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Pension Update

September 2007

Three Not So Easy Pieces

Three recent judicial decisions. Three courts at different levels. All dealing with surplus in one way or another and all seeming to favour the employer. All have complex sets of facts or leave unanswered questions that make it difficult to extrapolate the holdings of the courts to similar situations with confidence.

Rogers v Bushau, a decision of the Supreme Court of Canada, released June 22, 2006.

Kerry (Canada) Inc. v. DCA Employees Pension Committee, a decision of the Ontario Court of Appeal, released June 5, 2007. (Application for leave to appeal to the Supreme Court of Canada has been made.)

Sutherland v. Hudson's Bay Co., a decision of the Ontario Superior Court of Justice, released July 31, 2007. (To be appealed.)

From these three decisions come three general principles that signal the directions in which the courts seem to be going, and a number of more particular principles, that will be welcome to employers, as long as long as they are supported in individual cases by plan and trust language.

The General Principles:

- Classic trust law does not necessarily apply to pension trusts. It can be displaced by a legislative scheme.
- Pension Plans have an important social value recognized by legislation that courts should take into account in arriving at their decisions. A fair and delicate balance between the interests of the employer and employees should be maintained.
- The reasonable expectations of the employer in establishing a pension Plan must be taken into account in interpreting a pension Plan and trust, including exclusive benefit language.

The first two principles were articulated by the Supreme Court of Canada in the *Bushau* decision. The third principle was most strongly articulated by a Justice of the High Court in *Sutherland*, but was also suggested in *Kerry and Bushau*.

Further, given the departure by the Supreme Court of Canada from the strict imposition of classic trust law to pension trusts, legislatures may be encouraged to provide more comprehensive legislative schemes in problematic areas where classic trust law is currently being applied, such as plan mergers and asset transfers. Such provisions would decrease the costs and uncertainties of pension trust litigation. The existing uncertainties help neither the employer nor plan members.

The Particular Principles:

Follow with caution: The application of most of the following principles to particular plans is dependent upon the present and the historic plan and trust language.

- Plan members cannot invoke the ancient British trust law rule in Saunders v. Vautier to force the wind up of a pension plan by unanimous agreement of plan beneficiaries. *Comment: The Court did not completely close the door to the use of the rule, suggesting that it might be invoked in some circumstances, e.g. a plan limited to a few senior executives.*
- A closed plan can be reopened. Reopening a plan for

the purpose of preventing a wind up and the consequent distribution of surplus is not a contravention of the employer's duty to act in good faith in amending a plan.

- A defined benefit plan governed by a trust can be merged with another defined benefit plan governed by a different trust and the surplus in one plan can be used to cover the deficit of the other.
- Plan expenses going to the administration of the plan (though not employer related expenses) may be paid from the pension fund. The payment of expenses from a plan that is subject to a trust is subject to trust law, but the general law of trusts contemplates that trust expenses may be paid from the trust unless another intention is evident. Silence as to the payment of expenses does not mean that the employer is prohibited from paying expenses from the pension fund.
- Exclusive benefit language in a defined benefit plan or related trust agreement need not preclude:
  - employer contribution holidays otherwise available under the applicable legislation
  - the addition of new groups of members to a plan
  - plan mergers
  - the addition of a defined contribution component directly or by way of plan merger.
- an employer is not subject to a fiduciary duty to members when amending a plan. The employer cannot act for an improper purpose and is bound by a duty of good faith. However, this does not mean exclusive concentration on the effect on existing plan members.
- a conversion of a defined contribution plan into a defined benefit plan is an adverse amendment. The administrator is required to give notice under Section 26 of the *Pension Benefits Act* (Ontario). However, failure to give adequate notice to plan members of an advance amendment does not necessarily result in the revocation of, or the refusal to register, a plan amendment.
- Contribution holidays may be taken so long as the plan does not prohibit them (e.g. there is no specific formula for employer contributions in the plan text or specific legislation requiring such contributions). Exclusive benefit language and member entitlement to surplus on plan wind up do not negate the right of the employer to take contribution holidays. *Comment: This was settled law in the 1994 Supreme Court of Canada decision in Schmidt, and stays settled notwithstanding repeated challenges from plan members.*
- A plan may introduce a new category of members under a power to unilaterally amend the plan and contribution holidays can be extended as to those members. *Comment: The courts also seem to be suggesting that there is no difference in principle in amending a Plan to permit new members and a plan merger.*
- Surplus from a defined benefit component of a plan can be used for employer contributions to a defined contribution component of the same plan.
- The establishment of a defined contribution component of a defined benefit plan does not constitute the creation of a separate plan.
- The suspension or cessation of employer contributions as a ground for the power of the Superintendent to require a wind up does not extend to a cessation of contributions because of contribution holidays that have been validly taken. *Comment: Although the decision on this point relates to federal*

pension legislation, it will be useful in jurisdictions with similar legislation.

This Pension Update will first outline the facts of each case, summarize the decisions of each of the three Courts, and then raise some questions that arise from the decision.

Bushau v. Rogers Communications Inc. (Supreme Court of Canada)

The facts:

- The Plan and trust were established in 1974 by Premier Communications, which was later acquired by Rogers Communications Inc. ("RCI"). The Plan was a defined benefit plan.
- The Plan provided that surplus on plan termination would go to the Plan members. In 1981, the Plan was amended by the employer to provide that surplus on Plan wind up would revert to the employer.
- In 1984 the Plan was closed to new members.
- RCI began to take contribution holidays in 1985.
- In 1992 the Plan was merged with other RCI pension plans. The pension trusts of the merging Plans were not merged.

Members' claims:

The members sought to terminate the trust for the original Premier Communications Plan and to thus obtain the surplus in the Plan that would be payable to them on Plan termination.

The Court's ruling:

The Court held that members of a pension plan cannot invoke the rule in *Saunders v. Vautier* to terminate the Plan. Pension trusts are subject to all applicable trust laws, but such trust laws can be displaced by legislation which displaces the common law rules. Applying the rule in *Saunders v. Vautier* would disregard the employer's role in respect of the Plan and the trust, circumvent the terms of the contract at the root of the trust and the reasonable expectations of the parties, and make the legislative framework for the termination of pension plans irrelevant.

A pension trust cannot be terminated without taking into account the plan for which it was created and the specific legislation governing the plan. In this case the power to terminate a plan and to deal with issues relating to wind up was held to lie with the Superintendent, as part of the legislative scheme governing pension plans. Whether or not a closed plan can be reopened is also a question for the Superintendent. The court cannot simply assign the responsibilities of the administrator and the Superintendent to the trustee/custodian in a manner contrary to the legislative scheme; moreover, such responsibilities are not within the authority and power of the trustee/custodian under the trust agreement between the trustee/custodian and the employer. Where the PBSA provides recourse to plan members, they should use it, including the right to ask the Superintendent to exercise his powers.

Powers of amendment of the employer are not forfeited or barred because of the closure of the plan. An employer is under a duty of good faith in making plan amendments, but that duty requires the employer to act in such a way as to ensure the protection of employees' pension benefits, not in a way that would reduce, threaten or eliminate them. In this case since reopening the Plan would not deprive the members of the benefit of the rule in *Saunders v. Vautier*, since they at no time had the benefit of the rule, it did not affect those benefits.

The Court also held that there were no legislative grounds for the termination of the Plan by the Superintendent. The

suspension or cessation of employer contributions as a ground for termination did not include the suspension or cessation of employer contributions because of contribution holidays validly taken. (The federal Superintendent subsequently refused to terminate the portion of the Plan that was the original Premier Communication Plan.)

Unanswered questions:

- Exactly when and how will the legislative scheme displace a classic trust principle? There are robust legislative schemes that deal with the distribution of surplus on plan wind up. Why couldn't such schemes be considered to displace classic trust law? The horse is out of the barn on this issue, but there may be others that legislatures could develop.

Kerry (Canada) Inc. v. DCA Employees Pension Committee (Ontario Court of Appea))

The facts:

- The Plan was established by Canadian Doughnut Company Limited in 1954 as a defined benefit Plan. A separate trust agreement was entered into at that time. Kerry (Canada) Inc. ("Kerry") is the successor to the Canadian Doughnut Company Limited.
- The trust agreement provided that the expenses of the trustee/custodian would be paid by the Company. The original Plan text was silent as to the payment of Plan expenses.
- The trust agreement contained exclusive benefit language.
- The amendments to the Plan in 1975, 1987 and 2000 purported to give the employer the power to pay Plan expenses from the fund. The employer paid all Plan expenses up to 1985. Beginning in 1985 third party expenses were paid from the pension fund.
- A defined contribution component was introduced into the Plan in 2000. Existing members could convert their defined benefit entitlements to DC accounts, or retain their accrued defined benefit in the DB component. New members were required to participate in the DC component. Thereafter the DC component contained new members and those in the original DB component who had converted their DB entitlements. The 2000 amendment confined the beneficiaries of the DB fund to members of the DB component of the Plan. Members of the DC component were not designated Fund beneficiaries. The Plan provided that the DB and DC funds were separate and that there was no recourse from one to the other.
- The employer took contribution holidays from 1985 to 2001, using DB surplus to fund the DC component.
- The monies contributed to the DC component were held by Standard Life Assurance Company pursuant to an insurance contract. The policyholder was the Company.

Members' claims:

Plan members claimed that the expenses paid from the pension fund must be repaid, that surplus in the DB component could not be used to fund the DC component, and that since adequate notice was not given of the Plan conversion, the Superintendent should have refused to register the Plan conversion amendment.

The Court's ruling:

The Court held that in accordance with general trust practice and principles, the expenses of administering a

pension trust, including expenses for actuarial, accounting and investment functions, are payable by the trust. Since the employer undertook to pay the trustee's expenses, it retained the obligation to do so. The exclusive benefit language of the trust agreement was directed to "true" amendments; that is, amendments that change a party's rights or obligations. Since the employer had no obligation to pay the expenses of the Plan (except as specified in the trust agreement) the amendments to the effect that the expenses of the Plan would be paid from the fund did not contravene the exclusive benefit language. However, neither silence as to the payment of plan expenses in plan and trust documentation, nor the voluntary payment of those expenses by the employer over a period of time, created a legal obligation of the employer to pay expenses, nor did they amount to a revocation of the pension trust. A revocation is the return of monies to the person who placed the funds in trust.

As to the contribution holiday issue, the Court held that the addition of the DC component did not create a new Plan. Cross-subsidization of the DB to the DC component was not prohibited, as long as the DC members were designated beneficiaries. The Plan could be so amended with retroactive effect, and the members would be so designated. The requirement to make contributions is not a separate trust obligation. Since members do not have an enforceable claim to surplus while a pension plan is ongoing; it follows that they cannot compel employers to make contributions to preserve or increase the actuarial surplus. Contribution holidays do not constitute a partial revocation of trust since there was no binding promise to pay certain monies to the fund, but only to make contributions when necessary. A policy interest in ensuring that a pension plan is well funded does not mean that contribution holiday provisions need be construed narrowly.

As to notice, the Court held that the conversion from a DB to a DC Plan is an adverse amendment under Section 26 of the *Pension Benefits Act* (Ontario). Accordingly there was the requirement to give notice under that provision. However, the Superintendent may register an amendment even if inadequate notice has been given. Further, the Superintendent may register an amendment even if he is concerned that it may be invalid, since the legality of Plan provisions is often a difficult question that requires determination by an appropriate adjudicative body.

Unanswered questions:

- Could the obligation to pay the expenses of the trustee/custodian have been eliminated by entering into a trust agreement with a different trustee? One would think that the payment of the expenses of the trustee, unless set out in the Plan, would be a matter of contract between the employer and the trustee.
- The Court states quite clearly that the payment of monies to the employer to reimburse the employer for Plan expenses would constitute a revocation of the trust as a return of contributions in this case because of the exclusive benefit language in the trust agreement. However, monies could be paid by the trustee directly to third parties for the same Plan expenses without revoking the trust. This ignores the distinction between the employer in its capacity of plan administrator being reimburse for expenses of administration, and the employer in its capacity of plan sponsor receiving a return of contributions as such. Further, a prohibition against reimbursing the employer for expenses of administration while permitting the payment directly to third parties appears to be a matter of form over substance.
- The decision does not address very satisfactorily the fact that under the Plan terms there was no recourse from one fund to the other.

Sutherland v. Hudson's Bay Co. (Ont. Superior Court of Justice)

The facts:

- The Plan was established in 1971 as a defined benefit Plan of Simpsons, Limited (Simpsons). A separate trust agreement was entered into at that time. That trust agreement was incorporated by reference into the Plan and the Plan was similarly incorporated into the trust agreement.
- Simpsons was taken over by Hudsons's Bay Company ("HBC") in 1991.
- The Plan was closed to new members in 1988.
- Amendments in 1994 and 1998 changed the definition of Member, and made other changes, which involved:
  - A reopening of the Plan.
  - The addition of Zellers and Kmart (part of HBC's corporate family) as participating employers.
  - The creation of a defined contribution component of the Plan.
  - The extension of contribution holiday provisions to include employer contributions for Zellers and Kmart employees under the defined contribution component of the Plan.
- The defined contribution Plan component was established pursuant to an insurance contract.
- The assets of the DC component of the former Zellers and Kmart Plans were subsequently merged into the Plan.
- Apparently the DC component initially did not consist of self-directed accounts. However in 2001 the DC accounts became self-directed under a new insurance contract with Standard Life. The contract with Standard Life was between HBC, Royal Trust and Standard Life. Standard Life was the agent and service provider for the DC Plan component. The earlier Sun Life policy in favour of HBC as policyholder did not appear to be part of the trust; however, it was folded into the Standard Life policy arrangements.
- The Plan and the trust agreement included exclusive benefit language.

Members' claims:

The employees of the Plan who were members at the time that it was closed to new members claimed that various breaches of trust had occurred:

- The use of the surplus existing in the Plan before the addition of the DC component and new participating employers; and
- The amendment of the Plan to permit the reopening of the Plan (the Superintendent had threatened to require a wind up).

The Court's ruling:

The interesting principle of plan and trust interpretation, strongly articulated in the Sutherland decision but also suggested in *Kerry and Bushau* is that the interpretation of a plan document, including the trust agreement, at any particular time should be approached by addressing the intention of the employer/settlor at the time of the creation of the plan and the establishment of the trust.

The original Plan defined "Company" as follows: "Simpsons Limited and its subsidiaries and shall for the purposes of this Plan include such of its wholly-owned subsidiary companies and associated companies as shall

have been designated for this purpose by the Board of Directors of the Company and its and their respective successors."

The Court interpreted that definition very broadly as accommodating the numerous corporate developments that could reasonably be expected to occur over the course of the corporate life of Simpson:

- Not restricting membership to employees of companies in existing relationships.
- Including employees who became employees of Simpsons by virtue of a corporate amalgamation by operation of the law of amalgamation.
- Including of employees of successors to Simpsons ie. HBC, including its network of corporate relationships.
- Not restricting employees to employees of companies who were in the same line of business as Simpsons.

The Court also interpreted the exclusive benefit provisions broadly as not restricting the nature of the benefits that could be provided under the Plan to the defined benefit provisions of the original Plan.

Given its interpretation of the Plan and trust in the light of the intention of the original settler, the Court held that the members' claim to a breach of trust by HBC failed. HBC had done nothing that was not within the possibilities contemplated in the original Plan.

This decision includes a useful discussion of the employer's duty in amending a Plan, which supplements the discussion in *Kerry*. The Court said there was no employer's fiduciary duty as such in amending a Plan, but there was a duty not to amend the Plan for improper purposes or a duty to act in good faith. (The Court equated these standards). Again the Court returned to the intention of the original Plan, stating that the test of proper purpose is the consistency with reasonable expectations for the scope and nature of the trust fund at the time of its creation.

The Court stated that the duty of good faith does not mean exclusive concentration on the effect of a plan amendment on the existing plan members. Improper purpose or acting in bad faith could include:

- Coercing members to abandon their rights under a pension plan;
- Granting enhanced benefits to employees in their capacities as shareholders; or
- Retaining plan surplus on a sale of assets or sale of surplus.

but in this case did not include:

- Reopening the Plan to avoid a wind up since the trust fund was still being used for the members. Since the members could not require a wind up, reopening of the Plan did not take away any right to surplus that would arise only on wind up.
- Restoring powers to designate new participating employers that had been voluntarily relinquished in 1988 with the closing of the Plan.

Unanswered questions:

- If the Plan wound up with a deficit in the DB component, would the DC accounts be proportionately reduced? Could language in the Plan avoid either of these results?

Our Recommendations to Employers

As we have noted throughout, an employer cannot rely upon the principles gleaned from the three judicial decisions considered in this article without a careful

consideration of the specific language in the plan and trust agreements throughout the history of the plan. Accordingly we strongly recommend that employers seek legal advice if they are contemplating, or if you have implemented and have concerns as to, any of the following:

- The addition of new groups of members/participating employers to pension plans;
- A DB-DC plan conversion;
- The addition of a DC component to a DB Plan;
- A plan merger;
- Any other asset transfer;
- The payment of plan expenses from the pension fund; or
- Closing a plan to new members; or
- Reopening a closed plan.

Sooner or later, if the issues have not been properly addressed, they well may surface, perhaps in the context of a sale or reorganization of business, perhaps in the context of a distribution of surplus, perhaps in the context of a wind up or partial wind up. If there is a legal challenge, the courts may or may not want to go your way; they can only go your way if there has been careful knowledgeable drafting.

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.

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