THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA

Case No: 490/97

In the matter between

TEK CORPORATION PROVIDENT FUND AND 10 OTHERS **Appellants**

and

ROY SPENCER LORENTZ **Respondent**

CORAM: VAN HEERDEN DCJ, SMALBERGER, GROSSKOPF, HOWIE *et* MARAIS JJA

DATE HEARD: 6 May 1999

DATE DELIVERED: 3 September 1999

Pension scheme - surplus in fund - entitlement thereto - competing claims by employer and employees - "contribution holiday" - when permissible - effect of registrar's approval in terms of sec 14 (1) of Pension Funds Act 24 of 1956 considered.

JUDGMENT

MARAIS JA

MARAIS JA:

[1] Simple sounding catch-phrases designed to capture elusive concepts in a few easily remembered words are useful in daily discourse but they have their dangers. They may mask the complexity of the concepts or provide a springboard for leaps into the drawing of inaccurate or fallacious analogies. "Contribution holiday" and "pension fund surplus" are such catch-phrases and it is with them that this appeal is concerned. They owe their genesis to the phenomenon of surpluses (both notional and real or actual) arising in pension funds. What may legitimately be done with such surpluses is an intensively debated topic in the pension industry.

[2] Much as the pension industry may wish to have this court decide the many issues which can arise in that connection, the court is not at large to do so and must confine itself to the specific problems which arise in this case. The answers to those problems depend of course upon the particular facts and circumstances of the case. While some of this court's conclusions may be of general application, others will not.

[3] There is no need to provide a detailed account of the history of the matter

and the rules of the relevant funds. That was done by Navsa J in the court *a quo*. His judgment is reported in 1998(1) SA 192 (W). When it is necessary in order to understand the import of what is said in the present judgment, appropriate reference will be made to the relevant rules and circumstances. I shall continue to use the abbreviations of the names of the companies involved which were used in the judgment of the court *a quo*. I shall also dispense with the use of unessential capital letters.

[4] In the hope that jettisoning unnecessary detail will bring the problems into sharper focus, I abbreviate the history of the funds. The Tek Corporation Pension Fund (1991) was established on 1 January 1991. It is a defined benefit fund - one which undertakes to provide its members with the benefits defined in its rules: primarily (there are also other benefits) a pension expressed as a percentage of final salary and based on years of service. The rules of the fund required the employee-members to make a recurring fixed contribution. (Rule 4.1.1.) The amount, if any, to be paid by the employer had to be agreed with the fund's trustees from time

to time but it could not be less than an amount calculated by the fund's actuary to be necessary to ensure the financial soundness of the fund. (Rule 4.2.1.) A stage was reached when a substantial surplus existed in the fund. A surplus in such a fund is the amount by which the actuary's assessment of the value of the fund's assets exceeds the actuary's assessment of its liabilities. The existence of the surplus relieved the employer of any liability to contribute to the fund for as long as the surplus continued to exist. That was the inexorable effect of Rule 4.2.1. The consequence was that as from 1 December 1991 the employer made no further contribution to the fund. This is what is referred to in the pension industry as taking a "contribution holiday". In the context of the rules of this pension fund the usage of the expression may be somewhat misleading. The word "holiday" implies a temporary respite from duties with which one is ordinarily burdened. It postulates that there is an existing and enduring obligation of some kind. In this pension fund the effect of rule 4.2.1 is that, depending on the circumstances, the liability of the employer to contribute may never arise and, if it does, it may be of

limited duration. Be that as it may, the expression is convenient and I shall continue to employ it.

[5] In October 1992 the establishment of a defined contribution provident fund (as opposed to a defined benefit pension fund) was mooted. Unlike the position in a defined benefit fund, it is inherent in a defined contribution fund that no "surplus" can arise. That is because there are no predetermined benefits payable. Instead, the members are entitled to whatever the fruits (be they sweet or bitter) of the investment of the defined contributions may prove to be. It followed that if such a fund was established there could be no prospect of the employer being relieved of its obligation to contribute to the provident fund because of the existence of a surplus in that fund.

[6] The Tek Corporation Provident Fund was established on 1 June 1993. The pension fund continued to exist but over a period of time the overwhelming majority of the pension fund's members elected to transfer to the provident fund. There is some dispute as to whether all of them did so but that is not of great

moment . What is quite plain is that there would continue to be persons, especially pensioners, for whom the pension fund would have to provide but its potential liability would be greatly diminished. The provident fund, on the other hand, would have to provide for all those employees who elected to transfer to it. The two funds existed side by side thereafter.

[7] Those employees who transferred from the pension to the provident fund were required to take with them into the provident fund the actuarially assessed value of their interest in the pension fund and they did so. Despite that there remained a substantial surplus in the pension fund. It was thought that it would be permissible in law to transfer the surplus in the pension fund to the provident fund for use in one, or other, or both of two ways: first, to enable the employer to take in the provident fund the "contribution holiday" which it had enjoyed in the pension fund; secondly, to fund a stabilization account to be used to meet future cost increases in the provision of death and disability benefits.

[8] As a fact the surplus was not transferred to the provident fund. However, on the strength of advice it had been given, the employer commenced taking a "contribution holiday" in the provident fund as from 1 November 1993. For reasons upon which it is unnecessary to dwell, it ultimately became common cause that the employer had not been entitled to do so.

[9] Consequent upon the sale of the Defy Division of the employer (Tek) to Malbak, with effect from 1 April 1994, approximately two-thirds of the members of the provident fund (who had not long before transferred to that fund from the pension fund) ceased to be employed by the Tek group and ceased to be members of the Tek provident fund. Instead they became members of the Malbak provident fund taking with them into that fund "the full amount of the current credit held in respect of each such member in terms of rule 5.1(a) and (b) of [Tek's] provident fund". (Cl 10.6 of the relevant Sale Agreement.)

[10] It was at this stage that the erstwhile Defy/Tek (now Malbak) employees

began to question the legitimacy of the use to which Tek intended putting the surplus which had arisen in the Tek pension fund and to advance the contention that once the surplus in the pension fund had been transferred to the Tek provident fund at least some of it should "follow" them into the Malbak provident fund. The issue was debated in an exchange of correspondence and the employees' contention was rejected.

[11] The position taken by the chairman of the board of trustees of both the Tek pension fund and the Tek provident fund was quite unequivocal. In a letter dated 3 October 1994 he said (a) that it had been their "consistent view that any surplus existing in the pension or provident fund lies within the control of the employer company", (b) that there "is nothing in law (in the Pension Funds Act or elsewhere) which requires that amounts in excess of actuarial reserves be transferred" in the prevailing circumstances, (c) that "whatever may have been decided regarding the application of surplus in the pension fund, there is nothing in the rules of the

provident fund which requires the trustees to pay amounts in excess of actuarial reserves", (d) that in comparable circumstances "it has not been the practice of the Tek Corporation Provident Fund to transfer amounts in excess of actuarial reserves", and (e) that "in the absence of any formal agreement which is binding on the provident fund, the company cannot support the transfer of amounts in excess of actuarial reserves in respect of employees of the Defy Appliances Division". In a letter dated 18 October 1994 he declined to give an "undertaking that should the surplus be used at any time in the future for the enhancement of Tek employee benefits Defy ex-members of the fund will benefit to a proportionate extent", adding that "it is our view that the surplus falls under the control of the company and any such undertaking could potentially inhibit our access to it".

[12] These proceedings were then instituted on 6 September 1995 by Mr Lorentz as a former member of both the pension and the provident fund and a present member of the Malbak provident fund. Because it was thought that the

surplus had already been transferred from the Tek pension fund to the provident fund the declaratory orders claimed were attuned to that situation. It became clear when answering affidavits were filed and after oral evidence was given pursuant to an appropriate order that that be done, that the surplus had not been transferred. Indeed, the trustees and the employer had by then altered their stance substantially. On 15 September 1995 it was decided that the pension fund which had already undergone one change of name should be renamed yet again due to group restructuring as the Plessey Corporation Pension Fund. It was now to be the fund which all new employees in the Plessey group would be obliged to join. The surplus in that pension fund was to remain where it was to enable the employer to continue enjoying the contribution holiday in that fund. The Tek provident fund was to continue to exist. The amount which the employer should have contributed to the provident fund but failed to contribute in the belief that it could use the surplus in the pension fund to provide a contribution holiday in the provident fund,

was largely made good.

[13] This change of stance prompted a revision of the declaratory orders sought and Navsa J ultimately granted declaratory orders which I paraphrase thus:

(1) An order declaring that the trustees of the pension fund are not entitled to use the surplus in the pension fund to enable the employer to avoid paying contributions to the provident fund " or otherwise for the benefit of" the employer.

(2) An order that the trustees of the pension fund determine what portion of the surplus is to be transferred to the provident fund pursuant to the transfer of members of the pension fund to the provident fund;

(3) An order that, in so determining, the trustees must have regard to

(a) the extent of the surplus as it existed during the period 31 August 1993 to 1 November 1994, and

(b) the returns on the investment of that surplus achieved by the pension fund from 1 November 1994 to the date of their determination;

(4) An order that within two months of that determination the trustees effect payment of the amount so determined to the provident fund;

(5) An order that within one month of receipt of payment from the pension fund the trustees of the provident fund must "determine the manner in which the said funds are to be used for the purpose of increasing the benefits payable by the provident fund" to those who became members on 31 August 1993 and other beneficiaries whose benefits are derivative - widows, children, etc;

(6) An order that the pension fund and the provident fund pay the costs of the

application jointly and severally, including the costs of two counsel. The applicant (Mr Lorentz) was denied the costs attendant upon the citation of individual trustees as parties to the application.

[14] Leave to appeal to this court was granted by the court *a quo*. In essence what the appellants would have us say, is this:

(1) For as long as a surplus in the pension fund exists, the employer is under no obligation to contribute to the pension fund and that is so irrespective of the source of the surplus. (Navsa J had held that this is so only to the extent that the surplus is attributable to overfunding by the employer);

(2) While such a situation exists, members and erstwhile members of the pension fund have no right to demand that the surplus or any part of it be used to increase the benefits payable either upon retirement or upon transfer to another fund;

(3) On the facts, the trustees and the employer did transfer "a sufficient and proper" portion of the surplus to the provident fund in respect of each of the transferring members;

(4) The rules of the pension fund do not empower the trustees to do what the court *a quo* ordered them to do;

(5) The court *a quo* should have dismissed the application with an appropriate order as to costs.

[15] A number of propositions are either axiomatic or not in dispute. The pension fund, the powers and duties of its trustees, and the rights and obligations

of its members and the employer are governed by the rules of the fund, relevant legislation and the common law. The fund is a legal *persona* and owns its assets in the fullest sense of the word "owns". (Sec 5(1)(a) and (b) of the Pension Funds Act 24 of 1956.) The object of the fund is "to provide retirement and other benefits for employees and former employees of the employers in the event of their death". (Rule 1.3.) The trustees of the fund owe a fiduciary duty to the fund and to its members and other beneficiaries. (Sec 2(a) and (b) of the Financial Institutions (Investment of Funds) Act 39 of 1984 and Rule 18.1.4.) The employer is not similarly burdened but owes at least a duty of good faith to the fund and its members and beneficiaries. (Cf **Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd** [1991] 2 All ER 597 (Ch) at 604g - 606j.) The rules of the fund spell out the circumstances in which the employer must contribute to the fund and how the *quantum* of the contribution is to be determined. (Rules 4.2.1 and 19.5.) The existence of a surplus in this case cannot be ascribed solely to past overfunding by

the employer. The sources of that surplus are diverse. They have not been identified and isolated nor have their respective contributions to the surplus been quantified. However, on any view of the matter, the surplus must be attributable at least in part to contributions from sources other than the employer.

[16] I move to controversial terrain. Some preliminary observations seem necessary. Defined benefit pension funds do not exist to generate surpluses but they may arise when reality and actuarial expectation do not coincide. In assessing the financial health of a pension fund an actuary is gazing into the proverbial crystal ball to see what the future will hold. The use of the metaphor is not intended to demean the exercise; it is highly sophisticated and requires considerable training and skill,yet it remains, when all is said and done, an exercise in prophecy. Some of the data available may be relatively immutable and provide a secure foundation for predictions. Much of it is not. There are a host of factors about which assumptions have to be made because they lie in the future. Examples are rates of

return upon different categories of investment, the rate of inflation, governmental fiscal policy, increases in salary, mortality rates for active and retired members, the rate of employee turnover, the incidence of disability, and the extent to which early retirement options may be exercised. The list is not exhaustive but it suffices to show the very considerable role that assumption plays in the assessment of the financial soundness of a pension fund and explains why even the most meticulously assessed valuation may be confounded by subsequent experience. While it is obviously so that the funds necessary to ensure that the defined benefits which the pension fund must provide are paid and will continue to be paid, are sacrosanct and may not be used for the benefit of the employer, that is not necessarily so of funds which are plainly surplus to that requirement. I say "plainly" advisedly because the existence of a surplus at any particular point in the history of a fund may be so potentially transitory that it would be imprudent to diminish the fund by eliminating the surplus.

[17] It has often been argued that in a situation like the present (sometimes described as "balance of cost" pension schemes) where the employer is the ultimate guarantor of the financial soundness of the fund, any surplus should enure to its benefit as the members of the fund carry no risk in that regard. The contention seems to me to be unduly simplistic but whatever its merits (if any) may be in equity, it begs the question whether any such entitlement exists in law. As Warner J observed in **Mettoy Pension Trustees Ltd v Evans** [1991] 2 All ER 513 (Ch) at 551b "One cannot in my opinion, in construing the rules of a 'balance of cost' pension scheme relating to surplus, start from an assumption that any surplus belongs morally to the employer." Once a surplus arises it is *ipso facto* an integral component of the fund. Unless the employer can point to a relevant rule of the fund or statutory enactment or principle of the common law which confers such entitlement or empowers the trustees to use the surplus for its benefit, the employer has no right in law to the surplus. It goes without saying that whatever negotiations

may be taking place behind the scenes to cater for such situations by way of legislation, as has been done in some other countries, this court can judge the matter only in accordance with existing law. In **Schmidt v Air Products Canada Ltd** [1994] 2 SCR 611 Cory J, writing for the majority, said: "Regrettably a comprehensive approach to the issues arising from pension surplus has yet to be enacted in any part of this country. The courts have on a number of occasions been required to determine the allocation of pension surplus. Yet the courts are limited in their approach by the necessity of applying the sometimes inflexible principles of contract and trust law. The question of entitlement to surplus raises issues involving both social policy and taxation policy. The broad policy issues which are raised by surplus disputes would be better resolved by legislation than by a case-by-case consideration or individual plans. Yet that is what now must be undertaken." (At 652d - e) I echo those sentiments.

[18] It was not suggested that there is any principle of the common law which

would enable the employer to lay claim to a surplus arising in the way in which this one did, either during the life of the fund or upon its liquidation. Nor am I aware of any such principle. There is no relevant statutory enactment which confers such a claim. What is left are the rules of the pension fund. To those I now turn.

[19 The first point worthy of note is that there is nothing in the rules which explicitly entitles the employer to lay claim to a surplus either during the life of the fund or upon its liquidation. Yet it is plain that the possibility of a surplus arising was contemplated. Rule 19.5.1 requires an actuarial valuation of the fund to be made at intervals not exceeding three years. Rule 19.5.2 reads:

> "If the valuation discloses that there is a substantial actuarial surplus or that there is a deficit that requires to be funded, the manner of dealing with the surplus or funding the deficit shall be considered by the trustees and recommendations made to the principal employer for a decision. The principal employer's decision shall be made within the limitations imposed by the [Pension Funds] Act and the Registrar's practice and shall be final. Where necessary, the trustees shall alter the rules to give effect to such decision."

[20] This provision appears to be the only one in the rules which deals expressly

with a possible surplus. A number of features strike one. The rule is to operate only where a **substantial** surplus exists. The same rule governs a deficit but the deficit need not be substantial. It seems reasonably clear that the rule contemplates valuations made during the continuing existence of the fund and provides for what is to happen where substantial surpluses or deficits arise while the fund continues to exist. It does not appear to be aimed at dealing with surpluses or deficits arising upon liquidation. There are other rules dealing pertinently with the realization of the assets of the fund and the apportionment of the proceeds after payment of all liquidation expenses. (Rules 16.1 and 16.2.) It is significant that any balance then remaining must go to members, pensioners and other beneficiaries on an equitable basis recommended by the fund's actuary and approved by the liquidator. No part of it goes to the employer. Indeed, the employer has no say at all in the process.

[21] During the continuance of the fund the employer is certainly accorded a good deal of say by rule 19.5.2 but there are limits to it. The limitations imposed

seem to me to be designed to ensure that the objects of the fund are realized. Why else would the trustees have to play a role by making appropriate recommendations and the power of the employer be made subject to the limitations of the Pension Funds Act and the Registrar's practice? It is difficult to reconcile those provisions with any suggestion that the employer is free to take a decision which is solely in its own interests but not that of the fund and its members. If it had been intended to confer upon the employer an unfettered power to do what it liked with an identified surplus, I would have expected the framers of the rules to say so clearly and unambiguously. In so far as it was contended in the pre-litigation correspondence that any surplus "lies within the control of the employer company" in the sense that the employer has uninhibited access to it, I consider the contention to be wrong.

[22] That does not mean that the employer can derive no benefit whatsoever from the existence of a surplus. A recommendation by trustees that a surplus be

retained to counter a perceived risk of future adverse volatility in the investment environment, if accepted by the employer, will benefit the employer in as much as it will not be liable to make contributions to the fund for so long as the surplus exists. But that would be a fortuitous and incidental advantage flowing from a recommendation made by the trustees in the interests of the fund and its members. In so recommending the trustees would not be acting in breach of their fiduciary duties nor would they be acting *ultra vires*. Nor would the employer be acting in bad faith towards its employees in accepting the recommendation.

[23] While on this topic it would be as well to correct a misconception which led Navsa J to hold that it was not permissible for the employer to avoid making contributions by reliance upon the existence of a surplus save to the extent that the surplus was attributable to past overcontribution from the employer. With respect to the learned judge, I do not think that is correct. It overlooks the distinction between a defined benefit scheme in which the employer's contribution is fixed and

must be paid irrespective of the state of the fund, and a scheme like the present in which it is not and liability to contribute arises only when it is necessary in the estimation of the fund's actuary to ensure the financial soundness of the fund. In the former class of case there is an existing and continuing liability to contribute and using the existence of a surplus to avoid the making of contributions could not be justified. In the latter class of case, of which the present is an example, there is no predetermined and continuing liability to contribute. The liability arises only when need arises. Present a surplus, absent a need and absent a liability. The employer is therefore not being relieved of a liability and is receiving no benefit to the detriment of the fund or its members. It is irrelevant how the surplus arose and whether or not it is attributable to overcontribution in the past by the employer. There is simply no liability to contribute in such circumstances.

[24] It is another matter whether the employer is entitled to insist upon the trustees preserving a surplus even if only to allow it to take or prolong a

contribution holiday. Rule 11.1 empowers the trustees "to review the level of pensions being paid from the fund and [they] may direct that pensions be increased". It provides that the "amount of the increase shall be determined by the trustees in consultation with the .... employer and the actuary". It is far from clear to me that the imposition of the obligation to consult with the employer as to the amount of any increase is tantamount to conferring upon the employer a power of veto which would enable it to prevent the trustees from directing that any increase at all be given. It may be, I express no opinion on it, that the employer may legitimately require the trustees not to exhaust a surplus to such an extent that an easily foreseeable deficit will arise in future which will render the employer liable to contribute to the fund. But that is a far cry from accepting that the employer can dictate to the trustees that a substantial surplus be kept intact purely to insure it against any potential future liability to contribute to the fund. Insistence on that being done in the face of a financially rational and well motivated

recommendation from the trustees that, for example, pensions being paid be increased, in circumstances in which that would not have the effect of triggering the employer's liability to contribute, would not be consistent with the good faith which the employer is required to show towards its employees.

[25] Rule 16.4 also has some bearing upon the question of whether or not the employer is entitled to the benefit of a surplus. That rule caters for the case where the employer ceases to be liable to contribute to the fund as a result of a decision to establish, or participate in, another pension fund. No liquidation of the former fund takes place. Instead, the trustees "shall cause the assets .... to be transferred to the other .... fund". Again, there is no provision for a refund to the employer if a surplus exists in the former fund.

[26] The focus thus far has been upon the question of whether, and if so, to what extent, the employer is entitled to benefit from the surplus in the pension fund. I turn to the question of what the employees' rights in respect of the surplus are. It

was common cause that rule 11.1 authorises the trustees to increase only "pensions being paid from the fund" and that it does not authorise any generally applicable increase in pension benefits payable to active members upon their retirement in terms of rule 5.1. Indeed, one looks in vain for any provision in the rules of the fund which would authorise an increase of the latter kind. Counsel were agreed that rule 11.2 appears to authorise only *ad hoc* increases in benefits payable to particular individuals. An appropriate amendment of the rules would be necessary and that cannot be achieved without the consent of the employer. (Rule 21.1.)

[27] It is the dearth of appropriate provisions in the rules to govern the situation which arose in this case which, in my view, places an insuperable obstacle in the way of upholding the orders numbered (2), (3), (4) and (5) in paragraph [13]. That *lacuna* seems to me to destroy the contention that the trustees are bound to transfer from the pension fund an appropriate portion of the surplus to the provident fund. It disables one from accommodating within any of the existing rules of the pension

fund that which the court *a quo* was persuaded to order to be done in that connection.

[28] An unavoidable consequence of the absence of appropriate provisions was that counsel for respondent were constrained to rest their argument upon what they described as analogous provisions in the rules which, so it was said, gave "an indication" as to what should be done in this admittedly different situation. In my opinion there are serious conceptual difficulties in the way of such an approach. What the trustees may do with the fund's assets is set forth in the rules. If what they propose to do (or have been ordered to do) is not within the powers conferred upon them by the rules, they may not do it. They have no inherent and unlimited power as trustees to deal with a surplus as they see fit, notwithstanding their fiduciary duty to act in the best interests of the members and beneficiaries of the fund. It may seem odd to speak of powers being beyond the reach of the trustees and the employer when the rules empower them to amend the rules but the

contradiction is more apparent than real. First, their substantive powers at any given moment are circumscribed by the rules as they are at that moment. The fact that power to change the rules exists is irrelevant when assessing whether or not the particular exercise of power in question was *intra* or *ultra vires*. Secondly, there are a number of qualifications in both the rules and the Pension Funds Act to the exercise of the rule amending power conferred by rule 21. It is unnecessary to spell them out; it is sufficient to say that the trustees and the employer do not enjoy absolute autonomy in that regard.

[29] Let me recall the essentials of what happened here. The surplus in the pension fund existed. On the strength of it the employer had taken a contribution holiday. A new and different fund was created - the provident fund. Most, if not all, of the pension fund's members transferred to it but the pension fund was not liquidated. It continued to exist side by side with the provident fund and so did its obligations towards those who were already on pension and those members who

did not transfer to the provident fund. The employer's potential liability to contribute to the pension fund remained. Had it been liquidated in terms of rules 16.1 and 16.2 as a consequence of any of the circumstances therein set forth having arisen, it would have been clear what would have had to be done with the assets of the fund. Rule 16.2 is quite explicit: "the liquidator shall realise the assets of the fund and, after payment of all expenses incurred in liquidating the fund, apportion the proceeds amongst the active members, pensioners and other beneficiaries on an equitable basis recommended by the actuary and approved by the liquidator". Provision is also made for the inclusion in the apportionment of some former members. The details are not important. What is important is that the employer would have had no claim to participate in the apportionment whether or not a surplus existed, and that the employees' rights would have depended upon what apportionment was made in terms of rule 16.2.

[30] Had the circumstances catered for in rule 16.4 arisen, the position would

have been equally clear. That rule provides that if the employer's contributions are terminated by the giving to the trustees of the written notice of termination which rule 16.1 empowers the employer to give, and that is "the result of a decision to establish, or participate in, another approved pension fund then the fund shall not be liquidated .... but the trustees shall cause the assets of the fund to be transferred to the other approved pension fund". Again, the employer would have had no claim to any part of those assets which would have included of course the surplus. Equally, the employees who were members of the former fund would not have been entitled to require the trustees to do anything with the surplus other than to transfer it to the "other approved pension fund". What their rights would have been thereafter would have depended of course upon the rules of the "other approved pension fund".

[31] None of the provisions in the pension fund's rules prior to their amendment as a consequence of the decision to establish a provident fund could accommodate

what the employees required, and Navsa J ordered, to be done with the surplus. The question which has next to be considered is whether any of the amendments altered the position. I leave out of account those which have no relevance.

[32] Amendment No 4 was effective from 30 September 1992. It added to Rule 3 two additional provisions to take account of the situation which arose when T I Technologies (Pty) Ltd ("TIT") ceased to be a subsidiary of Tek. The employees of TIT were given the option of becoming members of a newly established provident fund and of having their "accumulated contributions .... in the service of TIT" transferred to an approved pension or retirement annuity fund or into the provident fund for their benefit. This was what was later described as the "withdrawal benefit". Rule 3.2 *bis* went on to provide that an "amount determined by the trustees on the advice of the actuary to be the rest, after deduction of the members' withdrawal benefit mentioned above, of the reserve value (if any) of the members' accrued pension benefit shall be transferred to the provident fund to be

applied in terms of the provident fund rules". Rule 3.2 *ter* catered for the TIT employees who did not opt to join the newly established provident fund. They were given the choice of having the "reserve value of [their] accrued pension benefit, as determined by the actuary" transferred to one or other of three named funds. The rule concluded with a paragraph stating that once payment had been made in terms of rule 3.2 *bis* or 3.2 *ter*, the fund's "liability to the members mentioned shall be discharged and they will have no claim against the fund".

[33] This amendment is significant for two reasons. First, it accords nobody, either departing members of the Tek pension fund or the employer, rights in any surplus which might then have existed in the fund. Secondly, it complicates the issues before the court because the orders granted by Navsa J failed to take the position of those employees into account. If those orders were justified in respect of the other employees, it may well be that the TIT employees should not have been excluded from any participation in the surplus. Those employees are not before the

court and it would not be right to make pronouncements affecting them without having heard what they might have to say. However that may be, the conclusion to which I have come regarding the correctness or otherwise of the orders granted by Navsa J makes it unnecessary to pursue the point.

[34] Amendment No 5 came into effect on 1 June 1993. It came about because of the establishment of the Tek provident fund. Certain "Special Provisions" were added to the rules. They gave active members of the pension fund the option of remaining active members of the fund or of becoming members of the provident fund. Those who elected to join the provident fund ceased to be members of the pension fund. For the rest the provisions of amendment No 5 were much the same as those of amendment No 4 save that there was no express exclusion of any other claim against the fund.

[35] I shall return later to amendment No 6. Amendment No 5 was itself amended by amendment No 7 with effect from 1 June 1993. What the amendment

did was to make it possible for the trustees, in consultation with the actuary, to transfer to the provident fund in the case of each active member who elected to join it "such additional amount (if any) as the trustees, in consultation with the actuary, shall determine; to be applied under the provident fund in terms of the rules of that fund". While this amendment might at first blush appear to authorise use of a surplus to increase the benefits to which employees would become entitled upon retirement (prompting counsel for respondent to describe it as "serendipitous"), in fact it did not.

[36] The reason is this. Any such "additional amount" which might be transferred to the provident fund had "to be applied under the provident fund in terms of the rules of that fund". A corresponding and contemporaneous amendment of rule 4.2 of the provident fund required such amount to be credited to Reserve Account No 2 and for there to be deducted from that account "such amounts .... as are required to meet the employer's contribution in terms of rule 4.1 until

such time as the amount standing to the credit of Reserve Account No 2 is exhausted". The trustees were also authorised to use part of the amount standing to the credit of that account to meet "the expenses of the fund". In short, the dominant purpose of the amendments was to enable the employer to do what it now concedes it was unlawful to do, namely, to use the surplus in the pension fund to finance the contributions which it was obliged to make to the provident fund. They were not intended to confer, nor are they capable of being interpreted as conferring, upon the trustees of the pension fund the power to do what respondent would have them do and what Navsa J has ordered them to do.

[37] Amendment No 6 took effect from 1 March 1993. It gave wage earning active members the option of transferring to the Metal Industries Provident Fund or remaining as members of the pension fund. A member transferring ceased to be a member of the pension fund and became entitled to a lump sum benefit equal to his or her actuarial reserve as determined by the actuary as at the date of his or her

withdrawal from the pension fund. That sum (after payment of income tax) had to be transferred to the Metal Industries Provident Fund to be applied under that fund in terms of its rules. The complications which amendment No 4 creates for the orders granted by Navsa J arise again here for similar reasons.

[38] With the wisdom of hindsight one can see what went wrong when the issue of establishing a provident fund and what should be done about the surplus in the pension fund arose. The premise upon which the matter was approached, namely, that the fate of the surplus was entirely in the hands of the employer, was incorrect. The trustees of the pension fund and the employer failed to appreciate that it was incorrect. The misconception permeated the drafting of the amendments discussed earlier and diverted attention from the real question which was how to resolve the issue of the surplus to the satisfaction of all. Because the existing rules of the fund did not cover the situation which it was sought to create, a mutually satisfactory solution should have been negotiated and the rules amended accordingly. That

would have required consensus to be reached between employer, trustees and employees. Failing consensus, there would have been stalemate and the surplus would have had to remain where it was - in the pension fund. Whether or not the provident fund would have been created none the less it is not possible to say. The employer asserts that it would not and perhaps that is so but the fact of the matter is that it now exists.

[39] The present situation is probably satisfactory to nobody. The employer cannot benefit from the surplus in the pension fund save in the limited sense which I have explained earlier (prolongation of the contribution holiday in the pension fund). The employees who have transferred to the provident fund have no existing access to the surplus in the pension fund. The only persons who might benefit from its existence during the life of the pension fund are those already on pension (or their dependants). Their benefits could conceivably be increased under rule 11.1. A return to the drawing board appears to be the only way in which the

unsatisfactory aspects of the situation can be resolved.

[40] There is little point in reviewing and discussing the other cases in foreign jurisdictions to which this court was referred. They are certainly informative and helpful in a general sense but in the end the answers to the questions which arise in this case must be found in the rules of this particular pension fund and the law of South Africa. To the extent that anything said in the unreported decision in **Sauls v Ford South Africa Pension Fund and Others** (Case No 1878/87 South Eastern Cape Local Division) (and tentatively approved in another unreported decision of the High Court of Namibia in **Rössing Pension Fund v Lyners and Others**, 20 November 1996) is inconsistent with the conclusions reached in this case, it should be regarded as overruled.

[41] It seems advisable to deal with a particular contention advanced by appellants which may surface again if there is further litigation in this dispute. It was that the registrar's approval in terms of sec 14(1) of the Pension Funds Act of

what was done when the provident fund was created and some of the assets of the pension fund were transferred to it precludes the court from entertaining respondent's claims unless the registrar's certificate given pursuant to sec 14(1)(e) is set aside on review. I do not agree. The registrar's certificate is predicated upon an *intra vires* and properly taken decision by the trustees of the fund. If the decision of the trustees is open to attack because it is *ultra vires* or because it has not been properly arrived at, the registrar's certificate cannot save it.

[42] The upshot of all this remains to be stated. I refer to the orders of the court *a quo* by the numbers assigned to them in paragraph [13] of this judgment.

Order (1): Given the intransigent insistence of the trustees and the employer prior to the institution of these proceedings that the employer alone was entitled to decide what would be done with the surplus, and given the subsequent retention in the rules of the relevant funds of amendments purporting to authorise the use of the surplus in the pension fund to meet the employer's obligations to the provident fund

even after the disavowal of any intention to do so, the granting of an order specifically prohibiting its use for the purpose cannot be criticised. The belated change of stance by appellants in that regard and the concessions made for the first time in the papers were not, in my view, sufficient to disentitle respondent to such an order. The extension of the order to prohibit the use of the surplus "otherwise for the benefit of" the employer is another matter. I consider that to have been too sweeping in its compass. It would prevent the employer from taking a contribution holiday in even the pension fund (save to the extent that its own payments had contributed to the surplus). For the reasons given earlier, that limitation is not justified.

[43] **Orders (2), (3), (4) and (5):** These require the trustees to act in ways in which they are not empowered to act under the existing rules of the pension fund. They should not have been made.

[44] **Order (6):** The costs order was the consequence of respondent's success

on virtually all fronts before the court *a quo*. It requires revision in the light of this court's conclusions.

[45] To revert to the contentions advanced by appellant and which are listed and numbered in paragraph [14] of this judgment:

(1) is correct; (2) requires considerable qualification; (3) is an assertion which cannot be made in the circumstances; (4) is correct; (5) does not necessarily follow.

[46] **Ad (2):** It is so that during the continuance of the pension fund its members cannot demand that the surplus be used to increase the benefits payable upon retirement. Whether or not they may require the surplus to be transferred to another fund upon their transfer to that fund will depend upon the circumstances giving rise to the transfer. For example, a transfer in the circumstances postulated in rule 16.4 would require the assets of the fund (which would include the surplus) to be transferred because the rule so provides. A transfer not catered for by any of the rules could not take place without the concurrence of the members and what is

to happen to the surplus would have to be negotiated with the employer and the trustees and appropriate amendments to the rules would have to be made to enable the trustees to give effect to the consensus reached.

[47] In so doing account would have to be taken of sec 14(1)(c) of the Pension Funds Act which deprives a transfer of any force unless the registrar is satisfied *inter alia* that the scheme "accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the rules of a fund concerned". What is comprehended by the expression "reasonable benefit expectations" is not easy to say. Plainly it must mean something over and above the defined benefits to which the persons mentioned are entitled. Periodic inflation related increases in payments to existing pensioners may be an example. But it is a huge step from there to the bold proposition that whatever the size of a surplus may be, and however it may have come about, members and erstwhile members of a fund are reasonably entitled to expect that it, or most of it, will be applied in such

a way as to give them benefits substantially greater than those to which they are entitled as of right. It is a step which I am not prepared to take. Before any sensible view could be formed as to whether or not an expectation is reasonable one would need to know a good deal more about such things as the state of the existing fund, its potential liabilities, the history and sources of the surplus, the respective contributions of the members and the employer to it, and so on.

[48] **Ad (3):** It is not possible to say whether or not "a sufficient and proper" portion of the surplus was transferred to the provident fund. It is so that when the transfer to the provident fund from the pension fund took place some additional benefits were conferred but the fact remains that the decisions to do so were made while the trustees and the employer were under a misapprehension as to the extent of the employer's power to decide what should be done with the surplus. Had they been aware of the true position and not misdirected themselves in that regard they may well have decided upon other courses of action in order to deal with the

surplus. It certainly cannot be confirmed, as counsel for appellants invited this court to do, that what was done in that regard amounted to "a sufficient and proper" discharge by them of their obligations in regard to the surplus. As against that, what respondent requires to be done is beyond the existing power of the trustees. It may well be that there is other relief to which respondent would have been entitled as a consequence of the fundamental misconception under which the employer, the trustees, and their advisers laboured in reaching the decisions which were reached but that is not the question before us. The question is whether the relief sought and granted was correctly granted.

[49] **Ad (5):** For the reasons given in paragraph [42] I consider that respondent was entitled to some of the relief which he sought in the court *a quo*. While it is so that he should not have been granted all the relief which he sought, he has succeeded also in having declared as wrong in law the premise upon which the trustees and the employer relied, namely, that the power of disposition in respect

of the surplus lay solely with the employer. As against that, appellants were entitled to resist being ordered to do what they were ordered to do in terms of paragraphs (2), (3), (4) and (5) and their resistance should have been successful. Those orders related to issues which were central to the litigation and the appellants' successful resistance of them should be reflected in the costs orders which should have been made by the court *a quo*. The limited respects in which respondent was entitled to succeed in the court *a quo* related to matters which were really no longer in dispute after the filing of appellants' answering affidavits and the subsequent phases of the litigation were devoted essentially to those aspects of the matter in respect of which appellants should have been successful and respondent unsuccessful. Costs are of course a matter of judicial discretion and this court is obliged to make the costs order which it considers would have been appropriate if the court *a quo* had reached the conclusions which this court has reached. I consider that it would be fair to order first, sixth and seventh appellants to pay

respondent's costs in the court *a quo* up to and including the stage at which it was ordered that oral evidence be heard, and to order respondent to pay appellants' costs thereafter.

[50] The costs of appeal stand on a different footing. Appellants have enjoyed substantial success on appeal. Important orders made by the court *a quo* have been set aside and some significant misconceptions rectified. Respondent persisted in defending the grant of those orders. Appellants on the other hand persisted in the claim that the entire application should have been dismissed with costs. Respondent has been successful in resisting that claim. In the circumstances the respective measures of success should receive some measure of recognition in the costs order. I think that respondent should be ordered to pay three-quarters of appellants' costs of appeal.

[51] In the result, it is ordered that the appeal be upheld to the following extent:

(1) The orders of the court *a quo* are set aside and substituted by the following orders:

(a) It is declared that the trustees of sixth respondent (Tek Corporation Pension Fund (1991), now renamed Plessey Corporation Pension Fund) are not lawfully entitled to make use of the surplus in the fund for the purpose of permitting seventh respondent (Tek Corporation Limited, now renamed Plessey SA Limited) to reduce, diminish or avoid its obligation to make contributions to first respondent (Tek Corporation Provident Fund) pursuant to rule 4.1 of the rules of first respondent, being annexure "AA" to the replying affidavit of applicant;

(b) For the rest, the application is dismissed.

(c) First, sixth and seventh respondents are ordered to pay applicant's costs, including the costs of two counsel, but excluding any costs attendant upon the citation of individual trustees as parties, up to and including the stage at which it was ordered that oral evidence be heard.

(d) Applicant is ordered to pay respondents' costs, including the costs of two counsel, incurred thereafter.

(2) Respondent is ordered to pay three-quarters of appellants' costs of appeal, including the costs of two counsel.

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R M MARAIS
JUDGE OF APPEAL

VAN HEERDEN DCJ)
SMALBERGER JA)
GROSSKOPF JA) CONCUR
HOWIE JA)

<u>TEK CORPORATION PROVIDENT FUND AND 10 OTHERS</u>

V

R S LORENTZ

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3 September 1999 Case No 490/97

CORAM: VAN HEERDEN DCJ, SMALBERGER, HOWIE *et* MARAIS JJA

Pension Scheme - surplus in fund - entitlement thereto - competing claims by employer and employees - "contribution holiday" - when permissible. Dicta in Sauls v Ford South Africa Pension Fund and Others (Case No 1878/87 South Eastern Cape Local Division) and Rössing Pension Fund v Lyners and Others, 20 November 1996 overruled - effect of registrar's approval in terms of sec 14 (1) of Pensions Funds Act 24 of 1956 considered.

R M M