

## PENSIONS & EMPLOYEE COMPENSATION BULLETIN

October 2007

### USE OF PENSION PLAN ASSETS TO FUND EXPENSES AND ISSUES ON INTRODUCING A DEFINED CONTRIBUTION COMPONENT STILL IN LEGAL LIMBO

#### EVOLVING ISSUES WORKING THEIR WAY THROUGH THE COURTS

Ontario courts have recently issued two decisions of interest to pension plan sponsors. The cases focus on the use of pension fund assets to pay plan expenses and also address issues related to introducing a defined contribution component (“DC Component”) into an existing defined benefit (“DB Component”) pension plan. We understand that leave to appeal to the Supreme Court of Canada is being sought in one case and the other case is under appeal. Although the appeal process may result in changes to both decisions, this bulletin summarizes the Courts’ deliberations to date in these evolving areas of pension law. We will issue further bulletins as the appeals are decided.

#### *Kerry (Canada) Inc. v. DCA Employees Pension Committee (“Kerry”)*

In June 2007, the Ontario Court of Appeal released its decisions on the validity of an amendment to the trust agreement to permit payment of plan expenses where the original trust agreement was silent on the issue. Also at issue was whether the employer could use surplus funds to fund the employer’s required contributions to both the DB Component and the DC Component of the plan. In September 2007, the court released a separate decision on the issue of responsibility for the costs involved in the actions. The Court of Appeal held that:

#### Plan Expenses

- It was permissible for the pension fund to pay third party expenses despite the fact that the original trust agreement required the company to pay trustee expenses and the trust agreement included a statement that the pension funds were to be used for the “exclusive benefit” of the members.
- The amendment to the plan to allow payment of third party expenses out of the pension fund did not constitute a revocation or partial revocation of the trust since no trust money was returned to the company and the trust agreement allowed the company to make this type of amendment.
- Even if the trust agreement was silent on the issue of plan expenses, silence does not create a requirement that the employer pay un-allocated expenses.

#### Addition of a DC Component

- The plan provisions permitted the employer to amend the plan to add a DC Component and the addition to the existing DB Component did not result in two separate pension plans.
- Since there was no language in the plan documents to prohibit the employer from taking contribution holidays, the employer could use surplus funds arising in the DB Component to fund its required contributions for both the DB Component and the DC Component of the plan. Both components constitute one pension plan and the plan documents did not prohibit cross-subsidization between each component.
- If members of the pension plan are entitled to surplus assets remaining in the fund on the termination of the plan, then members of the DC Component have the same entitlement as members of the DB Component regardless of whether such surplus funds were created in the DB Component.

### Costs

- Costs of the action could be paid out of the trust fund where either: (a) a plan does not state the rights of the unsuccessful parties to pension fund assets clearly or unambiguously; or (b) it is reasonable to consider that the claims of the unsuccessful party were advanced for the benefit of all persons beneficially interested in the trust fund.
- In this case, the claims of the plan member committee did not fall within either category and the Court ordered the committee to pay the company's costs.

### *Sutherland, Scott et al. v. Hudson's Bay Company ("Hudson's Bay")*

In July 2007, the Ontario Superior Court of Justice released its decision on the validity of amendments that allowed the plan sponsor to add a DC Component to the DB Component of the plan and to fund its required employer contributions for both components of the plan out of surplus assets in the pension fund. The court held that:

#### Addition of a DC Component

- The plan could be amended to add a DC Component and DC Component members would be entitled to assets in the same trust fund assets as DB Component members.
- The employer could use surplus assets in the trust fund to fund its required contributions to the DC Component without contravening any rights of employees. The employees are only entitled to claim a right to surplus when the amount of surplus becomes ascertainable on termination of the plan.
- If there is no restriction in the plan provisions, an employer may use surplus assets to fund its required employer contributions where:
  - o the members of the new DC Component of the plan are within the class of potential members of the plan;
  - o the provision of DC Component benefits is within the scope of the purposes for which the trust fund was established; and
  - o the plan is not being amended to establish a separate trust fund for the purpose of restricting the funding to DC Component benefits.
- Even in the case of a trust that is being held for the "exclusive benefit" of plan members, there is no absolute requirement on the merger of multiple plans to keep the assets of the trust separate from the assets of the other merging plans. However, an employer is prohibited from cross-funding merging plans where the plan documentation requires the plan administrator to maintain separate plans and trust funds.
- A proposed amendment that provides benefits to parties who are not within the contemplated class of members of the plan would constitute an unauthorized gift of trust property and is invalid.
- The plan amending power must be exercised in good faith and for proper purposes.
- The test to determine whether an amendment is made for a proper purpose is whether its effect is consistent with reasonable expectations of the scope and nature of the trust fund at the time of its creation.
- The test to determine whether taking a contribution holiday constitutes a proper purpose is whether the use of the surplus assets to fund the contribution holiday is consistent with the purposes of the plan and trust fund.
- If the Court finds that an amendment was made for an improper purpose and orders the return of the improperly used assets, then the assets would be returned to the pension fund, and not to the plan members.

#### Cases Under Appeal

As mentioned above, in *Kerry* the plan members have applied for consent to appeal the case to the Supreme Court of Canada. Similarly, the plan members in *Hudson's Bay* have appealed the Ontario Superior Court's decision. Until the

appeals in both cases are resolved, the law in respect to payment of plan expenses and the use of plan assets to fund an employer's required contributions to a DC Component is still unsettled. We will issue updates as each case works its way through the judicial system.

#### Recommended Action

In the meantime, plan sponsors should review current pension expense practices in relation to relevant provisions in pension plan texts and funding agreements to determine whether the plan documents support such practices. If not, plan sponsors should determine whether the plan terms permit an amendment to the plan to bring the plan in line with its practices or whether its expense practices should be brought in line plan terms.

Similarly, plan sponsors who are considering adding a DC Component to an existing DB Component of a pension plan should review plan provisions to determine whether the plan permits the employer to use surplus assets to fund its required contributions to the DC Component.

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*The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.*

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