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Pension Update

November 2006

Pension Matters – The Good, the Bad and the Undecided

Recent judicial activity continues to create opportunities for legal proceedings in respect of pensions. But are we litigating pension plans out of existence? Will be then do the same for group savings plans?

Buschau v. Rogers Communications Inc: A Dent in the Classic Trust Approach to Pensions

The Supreme Court of Canada's June 22, 2006 decision in *Buschau v Rogers Communications Inc.* is the first decision of that Court to limit the application of classic trust law to pension trusts. It gives clear recognition to the discretion of the Superintendent where there is a legislative scheme in place. That is the good news. It is also the bad news.

The good news: pension plan members and beneficiaries cannot themselves force a wind up of a pension plan. It had been argued that if all members and beneficiaries consented, the pension trust could be wound up under the common law rule in *Saunders v. Vautier,* an ancient (1841) decision, which, as the Court stated, was developed in circumstances very different from the modern pension plan trust. This finding was a little weakened by the suggestion that the rule in *Saunders v. Vautier* might still apply in small plans. However, employers will be comforted that the members cannot band together at a point where there is surplus in a plan where benefits are still being accrued to have it wound up. If members believe the plan should be wound up, they must cause the Superintendent to require the wind up, and the Superintendent must act within his/her legislative authority in doing so.

More good news: an explicit statement that the 1994 decision of that Court in *Schmidt v. Air Products* stands for the proposition that only *applicable* principles of classic trust law apply to pension trusts, not *all* principles. If there is a clear legislative scheme in place, it supplants classic trust law. The Court found there was a clear legislative scheme in respect to the wind up of a pension plan, both the requirement to wind up and the process of winding up, in the federal *Pension Benefits Standards Act.*

The bad news: the deference to the discretion of the Superintendent to require the wind up of a pension plan. Particularly from an Ontario legislation perspective, employers have wanted the assistance of the courts in applying the sometimes vague requirements of section 69 of the Ontario *Pension Benefits Act.* The legislation of other jurisdictions is also somewhat opaque, perhaps all the better for the regulatory authorities to exercise discretion. In *Buschau,* the Court seemed to allow a wide interpretation of the federal equivalent to Ontario's section 69(1)(a) – discretion to wind up when there is a cessation of contributions to the plan. In neither jurisdiction does the provision distinguish between plans where contributions are required but are improperly ceasing to be made, and plans where contributions have ceased quite legitimately because contribution holidays are being taken from the surplus in the plan.

The Court does seem to have issued a clear invitation to the Superintendent to wind up the Rogers plan in the circumstances. The Court commented on the similarity to the facts in the *Huus* decision of the Ontario Court of Appeal in 2002, often referred to as the *Weavexx* case. Both involved mergers of a plan with surplus with another plan in order to use up the surplus in that other plan, where members of the plan with surplus had called for a wind up of the plan before the merger. The implication of the Court in *Buschau* seems to be that the Superintendent in the *Weavexx* case should have required the wind up before the merger. The accepted view of that decision, however, has been directed towards procedural fairness: that the Superintendent should have considered the members' request for a wind up, not that the Superintendent should have actually required the wind up.

The Court also seems to suggests that the B.C. Superintendent deal with surplus distribution issues without the intervention of the courts based on the legislative scheme. This would be difficult in Ontario because of the effect of the *TecSyn* decision, which is to require an application to the court to vary the trust. The Court's suggestion would be more palatable if the B.C. legislative scheme dealt more clearly with trust law.

There are of course other matters which trust law is invoked that are also addressed in legislation; for example the payment of plan expenses from the plan, plan mergers

and asset transfers on the sale of a business. It would be difficult to argue that the legislation of any jurisdiction provides a detailed and useful code in these matters. Accordingly, *Buschau* may be limited to plan wind ups.

Of special interest is the cost award given to the trust company, National Trust, in the proceedings before the Supreme Court of Canada. National Trust argued against the application of the rule in *Saunders v. Vautier,* taking the understandable position that there was no authority under pension legislation or the trust agreement to wind up the pension trust except in accordance with the legislation.

Abbott v. Lockheed: Forerunner for Disclosure of Fees in CAPs?

Members of a 401(k) plan in the U.S. (analogous to a Group RRSP in Canada) have alleged a breach of fiduciary duty of the employer/administrator in permitting unreasonable fees and charges to be charged to a 401(k) plan, and the failure to disclose such fees and charges. In this case the service providers apparently took a percentage of the management fees for the particular funds, undisclosed to the member fundholders.

The members were also permitted to invest in the stock of the employer, but the stock was mingled with cash in a single fund and a management fee charged, so that the members who invested in company stock were worse off than if they had invested in the stock in the open market. This case has only gotten so far as pleadings, but the statement of claim is an eye opener as to the hidden fees and charges in Canadian capital accumulation plans. We suspect many employers themselves are not aware of the fees and charges that are levied against members directly or indirectly.

Nolan v. Ontario (Superintendent of Financial Services (the “Kerry case”)

The March 15, 2006 decision of the Ontario Divisional Court that we reported in the previous Pension Update has been appealed and will be heard early in 2007.

The Divisional Court decision caused concern in the pension industry because of two of its holdings. The first was that amending a pension plan to permit the payment of administrative expenses from the pension fund was a breach of the pension trust. The second was that surplus in a defined benefit component of a pension plan could not be used for the employer contributions to the defined contribution component.

A decision of the Ontario Court of Appeal on both these issues will be welcome.

Commentary on R. v. Norton

A Provincial Court Judge has delivered another zinger to the pension industry.

In a disturbing decision, with an apparent disregard of common usage in contracts, practice and terminology, the Court held that for purposes of criminal culpability under the *Pension Benefits Act* (Ontario), individual actuaries are agents of the pension plan administrator. As such, they are held to the same standards of care as administrators. However, the firm that employs those individual actuaries is not itself an agent of the administrator. Nor is it, apparently, an “actuarial firm.”

The foregoing conclusions are those of His Honor W.P. Bassel in *R. v. Norton*, in a decision released June 23, 2006, in respect of a pre-trial motion. The decision did not address the merits of the charges against the individual actuary and the firm that employed him (these charges regarded overstatements of the assets of two pension plans), but rather the basis under which such charges could be properly brought under the *Pension Benefits Act.*

Individual actuaries alone have culpability

There can be little doubt that the individual actuary is caught by the express words of Regulation 16 in respect of the requirements to follow accepted actuarial practice and the requirements of the *Pension Benefits Act.*

The problematic finding is that the individual actuary is the *agent* of the administrator, and so caught by the standards and duties of section 22(1) and (2). If that finding is correct, it follows that the individual actuary is also bound by the conflict of interest restriction in section 22(4).

As to the firm that employed the individual actuary, the Court held that that firm was not and could not have been the actuary, because an actuary must be an individual. The

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firm was not an agent of the administrator in the preparation of valuation reports because the firm was not itself an actuary. Nor was the firm vicariously liable for the breach of the *Pension Benefits Act* by its employee because the statute did not impose a direct primary duty on the employer.

Why not actuarial firms?
Employers often (if not usually) contract with the firms that employ actuaries, not with individual actuaries, unless such actuaries are sole practitioners. Engagement letters may or may not specify the name of the individual actuary providing the actuarial services, and they may provide for changes in the individual actuary who is assigned to the client.

In many cases, the contract may be specified to be between the actuarial firm and the employer in its role as employer, not in its role as administrator.

Further, the engagement letter between the actuarial firm and the employer may well provide that the firm (or individual actuary) in performing services which are clearly actuarial services, such as preparing valuations, is acting as a professional advisor and not as an agent. However, there is no indication in the decision that the Court received or considered the actual contract in the case.

As an aside, firms that employ actuaries are commonly called "actuarial firms" which is a term well understood in the pension industry, if not by the Provincial Court, although such firms may also describe themselves as employee benefit consulting or human resource consulting firms.

So, do we need two actuaries?
Actuaries are used to stick-handling the inherent conflict in being engaged by the employer, and acting in the employer's interest within the confines of legislative and professional standards, which do require regard for the plan members. They also have to withstand the scrutiny of pension regulators.

But perhaps every pension plan does need two actuaries, one for the employer and one for the administrator. Some industry experts have been making that point for years, and such is the requirement in the U.K.

Apart from the additional costs to the employer, which would be substantial, it is not clear what exactly the respective roles of the two actuaries would be. It is difficult to see why an employer would totally relinquish control over funding. Some employers and pension committees are currently wrestling with this issue.

Impact of decision
The decision did not address the liability of the actuarial firm for acts or omissions by its employees under civil proceedings. It is certain that the firm, as well as the individual, would be named in any civil lawsuit brought against an actuary by the employer, by plan members, or by an appointed administrator of an insolvent plan, and would be held liable for the acts of its employee, for failure to supervise if for nothing else. The law as to whether the plan actuary has a fiduciary duty to the plan members is developing.

In any event, the characterization of the actuary as an agent of the administrator by the Court in *Norton* will clearly impact such relationship issues, the issue of the applicable standard of care and the issue of conflict of interest for the purposes of civil liability.

Employers of actuaries (if we are not allowed to use the term "actuarial firms") will no doubt be relieved that they are not agents of the administrator, and have no vicarious liability for the breaches of the *Act* by their employees.

But individual actuaries should be concerned that if their firms are not liable, those firms may have less interest in the defence of the actuary. Will firms leave the heavy costs of defence of the criminal charge, and the severe professional consequences of a conviction, on the shoulders of the individual, while settling whatever civil actions are flying about?

How binding is the decision?
The decision in *Norton* was issued by a judge of the Provincial Court. Accordingly, it will probably be treated as having no binding effect and limited persuasive effect on federally appointed judges of higher courts, and probably very little effect, if any, outside Ontario.

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The analysis in *Norton* seems strained. For one thing, it is not evident in the decision that the engagement letter between the actuarial firm and the client was introduced in evidence or considered by the Court. For another, there seems little question that the actuarial firm would not only be named, but be liable to the client in a civil lawsuit; it seems anomalous that the firm would be responsible for the acts of an employee in a civil but not a criminal forum.

The trial has been held and a decision is expected in February of 2007.

If the individual actuary is convicted at the actual trial, it can be reasonably anticipated that the basis of the charges will be appealed at that point. If he is exonerated, there will be no higher court determination of the troublesome agency issue. For the sake of pension administration and governance, it would be helpful to have the decision of a higher court in the matter.

For the time being, however, we are left with the decision in Ontario,—however uncertain its foundation. Practically speaking, it is unlikely that charges will be brought against employers of actuaries for breaches of the *Pension Benefits Act.*

Future judicial decisions may or may not favour the actuaries' view of their professional activities and relationships. We doubt that any new legislation would have the effect of absolving either actuarial firms or individual actuaries of responsibility for breaches of the *Pension Benefits Act.* In any event, it would be prudent for actuarial firms and individual actuaries to review both their standard engagement letters and the terms of their errors and omissions coverage.

Pallett Valo LLP Pension Law Group

The Pallett Valo Pension Group has the senior counsel experience and capability to deal with all aspects of the establishment, operation and dissolution of pension plans. These can include plan mergers, asset transfers, surplus management and withdrawal, partial wind-up issues, as well as employer-sponsored retirement or savings arrangements (savings plans, Group RRSPs, defined contribution plans, defined benefit plans and executive supplementary arrangements). Recent regulatory guidelines governing capital accumulation plans have added a layer of complexity to these arrangements. We also advise and help develop compliance and good governance procedures in accordance with best practices to minimize liability of employers, administrators and custodians.

The members of the Pension Group work closely with the Pallett Valo Insolvency and Corporate Restructuring Group for the restructuring of pensions and other retirement or savings arrangements, and with respect to employee medical and insurance benefits.

Contact Members of the Pension Law Group at Pallett Valo LLP

Priscilla Healy phealy@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 255

Michael Nowina mnowina@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 285

John Varley jvarley@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 291

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If you would like additional copies of the bulletin, or know of anyone who would be interested in joining our mailing list, please contact **Jenny Chiu** at **jchiu@pallettvalo.com**.

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