement window was unreasonably short. However, if the early retirement window is viewed in isolation, the position is different. In using the phrase "viewed in isolation", I envisage a situation under which there had been no communications giving rise to Reasonable Expectations and, in particular, no suggestion in the communications that the conditions under which a member could take early retirement might change. In that situation, the members' only complaint could be that they were not given enough time to consider their positions and not that the new ER policy could not be implemented within a reasonable time. Although the time given to members for them to take their decision was short, and may even properly be seen as unfairly short, I do not consider that Holdings' actions satisfy the test of irrationality and perversity as I have explained it.

vi) Holdings was not in breach of any duty in inviting the Trustee to exercise its powers to admit to the M Plan individuals who had ceased to be members of the I Plan or the Main Plan as a result of the giving of the Exclusion Notices. Viewing this invitation in isolation, and thus on the assumption that the Exclusion Notices did not themselves give rise to a breach of duty, I can see nothing objectionable about such an invitation being given.

1537. This leaves for consideration the final alleged breach of duty, namely failures in the Project Waltz consultation process, to which I now turn.

Consultation on Project Waltz

1538. The RBs have serious criticisms of the way in which IBM consulted in relation to the Project Waltz proposals including breach of the statutory requirements. They say that IBM's conduct in this regard itself amounted to a breach not of the *Imperial* duty but of the contractual duty of trust and confidence.

1539. In the light of my decision on the main claim concerning breach of the *Imperial* duty, this aspect of the case is of less significance. I should nonetheless deal with the claim because it is relevant in two ways. First, it feeds into the appropriate remedy to provide in relation to the main claims. Secondly, it is important if I am held to be wrong in my conclusions on the main claim if this matter should go further.

1540. Reliance is placed on IBM's Business Conduct Guidelines and Core Values to which I have already referred: see paragraph 485 above and on the statutory requirements concerning consultation.

1541. As to the first of those, I agree that members were entitled to expect that the consultation would be carried out in accordance with IBM's own statements of principle; Mr Riley and Mr MacDonald were right to accept that. Thus:

i) The Business Conduct Guidelines required clear communication and the correction of any known misunderstandings or misrepresentations. In particular:

> ""Avoiding misrepresentation": "Never make misrepresentations or dishonest statements to anyone. If you believe that the other person may have misunderstood you, promptly correct any misunderstanding. Honesty based on clear communication is integral to ethical behaviour. The resulting trustworthiness is essential to forming and maintaining sound, lasting relationships."

ii) The Core Values underlined the need of "trust and personal responsibility in all relationships" saying that "IBMers… build trust by listening, following through and keeping their word; rely on our colleagues to do the right thing; preserve trust even when formal relationships end". And as Mr Palmisano is quoted as saying "….as a company we can never break that bond of trust. I think it's the brand, it's what the brand stands for. It's that integrity and that trust, we've been a hundred years building it and we have to live up to it".

1542. As to the legislation, I set out in Annex E the relevant provisions concerning the legal requirements in relation to changes to pension schemes. Under Regulation 8(1)(c), consultation was only required in relation to termination of future accrual. IBM nonetheless consulted on all the elements of Project Waltz.

1543. A general description of what consultation, in a pensions context, means in practice can be found in the decision of Sir Andrew Morritt V-C in *Pitmans Trustees Ltd v The Telecommunications Group plc* [2004] PLR 213, Ch D. He held that the essence of consultation is the communication of a genuine invitation, extended with a receptive mind, to give advice, and a genuine consideration of that advice; sufficient information must be supplied by the consulting to the consulted party to enable it to tender helpful advice: see [55]-[56] of the judgment.

1544. A failure by an employer to disclose the true reasons for its actions is said by the RBs to prevent there being any valid consultation. The RBs submit that the position is *a fortiori* when employees are misled as to what the actual proposals are in terms of the timing of their impact on employees. They rely on *UK Coal Mining Ltd v National Union of Mineworkers (Northumberland Area)* [2008] ICR 163. I take the following submissions from the RBs' written opening:

i) In that case, section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992 imposed an obligation to consult where an employer was proposing to make 20 or more redundancies [36], with section 188(4)(a) requiring the employer to disclose in writing "the reasons for his proposals" [42].

ii) UK Coal, although giving various indications as to the economic case for closing a mine, also told employees in its formal letters initiating a consultation that the mine was being closed for safety reasons.

iii) At first instance the Employment Tribunal held that, even though there was in fact no mandatory obligation to consult, having purported to consult employees the employer could not justify giving misleading reasons for its proposals by hiding behind the fact that it was not in fact obliged to consult at all. As recorded at [48], the Tribunal said:

> "In the real world employers cannot announce closures, leading to several hundred redundancies, without giving at least some indication of the reason for the closure decision itself. **In any event, if the employer chooses to give the information, it is important that the information should be true and should be given in good faith.** The whole purpose of the consultation process would be subverted if employers could with impunity give false information in the formal section 188 letters." (emphasis added)

iv) As the EAT further explained at [49]:

> "The tribunal then dealt with various issues raised before it. First, it found that there was no credible evidence that the reason for the dismissals was safety. This was entirely and deliberately misleading and involved a breach of section 188(4)(a). The real reason was economic. The tribunal said that the company 'was prepared to give whatever reasons suited it at the time'. The tribunal was not prepared to accept that this was simply a technical matter, at para 36:
>
> 'We take a very serious view of this deliberate breach of its obligations by the respondent. It is difficult to see how there can be constructive and meaningful consultation with an employer if the information given by that employer, in a formal document provided for the purpose of the consultations, is deliberately falsified. **Furthermore, the mutual trust which needs to exist between the employer and the unions, if there are to be successful consultations, is put at risk if the unions have cause to believe that they have been given false information**.' " (emphasis added).

v) The EAT agreed. Elias J concluded at [61]:

> "We agree with the unions' submission. The employers failed to comply with their obligations under section 188(4)(a) by giving a false reason; it cannot be the case that there is compliance when a deliberately misleading reason is given."

1545. In the context of the framework of IBM's own value system and the consultation legislation, I turn to the RBs' complaints which I can do largely by reference to the communications and events related in the section of this judgment dealing with Project Waltz (and in the course of which I have already made a number of observations). Let me list the complaints:

i) The giving of false information about the proposed date for closing the DB Plans with the "charade" that it was to be 2010 rather than 2011 or 2012. This is said to have breached the requirements of Regulations 11(2)(c) and (e).

ii) The withholding of the true reason for the Project Waltz changes, namely that these changes were needed urgently to keep to the 2010 EPS Roadmap. This breached the requirements under Regulation 11(2)(d) to provide any relevant background information.

iii) IBM did not consult with a receptive mind.

1546. Quite apart from the breach of statutory duty, the RBs' case is that IBM's failures give rise to a free-standing breach of the contractual duty of trust and confidence.

1547. IBM accepts that there were errors made during the consultation process in respect of Project Waltz, although Mr Simmonds says that those errors were technical and minor in nature and can be explained. Further, he says that some of the more egregious errors suggested by the RBs are not made out on the facts.

1548. In relation to the RBs' first complaint, IBM accepts that the identification in the consultation process of 2010 as the date of the intended closure to DB accrual was wrong, and ought not to have occurred, in the light of the fact that IBM had by that time settled on 2011 as the intended closure date.

1549. However, Mr Simmonds says that this error is explicable when put in its proper context. Mr Riley explained that the 2010 date was conceived as part of the negotiation strategy with the Trustee, and was always intended to be extended in return for the Trustee accepting some or all of the Project Waltz changes. He says that it had been thought that an agreed position between Holdings and the Trustee would have been arrived at before the consultation began, but that did not happen. I do not know the evidential base for that, but I am prepared to proceed on that basis for the moment. And so, Mr Simmonds explains, IBM could hardly undermine its own negotiating position by saying something different in the consultation from that which it was asserting to the Trustee. Nonetheless, even on IBM's own case, therefore, the mis-statement to members was a deliberate attempt

to preserve IBM's negotiating position with the Trustee.

1550. That may be an explanation, but it is not an excuse; and to my mind it is not even a very satisfactory explanation at that, given that the time pressure for all this came from CHQ in order to book the NPPC savings in 2009. Further, to describe it is as an error is only correct in the sense that it was, putting it at its most charitable, an error of judgment to have included the 2010 date in the consultation; it certainly was not an error in the sense that it was put in by mistake.

1551. In his oral submissions, Mr Tennet suggested that the tactic was to scare members by threatening something which was even more terrifying than that which was actually proposed, and that was designed and calculated to make already vulnerable employees even more fearful and concerned than they already were. The charade (his word) about the closure date was, he says, continued and perpetuated to the extent that IBM even planned who they should give credit to for persuading IBM that the closure date should be moved back to 2011 as I have described already at paragraph 1277 above. Mr Tennet submits that this was not a minor and technical error; rather it was a deliberate and serious one.

1552. For his part, Mr Simmonds takes Mr Tennet to task over those submissions, saying that the suggestion that the 2010 date was notified to members in order to scare them was not put to either Mr Ferrar or Mr Riley. In any case, Mr Lamb accepted that it was reasonable for IBM to treat discussions with the Trustee as negotiations. It is correct that the proposition that this was done to scare the members was not put to Mr Ferrar or Mr Riley. But what was put was that IBM "deliberately misrepresented the position to members" (Mr Ferrar) and that it "simply wasn't true" (Mr Riley). Mr Ferrar did not accept the proposition put to him since he considered, in the light of the (undisclosed) advice received that it was appropriate to consult as they did. It would have been pretty pointless for Mr Tennet then to go on to suggest that it was done to scare the employees since Mr Ferrar could only have answered "No" consistently with what he had already said. Mr Riley had to accept that the 2010 date was not on the table by the time the consultation process began: in other words he in effect accepted the proposition that it "simply wasn't true". Similarly, Mr Riley would surely have answered "No" because his perception was that the 2010 date was included simply because that had been the proposal originally put to the Trustee and IBM's position, absent an agreement, would be undermined if that date had not been maintained.

1553. In the end, I do not think anything turns on this particular difference between Mr Simmonds and Mr Tennet. I am not assisted by the use of emotive words such as "scare". The reality is that IBM was using the prospect of closure in 2010 as a tactic to persuade the Trustee and the members to accept the package which was on offer. If that is to be seen as a scare tactic, so be it; it was certainly part of IBM's approach, to use the phrase again, to play hardball.

1554. In any event, Mr Simmonds says that if this conduct constituted a breach of the relevant consultation regulations, the remedies and penalties for such breach are exclusively prescribed in the regulations; Regulation 18 of the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (SI 2006/349) provides that the "only remedies for a failure to comply with any obligations under [the relevant provisions of the regulations] are" (a) making a complaint to the Pensions Regulator (b) an improvement notice issued under section 13 of the Pensions Act 2004 and (c) a financial penalty under Regulation 18A. IBM submits that there is no warrant for imposing any further penalty on IBM by way of an additional remedy for breach of the contractual duty.

1555. If it is Mr Simmonds' submission that the only remedies for a breach of the Regulations can ever be those which are set out in Regulation 18, I disagree. I accept that the remedies for merely failing, whether properly or at all, to consult are found in Regulation 18: there is no cause of action for breach of statutory duty giving rise to any other remedy. I agree also that the contractual duty could not be invoked to circumvent the clear provisions of the Regulations; it would be inconsistent to conclude that a failure to consult of itself necessarily gave rise to a breach of the contractual duty.

1556. It does not follow, however, that the way in which an actual consultation is conducted cannot give rise to any other remedy. Consider a case where an employer is proposing changes to a scheme on which it is not obliged by

the Regulations to consult at all. But suppose that it decides to consult nonetheless and, in so doing deliberately and dishonestly misrepresents the facts to the employees. Whether or not the employees might have an action based on misrepresentation will depend on the precise facts of the case, and in particular on how they have acted in reliance on what they were told. But whether or not they have such a cause of action, I see no reason why the contractual duty should not be capable of being invoked in such a situation. If that is correct, then the position should, in my view, be no different if the changes proposed by the employer include one or more listed changes in respect of which the employer is obliged to consult. Regulation 18 does not, as I see, preclude a claim based on breach of the contractual duty because the breach of that duty is not only the failure to consult as required by the Regulations (although it includes that failure) but goes further. It falls potentially (and the answer will depend on the facts of the particular case) within the spirit and intent of the words of the EAT in *UK Coal* appearing in the longer passage quoted at paragraph 1543 above:

> "Furthermore, the mutual trust which needs to exist between the employer and the unions, if there are to be successful consultations, is put at risk if the unions have cause to believe that they have been given false information."

1557. Misleading information sufficient to put at risk that mutual trust and confidence may, it seems to me, be so misleading that it in fact destroys or significantly damages not only that degree of mutual trust but also (if it is any different, which it probably is not) the mutual trust and confidence which lies at the heart of the contractual duty.

1558. As to the RBs' second complaint, the failure to reveal the imperative of meeting the 2010 EPS Roadmap is said to have made it impossible for the members to formulate alternative proposals which addressed IBM's needs.

1559. Members did, however, put forward proposals to address what they thought IBM's requirements were. Thus one suggestion (referred to as the "PCC Worst Case" suggestion) was that the Plans should be closed to future accrual in 2013. This was rejected by IBM because this "would not assist IBM Corporation in achieving its 2010 EPS Roadmap savings" as Mr MacDonald said in his witness statement, although this was not, of course, known to the members at the time.

1560. The members' task was not assisted by what they were told at the 8th PCC session on 23 September 2009, namely that the proposal for 2013 or even 2012 was not "financially viable" for Holdings. Mr Ferrar appears to have been the IBM lead spokesman – the minutes describe him as attending to present the potential modifications to the then current proposals. There was a telling interchange (see Transcript Day 22 pages 23 – 26) where it was put to Mr Chrystie that there was no need to reduce pension costs in 2009 so far as the UK business was concerned. He stated that there was an income stream but that, given market falls in 2008, that began to reverse itself in 2010 and through 2011, and 2012. He agreed that he would therefore have seen the PCC solution which was to close the Plans in 2013 as perfect, if he had been interested in that. With that background, he was taken to the minutes of the PCC meeting and to the statement about financial viability. During the questioning, we find this:

> "Q. You said to me that it is actually a better solution for IBM UK. That is your evidence.
>
> A. What I said was that would have been attractive to me, yes.
>
> Q. It's five years of savings.
>
> A. Yes.
>
> Q. It puts the savings at the time when you have your rising pension costs. It is clearly financially viable as far as the IBM UK is concerned, is it not. Indeed, it is better than the solution which is being imposed?
>
> A. It would offer more savings in the out years.

Q. So what the PCC is being told here is incorrect, isn't it?

.....

Q. You would accept that is incorrect?

A. It wouldn't accord with my thinking."

1561. This, it must be remembered, is the evidence of the CFO, the most senior local finance executive.

1562. Mr Tennet returns to an earlier theme that the business justification was, in any case, only an exercise in advocacy after the relevant decisions had been taken. I have already concluded that Mr Chrystie did not see the exercise as one of advocacy, although Mr MacDonald, and quite possibly Mr Koppl, did. I do not think that this really adds anything, in terms of any breach of the contractual duty, to the points which I have just discussed.

1563. More significant is the fact that the UK business reasons presented included "competitive pressures". The inclusion in presentations of this factor in relation to pension changes (in contrast with other aspects of UKI Transformation) appeared for the first time in May 2009 after the decision to proceed (subject to consultation) had on any view been taken. Mr Tennet would say that this is another demonstration of his proposition that the business case was no more than an exercise in advocacy. Again, I do not think it takes him any further than the failure to reveal the real reason for the change.

1564. The third complaint is that IBM did not consult with a receptive mind. The first factor relied on is that Mr MacDonald and Mr Ferrar were looking to close the consultation (and to make a decision) as early as 9 September 2009 when Mr Riley had said in July 2009 that no decisions would be taken until after the consultation had closed on 20 October and feedback considered. Mr MacDonald reached his decision on 13 October 2009. And Mr Loughridge announced the changes to investors on 15 October 2009.

1565. The second factor is that IBM did not do what it said it would do: IBM had said at the 5th PCC session on 2 September 2009 that it wanted proposals by the end of the next PCC session (held on 9 September 2009) so that they could be "developed, modelled and discussed". That makes it surprising to find Mr Murphy sending the email to Mr Ferrar which he did on 10 September 2009 (already referred to in paragraph 1276 above) saying "you may want to spend a few mins scanning them in advance of when we go back to them with our solutions". In that passage "them" means the suggestions put forward by the PCC at the meeting the day before, obviously not the earlier suggestions which IBM told the PCC at this meeting had been rejected (including the "PCC Worst Case" suggestion). In any case, there is no evidence that IBM ever developed or modelled the proposals which were advanced by the members in the 6th and 7th PCC session; and Mr Chrystie confirmed that he did no such modelling.

1566. In relation to the second and third complaints, IBM accepts that references to the global strand of the business justification for the Project Waltz changes could have been made more explicit in the consultation exercise. But it submits that the criticisms made by the RBs in this respect are overblown. Thus it is IBM's case that:

i) Mr Ferrar and Mr Chrystie both testified that the 2010 EPS Roadmap was an important objective that was "socialised" throughout IBM and would have been known by most IBM employees going down way below senior management.

ii) Knowledge of the employees of the global justification for the Project Waltz Changes is supported by postings on the AMIPP website made following the commencement of the consultation process in July 2009:

a) The newsletter produced on 8 July 2009 stated that the reason for the Project Waltz Changes was that:

> "IBM wants to cut costs in order to make more money available for dividends, buying back IBM shares and acquisitions."

> The reader was then directed to previous AMIPP newsletters and the website for US employees for the background to IBM policy.

b) A note posted on 7 July 2009 asked:

> "Is there any evidence that anyone running the company looks any further into the future than the next share dividend announcement?"

iii) There was a reference in one of the slides shown to the PCC to 'IBM 2010 financial model May 2007'; Mr Riley confirmed that was a reference to the 2010 EPS Roadmap and Mr Ferrar said that that was one of the ways that it was referred to. Anyone on the PCC could have asked what it meant if he did not know: there is no suggestion that anyone did ask.

iv) Mr Riley recalled telling the PCC about the 2010 EPS Roadmap; he recalled telling the PCC that IBM UK was not on the roadmap line and there was a substantial risk ahead that IBM UK was on a different trajectory from the roadmap.

v) It is wholly understandable that IBM UK ultimately framed the justification for Project Waltz to the UK workforce in UK terms, particularly when there is no direct equivalent to EPS in UK terms, as the only publicly-listed IBM company is the US, so there are no UK shareholders.

vi) The UK consequences of the EPS target – NPPC and PTI – were included in the consultation materials; Mr Ferrar did not consider that there was a need to communicate the EPS target directly with the workforce, as the UK justifications for the changes broke the consequences of the EPS commitment down into specific understandable elements.

1567. Thus, whilst it is true that IBM did not spell out that the ultimate objective was the 2010 EPS Roadmap, the concept was sufficiently well known amongst the workforce for it to be enough that the explanation in the consultation material was limited to what that roadmap meant in the specific context of the UK business.

1568. I am entirely unconvinced by this line of argument. It is perhaps arguable, although I find it unattractive, that the members of the PCC would have been able to divine from the materials and communications to which Mr Simmonds refers that there were financial and commercial reasons for the changes emanating from Armonk. But I fail to see how the members of the PCC can reasonably be said to have had sufficient information to understand the commercial imperative of meeting a roadmap the details of which they had not been informed about. I remind myself, and the reader, of (i) the repeated requests made by the members of the PCC for details of the business rationale behind Project Waltz and (ii) the references made at the 8th PCC session on 23 September 2009 referred to at paragraph 1282 above. It is a bit rich for IBM now to come along and argue that the PCC had the necessary information all along. They were not even told that they had received enough information and were not going to get any more – but then such a response would itself have not looked at all good in the light of the professedly open consultation and the Business Conduct Guidelines and Core Values.

1569. As to Mr Loughridge's "pre-announcement" of the outcome of the consultation in his investor release of 15 October 2009, Mr Riley accepted that that was an unfortunate event which had nothing to do with the UK management team (to which, I add, the cynic, or even the RBs, might respond "and nor did the decision"). It would have been preferable if his announcement had been delayed until after the consultation had formally closed, but Mr Riley stressed that the announcement did not affect the outcome of the consultation. By that stage, UK management had decided in principle on the framework of the plan which was to be adopted, and the final meeting of the PCC had been held (on 8 October 2009), which had not raised any issues which would affect the overall scheme of the proposal. UK Management's hands were not forced by the announcement: no further information became available after the announcement (or was likely to do so) and Holdings would have come to the same conclusion whether or not the announcement had been made.

1570. As to the third complaint that IBM was not prepared to listen to any of the arguments, Mr Simmonds submits

that this is falsified by the clear documentary evidence that Mr Ferrar considered the "worst case scenario" in some detail; and by Ms Rosemary Townsend, an I Plan member representative on the PCC, who said that, at the week 4 PCC meeting, the PCC's first alternative suggestions were put to Mr Ferrar and Mr Pinder, who spent around two hours going through the suggestions line by line, and that they fully understood the PCC's reasoning. Ms Townsend went on to report that "IBM continue to consider our points and we feel it's been a very constructive committee".

1571. Again, I find this unconvincing. The complaint articulated by Mr Tennet relates to a failure to address the improvements suggested in the 6th and 7th PCC sessions. The fact that Mr Ferrar gave 2 hours attention to the earlier proposal from the PCC which was rejected is beside the point since other, later, suggestions also deserved attention; and, in any case, that fact does not show that the proposal was developed, modelled and discussed (*ie* discussed within IBM).

1572. In my judgement, and knowing what we now know, I consider that the consultation was not carried out in a way which was open and transparent. It did not in my view, accord with the approach which ought, in accordance with IBM's own philosophy, as set out the Business Conduct Guidlines and Core Values to be followed.

1573. Further, I have no doubt that, as a matter of principle, IBM was obliged to carry out the consultation in accordance with its contractual duty. I have already rejected Mr Simmonds' main argument to the effect that the members would have understood the global justification for the changes in other than the most vague sense: they would have had no inkling of the need to meet NPPC targets based on a roadmap that they knew little if anything about. The failure to provide this information in the face of clear requests from the PCC is simply not good enough, in my view.

1574. Moreover, I have rejected Mr Simmonds' submission that a breach of the Regulations cannot carry any consequence other than that laid down in the Regulations. In the context in which the deliberate provision of misleading information was given to the PCC, I consider this to be a serious matter. The decision in *UK Coal* shows the seriousness with which the courts treat misleading information in a similar, although not of course, identical context.

1575. Those factors alone (and ignoring the Business Conduct Guidlines and Core Values) are such, on almost any view I think, to cause the members to question the integrity and good faith of IBM in its consultation over the Project Waltz proposals. In my judgement, they are sufficient to give rise to a breach of the contractual duty. These matters put at risk the mutual trust which, to paraphrase the words used in *UK Coal*, "needs to exist between the employer and the unions, if there are to be successful consultations".

1576. The other factors are not, however, to be ignored although I would accept that they are only make-weights which, standing by themselves, would not give rise to a breach of duty. The fact that IBM may have been "selling" its proposals in the way it did may be thought by some to be unacceptable, but it was not, by itself, such as to destroy or seriously damage the relevant relationship of trust and confidence which lies at the root of the contractual duty. But as factors to be brought into account, they do weigh in the balance in favour of the RBs.

1577. I reach my conclusion without reliance on the principles to be extracted from the Business Conduct Guidlines and Core Value or the history of the Ocean and Soto changes. Relying, as I consider I am entitled to do, on the Business Conduct Guidlines and Core Values, the case is even clearer.

1578. Moreover, whether or not the members had any legal complaint, based on the *Imperial* duty or any other duty, it was absolutely clear to IBM before the Project Waltz proposals were announced that there would be a hostile reaction. It was, of course, left in no doubt about that once the announcement had been made. It then knew it was being accused of betrayal and breach of trust by many members. In those circumstances, it behove IBM to take the consultation with the utmost seriousness and to be frank and open with the members. This factor only goes to confirm me in my conclusion. Had I been wavering, I think that this factor would have pushed me to decide in favour of the RBs. But I do not need to rely on it.

1579. It is also the case that these failures have given rise to a breach of the Regulations. But this adds nothing to the case in relation to the contractual duty and does not provide the RBs with a remedy in this court.

1580. Turning from facts to consequences, when considering this aspect of the RBs' case, it is relevant to identify the relief being sought by the RBs. In the AVPs, the RBs' case on breach of the *Imperial* duty is divided into two parts: the substance of the Project Waltz proposals and the procedures adopted in implementing the proposals including the consultation process. The setting aside of the Project Waltz changes is limited to the former part of the case. In relation to procedural failures giving rise to a breach of the *Imperial* duty, the relief sought is a suspension of the implementation of the Project Waltz changes until the communication errors are put right, and a further period of consultation and notice is given to members.

1581. That is not quite the full picture. The suspension is sought, as well, to offer DB members "a proper opportunity after judgment… to consider the 2009 Non-Pensionability Agreements" and to provide a further period of notice in relation to any new proposal to changes in ER policy. Although worded in relation to early retirement between 60 and 63 on the counter-factual (as it turned out) footing that I had declined to order rectification, the same issue must, I think, arise in relation to a change of policy in relation to early retirement under age 60.

1582. As to the misleading inclusion of the 2010 date for closure of the Plans, Mr Simmonds tells me that IBM does not understand where this point takes the RBs. The main criticism appears to him to be that, because the global strand was not sufficiently disclosed, the PCC was hampered in its attempts to advance suitable alternatives to the Project Waltz changes. Quite apart from the fact that consultation is not negotiation, he submits that it is not clear how knowledge of the global strand would have led the PCC to develop different alternatives that would have stood a better chance of being accepted. No such alternatives have in fact been advanced by the RBs. For example, one aim of the PCC was to defer the proposed changes for as long as possible; knowledge that such a deferral was not acceptable because of the 2010 EPS Roadmap would not have helped them.

1583. He also submits that, given the minor and technical nature of the errors, it would be absurd to require the consultation process to be undertaken again if the Court is of the view that the substantive pension changes are valid. In any event, the Court ought not to allow the effect of any of the Project Waltz changes to be reversed as a result of those errors, as that would grant by the back door the substantive relief which, on this hypothesis, the RBs had failed to secure by the front door.

1584. Quite apart from his submission in relation to the exclusive nature of the remedies provided by Regulation 18 which I have rejected, Mr Simmonds submits that no remedy should flow from IBM's errors (or deceptions, I would add: which word to choose depends on your standpoint), but that rather Project Waltz should take effect as planned, with effect from its original date. There are two reasons he gives for reaching that conclusion:

i) First, he submits that "the overwhelming likelihood is that [a further consultation] would be a futile process" because the outcome of a renewed consultation would be the same. He says that ordering the consultation process to be re-run at this stage would be highly disruptive and difficult. There is, therefore, at least an onus on the RBs to suggest why it may not be futile and simply to say it cannot be assumed that the same conclusion would follow is, he says, not good enough. The only point in re-running the consultation process is if the PCC, or however they are constituted, those representing the members, can put forward a viable counter-proposal to achieve the aims of Project Waltz. Surely, he asks, if there were such a counter-proposal, it would have been suggested by now? After all, the RBs have had plenty of time to think of a different way of doing it, and lots of criticisms are made in the written closings about the severity of Project Waltz and its disproportionality: nobody on the RBs side has actually suggested a different way of doing things that would nevertheless achieve the objectives as they are now known to be.

ii) Secondly, he says the RBs should not be able to achieve by the back door that which they have failed to achieve through the front door. Mr Simmonds' position is that, if IBM has succeeded on the substantive elements of the claim but fallen short on this procedural aspect, whatever order is made must ensure that, if the decision following a further consultation remains the same, then the Project Waltz changes should take effect as from their original date. Otherwise the RBs will succeed in obtaining what they are seeking in the substantive part of

the case, namely a continuation of DB accrual amongst other things.

1585. I do not accept either of those submissions. As to the first submission, it is necessary to ask what it is that Holdings would be consulting about. If, substantively, I had held that the entirety of the Project Waltz proposals were valid, then the consultation would be in relation to precisely the matters on which the original consultation was actually made. I would then see some force in Mr Simmonds' submission although Mr Tennet says there is an answer to it in any case.

1586. But that is not the position. The effect of my decision on Issue 1 is that the proposals were proceeding on the basis of a material misunderstanding by Holdings of the meaning of the Trust Deed and Rules. They were further proceeding on two other serious misunderstandings on the part of IBM:

i) First, that there was no right to early retirement between ages 60 and 63; and

ii) Secondly, that members had no Reasonable Expectations of which Holdings needed to take account in formulating its proposals still less that they had Reasonable Expectations in any way relevant to Holdings' *Imperial* duty.

1587. Now, IBM says that this does not matter because the 2009 Non-Pensionability Agreements mean that salary increases are non-pensionable so that it does not matter that the final salary link is in fact preserved on the exercise of the Exclusion Power. It is not obvious to me that all members who entered into the 2009 Non-Pensionability Agreements would have made the same choice as they actually made if they had known that the final salary link would be preserved.

1588. IBM's answer to that, no doubt, is that the members all knew that if they did not agree, there would be no salary increases so the preservation of the final salary link makes no difference. That argument, of course, depends on acceptance of the proposition, which I have held to be correct, that the statement to the effect "no salary increases if you don't sign up" meant no increases during the remainder of the member's career. But that argument, in turn, does not meet another of my conclusions on the substantive claim namely that it was a breach of the *Imperial* duty to rule out altogether for the future the prospect of any salary increase. I appreciate that the actual 2009 Non-Pensionability Agreements only ran until 2011 but the original communication was not to that effect, and by the time the position was modified (or clarified as IBM, but not I myself, prefer to say), some members would already have made their decisions.

1589. In any case, the 2009 Non-Pensionability Agreements are not relevant to the complaint in relation to the change of ER policy.

1590. Moreover, any new consultation would have to be on the basis of the facts as they are known today (and in the light of my rulings on all the substantive issues). That includes knowledge of my decision in the Rectification Action. As to the Rectification Action, it is now known that C Plan members have a right to early retirement (without consent) after age 60 with an unreduced pension. It is again not obvious to me that all members who entered into the 2009 Non-Pensionability Agreements would have made the same choice as they actually made if they had known that they could retire after age 60 without consent on an unreduced pension.

1591. Quite apart from that, financial and economic circumstances (including IBM UK's trading position) may be very different today from at the time of the original consultation and, perhaps significantly, the position today may be very different from the projections on which IBM was operating at the time of the consultation. Further, the driver of the changes – to meet the 2010 EPS Roadmap by reducing NPPC costs – is now history. The NPPC savings were booked in IBM Corporation's accounts in 2009 as a result of the adoption of the Project Waltz changes and they will remain booked even if Project Waltz were to be unravelled; at least, the contrary has not, so far, been suggested. And the share price in 2009 and thereafter was what it was: that history cannot be changed. I do not know whether, today, there would be a business case, whether global or local, which would justify a departure from any Reasonable Expectations which the members were entitled to hold in 2009 and which, absent Project Waltz, they would still be entitled to hold.

1592. In my view, therefore, it cannot possibly be said that the outcome of a new consultation would be a foregone conclusion. A consultation today might result in IBM deciding that the Project Waltz changes are no longer needed in order to fulfil business objectives.

1593. Now, I am conscious that what I have said is hedged in pretty conditional language. I am reluctant to reach a final conclusion on whether there should be a further consultation because some of the matters I have just mentioned have not been raised in argument.

1594. I therefore consider that the appropriate course for me to take in this judgment is to rest with the conclusion that the consultation as in fact conducted resulted in a breach of Holdings' duty of trust and confidence and to hear further argument in relation to remedies along with further argument in relation to consequences and remedies on the substantive matters. However, IBM will see what I have said. It will, I hope, take stock and consider what points it can sensibly pursue. In that context, Mr Tennet's submission bears repetition:

> "It is alarming that IBM would consider a properly run consultation to be a foregone conclusion: if it were a foregone conclusion, it would not be a proper consultation at all, since IBM would not be keeping an open mind. There is no telling what additional proposals might be put forward by the new PCC, or how IBM UK's current management would respond, particularly in the light of the reams of further information now available following this trial (such as the detailed I Plan data now available to members, and the extremely positive investment performance experienced from 2009)."

Answer to Issue 4B

1595. In the light of the above discussion, the answer to Issue 4B is that Holdings was in breach of its implied contractual duty of trust and confidence as a result of the manner in which it consulted on the Project Waltz proposals. I do not propose to give any further answer to Issue 4B as it is expressed in the List of Issues.

Some final words

1596. There will be a further hearing to consider the remedies to be provided in relation to the breaches of duty which I have held to be established.

1597. I would like to thank all of the teams involved for their enormous hard work and thorough preparation. Without their excellent written submissions, this judgment would be very different in its form although not its result. It would be shorter and would probably have been delivered rather earlier. It would, however, be conspicuous in its failure to deal with many of the points which needed dealing with and with which I have in fact dealt.

ANNEX A
List of Issues

1. whether the Main Plan Exclusion Power was validly introduced into the Main Plan;

2. whether the purported exercise of the Exclusion Powers (and/or any other relevant powers vested in Holdings) in the manner envisaged by Holdings in the Exclusion Notices falls within the terms and scope of the Exclusion Powers in the Plans and/or those other relevant powers;

3. whether the purported exercise of the Exclusion Powers (and/or other relevant powers as mentioned in paragraph 2 above) in the manner envisaged by Holdings in the Exclusion Notices involves the exercise of the Exclusion Powers (and/or such other relevant powers) for an improper purpose;

4. whether Holdings and/or IBM UK have acted or would be acting contrary to the implied duty of good faith in relation to:

   4.1 exercising the Exclusion Powers (and/or other relevant powers as mentioned in paragraph 2 above) in the manner envisaged by Holdings in the Exclusion Notices;

4.2 procuring that members of the Plans expressed to be the subject of the Exclusion Notices enter non-pensionability agreements in the terms they did in October-November 2009 and March 2011;

4.3 implementing the "early retirement window" in November-December 2009;

4.4 introducing a new early retirement policy with effect from 6 April 2010;

4.5 inviting the Trustee to exercise its powers to admit the members referred to in paragraph 4.2 above to the M Plan;

4. B. whether Holdings and/or IBM UK were in breach of the implied duty of good faith as a result of the "procedures, tactics and timescales" they allegedly adopted in implementing Project Waltz.

ANNEX B

Ocean changes

	Previous provision (as shown in above table)	**New provision**
C Plan	Employee contribution rate: 4% pensionable earnings	New employee contribution rate: 6% pensionable earnings from 6.4.05 onwards[181]
N Plan	Employee contribution rate: nil Accrual rate: 1.75% of FPE up to UEL (less State pension deduction) plus 1.25% of FPE above UEL	Active N Plan members were given the choice of becoming a "**Non-Contributing N Plan Member**" or a "**Contributing N Plan Member**"[182] (i) For Non-Contributing N Plan Members: ▪ previous nil employee contribution rate left unchanged[183] ▪ for service from 6.4.05, accrual rate reduced to: 1.6% of FPE up to UEL (less State pension deduction) plus 1.1% of FPE above UEL[184] (ii) For Contributing N Plan Members: ▪ new employee contribution rate: 2% of pensionable earnings from 6.4.05 onwards[185] ▪ previous accrual rate left unchanged[186]
DSL DB Plan	Employee contribution rate: 5% of Contribution Salary for Category B and C Members	New employee contribution rate from 6.7.05: 6% for Category B Members. For Category C Members: 6% (Thorn members) and 7% (Software Sciences members)[187]
M Plan	No changes	No changes
I Plan	Employee contribution rate: 4% pensionable earnings	New employee contribution rate: 5% pensionable earnings from 6.4.05[188]

ANNEX C

Soto changes

	Plans affected	Effect of change
Partial non-pensionability agreement	All DB Plans	On *South West Trains* principles, the Trustee has administered the DB Plans in accordance with the 2006 partial non-pensionability agreements and has treated 1/3rd of salary increases as non-pensionable for the affected DB members.[199]
Transfer to Enhanced M Plan	All DB Plans	All active members of the DB Plans (except C Plan members with 30+ years' pensionable service) could elect to transfer to the Enhanced M Plan with effect on 6.7.06[200] The rules of the Main Plan and the I Plan were amended[201] to create: ▪ the Enhanced M Plan within the M Plan section of the Main Plan ▪ "Enhanced Deferred" status for the accrued DB benefits left within the DB Plans of the members who elected to transfer to the Enhanced M Plan The effect of these changes is explained further below.
Guaranteed pension increases	DB sections of the Main Plan	The previous provision in the Main Plan DB Rules for discretionary increases of pensions in payment (in excess of GMP) for pre-6.4.97 service was amended to provide:[202] ▪ that for 15 years commencing on 6.4.06, pensions in payment would be increased annually ▪ from 6.4.06 to 6.4.10 (inclusive), the increase would be 60% of the increase in RPI (subject to a maximum increase in RPI of 4%) ▪ from 6.4.11 to 6.4.20 (inclusive), the increase would be 50% of the increase in RPI (subject to a maximum increase in RPI of 5%) ▪ that thereafter, unless there was further agreement between the Trustee and the Company, increases would revert to being discretionary (Note: this change only affected the Main Plan DB sections because, as set out above, the I Plan Rules already contained provision for guaranteed increases.)
Increased employer contribution rate	M Plan	The employer contribution rate in respect of all ordinary (not Enhanced) M Plan members became 8% of pensionable salary[203] (instead of the previous age-related regime where employer contributions were 6% up to age 35 and 8% thereafter).

ANNEX D
THE WEBCAST

THIS WEBCAST WILL BE AVAILABLE FROM 0900H ON TUESDAY NOVEMBER 9TH

[1] Hello. My name is David Heath, human resources director for IBM in the UK. Thank you for joining this Webcast.

[2] Today, I am announcing some important proposed changes to our defined benefit pension schemes in the UK, including changes to employee contributions; a significant increase in the contributions the company is making and further measures to underpin the security of the plans.

[3] The proposals outlined today, have been agreed in principle with the pension plan trustee and, over the coming weeks, we will communicate with employees on these proposals. We plan also to consult with employee representatives directly through the recently elected Employee Forum.

[4] These proposals directly address a number of the concerns many of you have expressed about the security and the structure of these schemes within IBM.

[5] Today, I want to give you some more context and details about those proposed changes. These relate to all employees who have joined our *defined benefits* plans - the C Plan, I Plan, various Data Sciences plans and the **N** plan. (That's '**N**' for November).

[6] The initiatives I am outlining do NOT affect the majority of our employees who are members of the IBM Defined Contribution Pension Plans- for example, the M (for 'money') Plan.

[7] Let me just briefly clarify the key difference between a defined benefit pension plan and a defined contribution plan here. Put simply, a defined benefits scheme pays a retirement income based upon your number of years service and your final pensionable earnings. A defined contribution plan provides an investment return from set contributions provided by both the company and the employee-- this ultimately buys a pension that is determined at the point of retirement.

[8] As I said, the proposals today affect those on defined benefit plans.

[9] IBM is a strong and responsible company and I believe the proposals we are making offer a positive, measured response to a number of fundamental changes which are impacting employers across the UK.

[10] With these proposals, IBM is taking action with the intention of securing the sustainability of our defined benefit pension schemes.

[11] I want to focus on what, many of you will believe to be, the changes which will most directly impact you- proposed changes to employee contribution rates in respect of FUTURE service benefits.

[12] Before I get into detail, let me be clear here. This has NOTHING to do with any deficit in the IBM Pensions plans which is related to your past service. I will demonstrate to you later that IBM is continuing to meet its responsibilities here -- we are not asking employees to put one penny towards helping with that. But please allow me first to reflect on the context.

[13] Fundamentally, more people are living longer in the UK. The improvements in life expectancy appear to be sustained and if anything are accelerating. This trend of improvement in longevity is widely expected to continue in the future. As people live longer the cost of providing pension benefits increases significantly. In addition, lower inflation and lower real rates of investment return also contribute to higher costs of future pension provision.

[14] This additional expense has had a key impact on the sustainability of defined benefits pensions schemes and this has wide implications for both State-funded and for private pensions schemes.

[15] These issues have been well documented in the media across the UK in recent years and, most recently, you might have seen that the Government sponsored Turner Report has bought them into stark perspective.

[16] Turning to IBM, let's take a closer look at **our** defined benefit schemes, and the impact of higher life expectancies. The latest actuarial valuation shows that, since the last report which was published in 2001,

increased life expectancy (including an allowance for future improvements in life expectancy) has added around £235 million to the cost of benefits already earned. Of this, £105 million relates to employees, with the balance relating to pensioners and deferred members who have left the company but are not yet drawing a pension. This is being addressed by the company, as I shall explain later.

[17] In addition however, the cost of future service for employees has increased by about £10m every year for the same reason and that is why, from next April, we are asking you to share some of the increased costs of our defined benefit pension schemes as they relate to your future service.

[18] Let's just be explicitly clear here: we are asking you to take a share in the proportion of those costs which relate to pension benefits *you will earn* on future service. The company will bear the costs of increased life expectancy related to your already accrued past service. I should add that even with the new, proposed contributions, IBM will be paying the lion's share of future service costs.

[19] Now let me therefore take a little time discussing how the proposed contribution increases will apply. I'll start with the C-Plan.

[20] When C Plan was introduced in 1983, the employee contribution rate was 5% of Pensionable Earnings. This was subsequently reduced to 4% in 1986.

[21] It is now our intention to implement an increase in employee contributions of 2%, taking this from 4% to 6% of Pensionable Earnings, effective from April 6 in 2005.

[22] Next, let us consider the proposed contribution increase for those of you in the I Plan.

[23] Since its introduction in 1994, the employee contribution rate for members of I Plan has been 4% of Pensionable Earnings.

[24] We now wish to propose an increase in employee contributions of 1%, taking this from 4% to 5% of Pensionable Earnings, effective from April 6, 2005.

[25] There are also proposed changes to the current employee contribution rates for members of the Data Sciences sections of the IBM Pension Plan. Again, the company wishes to propose an increase of 1% in employee contributions.

[26] The proposed increase in employee contributions for I Plan members and for Data Sciences members is lower than the corresponding increase for members in the C Plan. This is due to the smaller impact of the assumptions for life expectancy in these plans.

[27] As with any pensions contributions, these increases in contribution are, of course, subject to appropriate tax relief.

[28] Finally, we come to those employees in N Plan.

[29] N Plan is a non-contributory scheme on the part of members, and the company proposes to retain this principle. The company therefore wishes to propose a reduction of 0.15% of pensionable earnings in the amount of pension that an employee will accrue for each year of future service from 6 April 2005.

[30] For Pensionable Earnings up to the Upper Earnings Limit, the accrual rate will be 1.6% compared with the current 1.75%.

[31] For Pensionable Earnings in excess of the Upper Earnings Limit, the accrual rate will be 1.1% compared with the current 1.25.

[32] The reduction in the future accrual rate for members in the **N** Plan has been calculated on a basis consistent

with, and of the same proportion as, the increase in employee contributions for members of the C Plan.

[33] I believe these changes in contribution or accrual rates represent a reasonable share of the increased cost of future service benefits resulting from improved life expectancy. We will also review employee contributions every three years moving forward, and we intend to continue to share any further changes in the costs of future service as appropriate, **up or down**, based on the results of future actuarial valuations.

[34] Let me just restate that we are not asking you to pay ANY additional contributions to cover the fund deficit or the costs associated with your *past* service.

[35] So let me explain now what the company proposes to do here.

[36] Let's talk about the overall pension funding position and the steps the company intends to take to deal with the deficit in the fund relating to past service.

[37] You may be aware that in recent months, a new Actuarial Valuation has been prepared which determined the size of the IBM UK pension fund deficit and the required level of company contributions from 2005. For clarity, formal valuations are carried out every three years by the Scheme Actuary. The latest valuation has now been completed and the Valuation Report will be published in December 2004. The trustee, separately, will be writing to all members shortly to inform them of this.

[38] The Scheme Actuary has determined that the deficit in the Main Plan (which includes the C-Plan, N-Plan and Data Sciences plans) at the end of 2003 was £900m and for the I plan was £19m.

[39] To address this deficit, IBM has agreed in principle to inject cash contributions to the defined benefit plans totalling *£200m for each of the next three years.* The company will make contributions to the Defined Contribution section of the Plan in addition to these amounts.

[40] Just to put this into context, the £200m a year compares to company contributions of £4 million in 2002; £69 million in 2003 and £139 million this year to the defined benefit plans. Cash contributions beyond the next three years will be based on subsequent triennial valuations.

[41] To further enhance the security of the plans, I am very pleased to tell you that the IBM Corporation has agreed in principle to *guarantee* company contributions to the fund. The principles of the guarantee are agreed and the legal documentation is currently being prepared.

[42] This guarantee, which I believe is excellent news for members, will be given by IBM World Trade Corporation, that's the holding company that conducts IBM's business outside the United States. The guarantee will be for the period up to the end of first quarter 2014. This period covers the next three Valuation Reports and roughly coincides with the period over which the actuarially-assumed investment returns and company contributions are expected to eliminate the deficits.

[43] As I said a minute ago, I believe the guarantee is excellent news for members. It enhances the security of members' benefits and demonstrates IBM's continuing commitment to the Plans and their members.

[44] Over the coming weeks, we will communicate with employees on these proposals. We plan also to consult with employee representatives directly through the recently elected Employee Forum and I will be leading a number of roadshows at IBM locations over the coming weeks: we'll notify you of the venues and the times in due course.

[45] So to recap, we plan for:

C-Plan- To Increase employee contributions for members by 2% of Pensionable Earnings

For N-Plan- To Reduce the accrual rate for future service for members by 0.15%

For the Data Sciences Plans --To Increase employee contribution rates for members by 1% of Pensionable Earnings

And for the 1-Plan- To Increase employee contributions for members by 1% of Pensionable Earnings

[46] Many other companies are responding to these pressures in similar ways while others have yet to tackle them. With our proposals, IBM's pensions plans remain extremely valuable benefits for our employees.

[47] I should add at this point that we did consider several other alternative proposals, including changes to retirement age and more widespread changes in benefits design. However, I believe very strongly that the initiatives I have just outlined are the RIGHT ones, which balance the need to ask you to take a share of increased future costs with long term security. I believe they are right for you as pension scheme members, for the UK business and for the company as a whole.

[48] With this very substantial cash injection, the guarantee and the changes we are proposing to make, I am convinced that we are putting IBM's defined benefit pension plans on a firm footing for the future.

[49] I believe that this series of initiatives demonstrates IBM's commitment to underpin the sustainability of the defined benefit plans in the UK.

[50] I hope to meet as many of you as possible in the forthcoming roadshows. In the meantime, any specific questions should be addressed to AskHR by email or by phone on Ext 543543.

[51] Many thanks for taking the time to listen to this call. Goodbye.

ANNEX E
CONSULTATION: STATUTORY PROVISIONS
Pensions Act 2004

1. Section 259(1):

"(1) Regulations may require any prescribed person who is the employer in relation to an occupational pension scheme and who -

(a) proposes to make a prescribed decision in relation to the scheme …

to consult prescribed persons in the prescribed manner before the decision is made. …

(3) The validity of any decision made in relation to an occupational pension scheme is not affected by any failure to comply with regulations under this section.

(4) Section 261 contains further provisions about regulations under this section."

2. Section 261:

"(1) In this section "consultation regulations" means regulations under section 259 ….

(2) Consultation regulations may –

(a) make provision about the time to be allowed for consultation;

(b) prescribe the information which must be provided to the persons who are required to be consulted; …".

(Occupational and Personal Pension Schemes Consultation by Employers and Miscellaneous Amendment) Regulations 2006
(SI 2006/349)

3. Within the Consultation Regulations, Regulation 3(1) provides that the Consultation Regulations apply to relevant employers (and to the trustees of the scheme). Regulation 6(1) then provides that no employer (or trustee) "may decide to make a listed change that affects an occupational … pension scheme unless such consultation as is required by regulation 7(3) has been carried out".

4. Regulation 8(1):

"(1) Listed changes that affect occupational pension schemes are -

(a) to increase the normal pension age specified in the scheme rules for members or members of a particular description;

(b) to prevent new members, or new members of a particular description, from being admitted to the scheme;

(c) to prevent the future accrual of benefits under the scheme for or in respect of members or members of a particular description; …

(g) to make any change specified in paragraph (2) or (3). …

(3) Listed changes affecting only benefits which are not money purchase benefits are -

(a) to change to money purchase benefits some or all of the benefits that may be provided under the scheme to or in respect of members or members of a particular description;

(b) to change, in whole or in part, the basis for determining the rate of future accrual of benefits under the scheme for or in respect of members or members of a particular description; …

(d) to make any other reduction in the rate of future accrual of benefit under the scheme for or in respect of members or members of a particular description.

(4) "Normal pension age" has the meaning given by section 180 of the Pension Schemes Act 1993 (normal pension age)."

5. Regulation 11:

"(1) In relation to a proposal to make a listed change affecting an occupational or personal pension scheme, each relevant employer to whom regulation 7(3) applies must provide information about the proposal to -

(a) such of his employees as appear to him to be affected members of the scheme, and

(b) any representatives of such members who are to be consulted under regulation 12(2)(a) or (3) or 13(2).

(2) The information provided under paragraph (1) must -

(a) be in writing,

(b) be provided before the start of consultation under regulation 12 or 13,

(c) describe the listed change and state what effects it would (or would be likely to) have on the scheme and its members,

(d) be accompanied by any relevant background information,

(e) indicate the timescale on which measures giving effect to the change are proposed to be introduced, and

(f) be given in such fashion and with such content as are appropriate to enable, in particular, representatives of affected members to consider, conduct a study of, and give their views to the employer on, the impact of the listed change on such members."

6. Regulation 15(2):

"In the course of consultation, the relevant employer and any person consulted are under a duty to work in a spirit of co-operation, taking into account the interests of both sides."

7. Regulation 18 (Remedies for failure to comply)

"(1) The only remedies for a failure to comply with any obligations under regulations 6 to 16 in respect of any proposal or decision to make a listed change are—

(a) making a complaint to the Regulator,

(b) an improvement notice issued under section 13 of the Pensions Act 2004 (improvement notices), and

(c) a penalty imposed under regulation 18A.

(2) A complaint under paragraph (1)(a) may be made by-

(a) any representative of affected members who falls within regulation 12(2)(a) or (3) or 13(2) (including any such representative who is not consulted), and

(b) any active or prospective member of an occupational or personal pension scheme who considers that he is or may be an affected member."