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Supreme Court of Canada Issues Definitive Guidance on Pension Plan Expenses and Use of Surplus

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Today, the Supreme Court of Canada released its judgment upholding the Ontario Court of Appeal decision in *Kerry (Canada) Inc. v. DCA Employees Pension Committee.*

The Supreme Court's decision provides helpful guidance on a number of important issues, including the payment of plan expenses from a pension fund, the use of actuarial surplus under a defined benefit ("DB") portion of a pension plan to fund employer contributions to a defined contribution ("DC") portion of the same plan, the appropriate standard of review to be applied to decisions of the Ontario Financial Services Tribunal ("FST"), and the circumstances under which pension related litigation costs are properly borne by a pension fund.

Of particular interest to employers, the Supreme Court confirmed that reasonable pension plan administration expenses are chargeable to a pension fund, unless expressly prohibited by the governing plan documentation (past and present). Also, the Court confirmed that there is no general rule against applying the surplus accumulated in a DB portion of a plan towards an employer's contribution requirement under the DC portion of the same plan.

HISTORY

The plan was established in 1954 by the Canadian Doughnut Company Limited (later, DCA Canada Inc.) and subsequently assumed by Kerry (Canada) Inc. (the "Company") in 1984. Throughout that time period, the plan was a DB plan funded through a trust, and the Company's practice was to pay the administrative expenses of the plan out of general corporate revenue. The original plan text was silent on the issue of payment of plan expenses. The trust agreement specified that the trustee's fees and any expenses incurred in the execution of the trust would be paid by the Company. The Plan was amended in 1975 to explicitly allow for the payment of expenses from the fund. Notwithstanding the amendment, however, it was not until 1985 that the Company began to have all third party plan administration expenses paid out of the trust fund.

In 2000, the Plan was amended to create a DC component for new employees. Existing DB members were given the option to convert their accrued defined benefits to a DC account balance. The Company had, since 1985, taken contribution holidays and continued to do so, using surplus held in the trust fund to make its DC contributions.

The conversion prompted a group of members and former members to ask the Ontario Superintendent of Financial Services (the "Superintendent") to investigate the propriety of the Company's actions, and specifically to order the Company to: 1) reimburse all plan expenses paid out of the pension fund, 2) reimburse all contribution holidays taken since 1985, and 3) refuse to register the 2000 plan amendment that created the DC component of the plan.

Following an investigation, the Superintendent proposed to order the Company to reimburse the pension fund for administrative expenses that were not for the exclusive benefit of the members. The Superintendent, however, did not refuse to register the 2000 plan amendment creating the DC component, and did not require the Company to pay back the approximately $1.5 million taken in contribution holidays. Following a hearing on the issues, the FST found that, for the most part, plan expenses had been properly paid from the Plan, notwithstanding trust language that stated that the pension fund was for the "exclusive benefit" of the members. However, it ordered the Company to repay certain consultant fees related to the conversion which were more properly characterized as employer expenses. The FST upheld the Superintendent's decision not to order the Company to pay amounts taken as contribution holidays from 1985 since it would have allowed the

Company to use surplus to meet its contribution obligations under the DC component of the plan, subject to a plan amendment. The FST's decision was largely overturned by the Divisional Court, and the Company appealed.

On the issue of plan expenses, the Court of Appeal held that, in the absence of a statutory requirement, or a specific undertaking made in the documents constituting the plan (such as the Company's undertaking to pay trustee fees and expenses), administration expenses could generally be paid from the trust fund. Silence in the documents did not create an obligation for the employer to pay. Consequently, it found that amendment to the plan expressly permitting reasonable administration expenses to be paid from the fund was permissible despite the "exclusive benefit" language in the trust agreement. The Court of Appeal clarified that only those expenses incurred on behalf of the plan were properly payable from the fund, and that expenses incurred by the Company for advice about the addition of the DC component under the plan were, in fact, expenses incurred for the benefit of the Company, thus largely reinstating the FST decision.

The Court of Appeal also affirmed the FST's decision that the Company was permitted to take contribution holidays under the DB component of the plan and that the contribution holiday taken in respect of the DC component was also valid, subject to the requirement of a formal plan amendment to include all plan members as beneficiaries under the trust. In doing so, the Court of Appeal rejected the Divisional Court's finding that the addition of the DC component created two separate plans with two separate pension funds.

Finally, the Court of Appeal held that the FST's decision not to order the Superintendent to refuse registration of the 2000 amendment was reasonable. It reached this conclusion despite finding that the conversion notice given to plan members may have been misleading. This aspect of the decision was not appealed to the Supreme Court.

THE SUPREME COURT OF CANADA DECISION

Applying a standard of "reasonableness", the Supreme Court upheld the Court of Appeal decision.

PLAN EXPENSES

The Court agreed that there was nothing in the Ontario *Pension Benefits Act* ("PBA") or at common law which obligated an employer to pay the expenses of administering a pension plan. It also held that the plan documents did not require, expressly or implicitly, that the Company be responsible for the payment of the plan expenses. In considering the language of the trust agreement, which the Court acknowledged required the Company to pay the expenses incurred specifically in the operation of the trust, the Court held that while the trust is an element of the plan, the expenses related to the execution of that trust are not inclusive of the broader administrative expenses of the pension plan such as actuarial, accounting, counsel and investment services.

The Court held that the exclusive benefit language in the trust agreement did not require the Company to assume responsibility for the plan expenses. It noted that the term "exclusive benefit" does not mean that no one but the members can benefit from a use of the trust funds; the exclusive benefit language did not, in its view, preclude an employer from enjoying a number of incidental benefits related the existence of the pension plan. The Court therefore held that it was to the "exclusive benefit" of the members to have the plan continue, and that the payment of plan expenses was a necessary component of its continuation.

The Court clarified that since the Company was not obligated to pay all plan expenses in this case, payment of proper administration expenses from the pension fund was not a partial revocation of the trust. Also, the Court concluded that the analysis does not change based on whether the expenses are charged by third parties or the employer itself. Once it has been determined that trust funds can be used for the payment of administration expenses, what matters is whether the funds are paying reasonable and "legitimate expenses necessary to the integrity and existence of the plan", not who provided the services.

CONTRIBUTION HOLIDAYS

The Court agreed that, from its inception, the plan permitted the Company to take contribution holidays. On the issue of using DB surplus to fund employer contributions to the accounts of DC members, the majority of the Court held that, because there is no statute or regulation prohibiting having both DB and DC components in a single plan or prohibiting a contribution holiday in respect of either component, the availability of a contribution holiday is dependent on the governing plan documents. The majority of the Court found that the DB portion and the DC portion were part of a single plan, and that, provided the plan is retroactively amended to make members of the DC portion beneficiaries of the DB trust fund, the terms of the plan permitted the contribution holiday.

The Court held that a retroactive amendment to make the DC members beneficiaries of the DB trust fund was not prevented by legislation. Since the DB members have no rights to actuarial surplus while the plan is ongoing, a retroactive amendment of this nature would not be taking away any vested property rights of the DB members; their interest in the actuarial surplus is only to ensure that it is neither withdrawn or misused.

LITIGATION COSTS

With respect to whether the costs of the litigation should be paid by the pension fund, the Court found that the nature of the litigation was adversarial and that expenses should not be paid from a pension fund in such circumstances. It also found that there was no reason to penalize the Company, since payment of legal costs from the fund could result in an earlier end to the Company's contribution holiday.

CONCLUSIONS

The Supreme Court's decision in *Kerry* has provided welcome clarification to a number of issues affecting employers who sponsor and administer registered pension plans. It establishes conclusively that there is no presumption that it is the employer's obligation to pay plan expenses, unless expressly required by the governing plan documentation. The decision also lays out a framework that assists our understanding of when employers will be permitted to use DB actuarial surplus to fund contributions under a DC portion of the same plan.

Employers or administrators wishing to charge administrative expenses to the pension fund, or that intend to take contribution holidays, should carefully examine all governing plan documentation, both current and historical, to determine whether any potential barriers exist.

If you have any questions about this important case, please contact one of the following members of the Pension & Benefits Group.

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