

Update

Pensions Law

June 6, 2007

Ontario Court of Appeal Determines Key Pension Issues

The *Kerry* Case Revisited

On June 5th, 2007, the Ontario Court of Appeal provided clear guidance to the sponsors of defined benefit pension plans on the following key issues:

1. Payment of Pension Plan Expenses from the Pension Fund

Previously, Ontario's Divisional Court ruled that an amendment to the *Kerry* plan permitting payment of administration expenses (such as accounting, actuarial and legal fees) was improper, on the basis that the plan, which was subject to a trust for the exclusive benefit of the plan's members, did not contain an express power of revocation. The Court of Appeal set aside this decision, holding that such payments *can* be made from the pension fund because:

1. The *Pension Benefits Act* (Ontario) does not govern the payment of pension plan expenses;
2. There are no principles of law or trust that required the employer to pay the expenses;
3. The provisions of the pension plan did not address the payment of such expenses (aside from those of the plan's trustee, which the employer acknowledged it was required to pay); and
4. The proper administration of a trust fund necessitates incurring expenses.

It is important to note that in *Kerry*, the plan and trust documents were silent from the outset on this issue (other than trustee fees), so that when the plan was amended to specify that reasonable plan expenses could

be paid from the fund, there was no change in the rights or obligations of the parties. To determine whether routine plan expenses may be paid from a particular pension fund a careful analysis of all historical plan documents, including all plan texts and funding agreements, is required.

2. Contribution Holidays

The Divisional Court previously held that the employer was entitled to take contribution holidays in respect of the defined benefit portion of the pension plan, and the Court of Appeal did not disturb that ruling. It is now clear that an employer may take contribution holidays when a defined benefit pension plan is in a surplus position unless this is explicitly prohibited by the plan's provisions.

3. Cross-Funding Subsidization

In *Kerry*, the pension plan had been amended to introduce a defined contribution component, and existing members were given the option of continuing in the defined benefit portion of the plan or converting to the defined contribution component. The defined benefit portion of the plan had a surplus which the employer then used to fund its contribution obligations to the defined contribution portion of the plan ("cross-funding subsidization").

The Divisional Court held that this was not permissible on the basis that the amended plan was, in effect, two pension plans (a DB and DC plan), each with its own pension fund and members.

The Ontario Court of Appeal overturned this decision, ruling that the *Kerry* plan was one plan with two components. Further, it held that although the plan's provisions required the fund to be used "exclusively" for the benefit of plan members, it was an "open" pension plan that had ever-changing classes of employees. The Court noted that the cross-funding subsidization was not prohibited by the trust agreement. The trust agreement only prohibited the use of the fund other than for the exclusive benefit of the beneficiaries of the fund. Accordingly, the Court

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held that so long as the members entitled to defined contribution benefits were designated as fund beneficiaries of the Kerry plan, then cross-funding subsidization is permissible.

It is important to note that the Court of Appeal distinguished *Kerry* from the recent Ontario Court of Appeal decision in *Aegon*, which involved the merger of two independent pension plans. In *Kerry*, the pension plan was designed for all-full time employees from the outset, whereas in *Aegon*, neither of the merged plans contemplated the existence of the members of the other.

4. Notice of Plan Amendment

The Ontario Court of Appeal determined that the plan conversion was an adverse amendment, and that the employer was required to transmit notice in compliance with the governing statute. It held further that the notice that was given in *Kerry* was inadequate. However, the Court determined that the Superintendent has the discretion to register an adverse amendment even where the notice provided was inadequate.

Please contact any member of our Pensions, Benefits and Compensation Group if you would like more information on these developments in pension law.

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