Articles

Pensions on marital breakdown Part 3: case-law – what does it tell us?

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In this article we consider what guidance we can take from reported decisions which have involved pension aspects of a settlement. Prior to legislative enactments, *Brooks v Brooks* [1996] AC 375, [1995] 2 FLR 13, provided a partial solution where pensions were an issue but its usage was restricted. *Brooks* had involved an unusual pension scheme and turns on its own facts. The essential points about the pension were:

- it was set up after the marriage, it was therefore clearly post-nuptial;
- the husband was the only member of the scheme – no other beneficiary was involved;
- the wife had earnings of her own from the company which supported a pension for her of the relevant amount.

Therefore, pursuant to the provisions of s 24 (1) (c) of the Matrimonial Causes Act 1973 (MCA 1973), the court had power to vary the nuptial settlement. Lord Nicholls however warned this decision should not be seen as a solution to the overall pensions problem. Then came s 166 of the Pensions Act 1995 which brought about amendment to the MCA 1973, and introduced pension attachment orders. The provisions were further improved by the Welfare Reform and Pensions Act 1999 which abolished the remedy created by *Brooks*, and introduced Pension Sharing.

What weight is to be attached to the value of the benefits may exercise the court's mind. In *H v H (Financial Provision: Capital Allowance)* [1993] 2 FLR 335 the pension had accrued over 13 years of service by the husband and during which, only 7 of those years had the parties been cohabiting. Thorpe J said, '[I]n deciding what weight to give to pension rights it is more important . . . to look at the value of what has been earned during cohabitation rather than look at the prospective value of what may be earned over the course of 25 or 30 years after separation'. This case was decided before the coming into force of ss 25B–25D of the MCA 1973 and we would suggest the important considerations are going to be:

- The ages of the parties – if they are comparatively young and it is 25 years until retirement, most assumptions made as to growth, inflation, etc pre-retirement are going to be wrong.
- The length of the marriage – if the parties have a short marriage, coupled with youth, it is costs disproportionate to try and analyse pre-marriage, post-marriage accrual and post-separation growth.

The cases

After the statutory enactments referred to above, the first reported case of significance was on earmarking (as it was then referred to). The decision was *T v T (Financial Relief: Pensions)* [1998] 1 FLR 1072. This involved a childless marriage lasting some 14 1/2 years where the husband was 46 and the wife 47. The wife did not work and the husband was a relatively high earner – £109,000 pa with bonus options. The wife sought an earmarking order in relation to the husband's pension to reflect her loss of rights under her husband's pension scheme. She also argued that the earmarked order should not terminate in the event of her remarriage. The court held the MCA 1973 did not require the court to compensate for pension loss and there was no advantage in directing an order at the pension providers for deferred periodical payments or a lump sum to make the husband pay the price for the wife's potential loss of a widow's pension, although there might be cases where that was appropriate. However on the husband's death in service the pension scheme trustees would be ordered to pay a lump sum to the wife equal to 10 times the annual maintenance payable from any death in service benefit.

Hot on the heels of *T v T* came *Burrow v Burrow* [1999] 1 FLR 508. After 16 years of marriage and with children aged 13 and 8 the husband (48) and wife (50) separated. The husband's interest in pension was £267,712 which enabled him to draw the benefits after his 50th birthday. In addition there was equity in the family home and the husband's 98% shareholding in the family business. A joint lives maintenance order was made in favour of the wife. It was also ordered that the wife should have half the maximum possible lump sum on the husband's retirement and one half of the annual net income from the pension scheme. The husband appealed. The court held than the effect of ss 25B–25D of the 1973 Act had not been to alter the basis upon which the courts determined applications for ancillary relief. The correct approach was to apply the s 25 criteria and with regard to pensions was not the mathematic or arithmetic compensation of lost pension benefits to which a party might otherwise claim an entitlement. There were difficulties in treating an annuity provided under a pension scheme in the same way as a capital sum available under that scheme.

Following the introduction of pension sharing orders, pension attachment orders have largely fallen out of vogue, for obvious reasons, most eloquently summarised by Mr Justice Wilson (as he then was) in R (*Smith) v Secretary of State for Defence and Secretary of State for Work and Pensions* [2004] EWHC 1797 (Admin), [2005] 1 FLR 97, at para [7]:

> 'In a sentence, the problem is that, notwithstanding divorce, the wife who has the benefit only of an attachment order remains hitched to the husband's wagon.'

However, pension attachment orders can still be a valuable and useful tool, especially in cases involving ill health, significant age gaps and old age. Interestingly, *T v T*, along with *Burrow v Burrow*, offered some guidance on the accuracy (or otherwise) of pension valuations and projections. Singer J stated:

> 'I should perhaps emphasise that these values are at best a guide, and their apparent precision (down to the nearest pound) is illusory, and the product of mathematical rather than predictive accuracy. For they necessarily incorporate various assumptions (as to the rate of future inflation before and after the pension commences in payment; an appropriate discount rate reflecting the tax-exempt environment (currently) enjoyed by the pension fund; and of course that ultimately unpredictable factor, mortality) . . . Thus (as has been said of a *Duxbury* fund) the only fact which can be predicted with absolute accuracy is that the prediction will turn out to be inaccurate.'

This judgment should perhaps be very much at the front of minds when parties' are deliberating as to whether, for example, the pension sharing order should be 53.53% or 54.89%. The expert may have calculated two different figures, one designed to achieve equality of pension income when the parties retire in 15 years time and the other to achieve an outcome of equality of the CETV. At the end of the day, both figures will be wrong (they are at best a guide), and parties should not see the fact that the expert has calculated a pension sharing order to two decimal places as a sign of the accuracy with which his figures must be viewed. By calculating the quantum of a pension sharing order to 2 decimal places somehow confers upon the calculations a degree of accuracy and certainty which simply does not exist.

We then have three well-known judgments which all make the same point that a pension is not a capital asset but simply a whole of life income stream. In *Cowan v Cowan* [2001] EWCA Civ 679, [2001] 2 FLR 192, Thorpe LJ stated:

> 'The special characteristics of the pension funds held by the husband and wife respectively require recognition. The husband's fund is all vested and is no more and no less than a whole life fixed rate income stream. The fact that it would cost £1.19m to purchase an identical income stream allows a capitalisation for comparative purposes. But it is not truly comparable with a cash fund of 1.19m for the obvious reason that the latter is replete with options as to deployment, investment, and spending, as well as having the capacity to survive intact the owner's demise.' (para [69])

In *Maskell v Maskell* [2001] EWCA Civ 858, [2003] 1 FLR 1138 a similar judgment was made, again by Thorpe LJ. The parties separated with three children and a shared care regime. The district judge had provided for all the equity in the matrimonial home and a policy to go to the wife and the husband to retain a smaller policy and his pension. The husband was only 41. The husband appealed successfully. Thorpe LJ stated:

> 'The judge [in the court below] is making the seemingly somewhat elementary mistake of confusing present capital with the right to financial benefits on retirement, only 25% of which maximum could be taken in capital terms, the other 75% being taken as an annuity stream. He simply failed to compare like with like.'

Martin-Dye ([2006] EWCA Civ 681, [2006] 2 FLR 901) involved an appeal in which the lead judgment was given by Lord Justice Thorpe. The principle issues in dispute did concern pensions, namely:

- How, following a decree of divorce or nullity, the court assessing the fair division of available assets in order to achieve a clean break between the parties, should treat pensions in payment.

The factual position in *Martin-Dye* can be summarised as follows:

- Long marriage – 16 years at the date of the petition.
- Husband was a commercial pilot working with British Airways who had taken early retirement on the grounds of ill health and whose pension was in payment.
- There were a variety of assets in addition to the pension – properties, a limited company, policies and some small investments.
- The wife argued greater pre-marriage acquired wealth and the husband countered with the value of his pension.
- After much litigation, and late in the day, an application was made to introduce fresh evidence and to re-open the appeal – the central point being the recognition of the need to refer to the cash equivalent of benefits rather than the cash equivalent transfer value (CETV) in considering the allocation of assets on divorce in this particular case.

What were the key components of the judgment? They included the following:

- A pension in payment is no more than a whole life income stream akin to an annuity.
- It cannot be sold, commuted for cash or offered as security for borrowings.
- It has no capacity for capital appreciation.
- The district judge's judgment had been flawed in dividing available assets between the parties ignoring the essential differences between saleable property and an income stream derived from an inalienable pension in payment. It had also been flawed by insufficiently reasoning her rejection of the husband's application for a pension sharing order.
- The judge on appeal from the district judge had fallen into error in rejecting the husband's appeal.
- Pensions are too characterised as 'other financial resources' as they do not sit comfortably in the category of 'property'. Nor do they sit comfortably in the category of 'income' because they do not derive from future endeavour.
- Because a clean break was inevitable in this case the court had a duty to consider either leaving the pension undisturbed and offsetting or, in the alternative, making a pension sharing order. The district judge had taken the former approach and a pension sharing order should have been adopted.

This case is often cited by solicitors making preliminary enquiries of a pensions' expert. Where there is a pension in payment they may say, 'The scheme has provided a CETV for H's pension which is in payment but do we need to ask for a CEB as well, like the *Martin-Dye* case?' This possible area of confusion may arise because of pension jargon. Before a pension scheme member retires, he is entitled by law to transfer his rights from his scheme into another pension arrangement. His ceding scheme will provide him with a CETV and since this figure is readily available, the legislation decided that this should be the basis for valuing pensions for divorce. However, once a pension comes into payment, in the normal course of events a member is not entitled to transfer his pension, and so a CETV is not automatically available. Thus, the legislation requires, in the absence of an automatic entitlement to a transfer value for pensions in payment, that the person responsible for the pension provides a figure called a cash equivalent of benefit (CEB).

In reality, pension scheme providers have standardised forms for pension valuations for divorce, and more often than not, these forms are pre-populated with the words cash equivalent transfer value alongside which there is a gap for a monetary amount to be inserted. Thus, irrespective of whether a pension is in payment or not, the scheme documentation will often refer to the figure as a CETV. Where you are provided with a figure referred to as a CETV for pension in payment, there is no need to go back to the scheme administrators asking for a CEB instead because: (a) you already have the right figure, just the wrong nomenclature; and (b) you will get very frustrated by the lack of understanding at the other end of the telephone!

The expert

Twelve years on from the introduction of pension sharing orders and as a response to some of the above case-law, we are seeing a far greater degree of sophistication in terms of how pensions are considered and trends emerging in arguments being run. Quite often letters of instruction to an expert will require that the expert considers the following points:

- A calculation of the pension sharing order required to achieve an outcome of equality of pension capital (as assessed by the CETVs).
- A calculation of the pension sharing order required to achieve an outcome of equality of pension income. This is often then broken down further, with different calculations being requested assuming that:
  (i) The wife retires at the earliest age permitted.
  (ii) That the wife retires at age 60.
  (iii) That the wife retires at age 65.
- A repetition of all of the above calculations, this time excluding:
  (i) The pensions accrued pre-cohabitation.
  (ii) The pensions accrued pre-marriage.
  (iii) The pensions accrued post-separation.
  (iv) A combination of (i) and (iii).
  (v) A combination of (ii) and (iii).
- If the case is to be settled by offsetting not pension sharing, a calculation of an appropriate amount of capital to be settled upon the wife assuming both parties retain their own pension provision.

The above wording in a letter of instruction would yield something like 25 different calculations and often the report would be man's best-known cure for insomnia. Often there is little difference between the percentages of pension sharing order calculated in each of the above scenarios, especially when it comes to distinguishing between pensions accrued pre-cohabitation and pensions accrued pre-marriage, where the period of cohabitation is relatively small. Often such distinctions lead to arguments as to whether the pension sharing order should be 53.45% or 55.12%. Remember the words of Singer J in *Burrow v Burrow*:

> 'Thus (as has been said of a Duxbury fund) the only fact which can be predicted with absolute accuracy is that the prediction will turn out to be inaccurate.'

The only reason the expert has calculated the pension sharing order to two decimal places is vanity on his part – he wants to demonstrate that his projected income figures balance to the nearest pound.