Exploring the *Kerry* Decision

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On June 5, 2007, the Ontario Court of Appeal released its decision in *Kerry (Canada) Inc. v. DCA Employees Pension Committee*[1]. This paper will review certain aspects of this decision and the post-*Kerry* environment.

Background

In 1954, the Canadian Doughnut Company Limited, which later became DCA Canada Inc., and was subsequently succeeded by Kerry (Canada) Inc. ("**Kerry**"), established a defined benefit ("**DB**") pension plan for its employees (the "**Plan**"). The Plan would be funded by a pension fund constituted as a trust (the "**Fund**") and both Kerry and the employees of Kerry would make contributions. Relevant terms of the 1954 Plan stated, in part:

> *"Trust Fund" means the Retirement trust Fund established, under the terms of the Retirement Plan and the undermentioned Trust Agreement, for the accumulation of contributions as herein described and for payment of certain benefits to Members.*
>
> *…However, all contributions made by the Company are irrevocable, and, together with all contributions made by members, may only be used exclusively for the benefit of Members, retired Members, their beneficiaries or estates and their contingent annuitants. No change or modification will effect any rights which such persons may have with respect to the terms of payment of, or the amount of, retirement income, which the contributions made by the Member and/or the Company, prior to the effective date of such change or modification, will provide.*

[1] [2007] O.J.No. 2176 ("*Kerry*").

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The 1954 trust agreement stated, in part:

> *WHEREAS it is deemed desirable that funds irrevocably contributed for the payment of benefits under the Plan be segregated and held in trust in a Trust Fund (hereinafter referred to as the "Fund") for the exclusive benefit of such employees or their beneficiaries or personal representatives…*
>
> *No part of the corpus or income of the Fund shall ever revert to the Company or be used for or diverted to purposes other than for the exclusive benefit of such persons or their beneficiaries or personal representatives as from time to time may be designated in the Plan except as therein provided.*

The Plan went through a series of amendments over the years. The amendments in 1975, 1987 and 2000 purported to give Kerry the power to pay the Plan expenses from the Fund. Until 1985, third party Plan expenses (such as the cost of actuarial, investment management and audit services provided to the Plan) were paid by Kerry. Afterwards, these expenses were paid by the Fund. The Plan was also amended in 1965 to explicitly refer to the company's ability to take contribution holidays. Beginning in 1985, Kerry took contribution holidays; that is, it made notional contributions to the Fund through utilizations of the actuarial surplus. By 2001, the total amount of contribution holidays taken amounted to approximately $1.5 million.

In 2000, the Plan was amended to offer a defined contribution ("**DC**") component. The Plan members were allowed to continue to accrue benefits under the DB provisions, or they could convert their accrued defined benefits into a lump sum and accrue benefits going forward under the DC provisions. All new Kerry employees were required to follow the DC scheme. Two classes of members were created by this amendment: those opting to remain in the DB

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component of the Plan (designated by the 2000 amendment as Part 1 members) and those participating in the DC component of the Plan (designated by the 2000 amendment as Part 2 members). The 2000 amendments expressly allowed Kerry to take contribution holidays in respect of Part 2 members using surplus in the Fund that had accrued prior to the introduction of the DC component (the "cross subsidization" issue).

Lower Decisions

After the 2000 amendments, the Superintendent of Financial Services (the "**Superintendent**") was asked by a committee of Plan members (the "**Committee**") to investigate irregularities in the administration of the Plan. After investigation, the Superintendent issued two Notices of Proposal: 1) to make an order requiring Kerry to reimburse the Fund for those third-party plan expenses that were not incurred for the exclusive benefit of the Plan members; and 2) to refuse to order Kerry to pay to the Fund that amount which equalled the total of contribution holidays taken. Denial of the registration of the 2000 plan amendments was also refused.

Kerry sought a hearing before the Financial Services Tribunal (the "**Tribunal**") on the first proposed order regarding the payment of the Plan expenses. The Committee sought a hearing before the Tribunal on the second proposed order regarding the contribution holidays.

Generally speaking, the Tribunal found in favour of Kerry on each issue. It held that the vast majority of the Plan expenses could be paid from the Fund and that Kerry was entitled to meet its contribution obligations by way of contribution holidays. It confirmed that surplus can be notionally applied against an employer's contribution obligation so long as the terms of the plan don't prohibit it (a specific formula for calculating the employer's annual contribution is an

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example of such a prohibition).[2] However, the Tribunal agreed with the Committee that the cross-subsidization was contrary to the terms of the trust. Since the trust provided that the Fund could only be used for the exclusive benefit of the Fund beneficiaries, and since the 2000 amendments stated that those beneficiaries were the Part 1 members, how could the surplus of the Fund be used to pay obligations related to the Part 2 members? It resolved this conflict by stating that it would allow the 2000 amendments to designate the Part 2 members as beneficiaries of the Fund, which was a designation allowed by the terms of the trust documents. Therefore, the cross-subsidization would not contravene the terms of the trust documents. The Tribunal did note, however, that the insurance policy that was used to fund for Part 2 members should be held by the trustee of the Plan.

The Committee appealed both decisions to the Divisional Court, who heard both appeals concurrently. The Divisional Court, granting little deference to the Tribunal and applying a standard of correctness, overturned the decisions of the Tribunal for the most part and also awarded the Committee costs for both the hearing at the Tribunal and the appeals to the Divisional Court.[3] Interestingly, the Divisional Court found that the 2000 Plan amendments created a second plan.

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[2] This was established in *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 ("***Schmidt***"). The SCC noted, that a company has the right to use the actuarial surplus to fund contributions while the pension plan is ongoing since the members have no entitlement to it at that time. Surplus doesn't crystallize until the wind-up of the plan. This is possible even where the trust agreement provides that the fund is to be used exclusively for the benefit of plan members. Justice Cory explained that members in plans with exclusive benefit language are entitled to two distinct types of benefits: the benefits promised under the pension plan and the right to share in surplus remaining on plan termination.

[3] The Divisional Court viewed the 2000 Plan amendments as having created two distinct pension plans and funds and that "cross-subsidization" (that being Kerry's usage of surplus money in the fund to satisfy contribution obligations in respect of those Plan members who followed the DC component of the Plan) was not allowed. It did, however, find that the contribution holidays taken in respect of the DB component of the Plan were allowed.

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Kerry appealed the judgment of the Divisional Court to the Court of Appeal of Ontario.

The Court of Appeal (the "**Court**") Decision

The Court considered the following four issues in the appeal:

1) Were Plan expenses properly paid from the Fund or must Kerry reimburse the Fund for them?

2) Could surplus pension funds be used to satisfy Kerry's contribution obligations in respect of the DC component of the Plan?

3) Did Kerry give proper notice to Plan members of the conversion option? If the notice was not sufficient, must Kerry issue a new notice and must the Superintendent refuse to register the 2000 Plan? And

4) Did the Divisional Court err in its costs award?

The Court considered the following two issues in the cross-appeal:

1) Must Kerry remit contributions in respect of the defined benefit component of the Plan? and

2) Does the Tribunal have the power to order costs payable from a pension fund?

My co-presenter, Caroline Helbronner, will be reviewing the first issue in the appeal. I will review the second and third issue in the appeal as well as the first issue in the cross-appeal.

Could surplus pension funds be used to satisfy Kerry's contribution obligations in respect of the defined contribution component of the Plan?

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After determining that the standard of review of the Tribunal's decision was one of "reasonableness", the Court found that the Tribunal's decision was, in fact, reasonable. The decision, therefore, ought not to have been interfered with by the Divisional Court.[4] The Court noted that the Tribunal's decision was also correct, for the following five reasons:

1) Applying the reasoning in *Schmidt*, nothing in the Plan and trust documents prohibited the taking of contribution holidays.

2) Section 9 of the *Pension Benefits Regulations*,[5] provides that after a plan conversion, surplus can be used to fund employer contributions.[6] Even though the Plan was not converted in full and merely added a DC component, section 9 "confirms that an employer is entitled to use the actuarial surplus to fund contributions where a defined benefit arrangement is not maintained".

3) Kerry was at liberty to introduce a new category of Plan member (s. 22 of the Plan permitted Kerry to unilaterally amend the Plan).

4) *Schmidt* confirms that a company is able to take contribution holidays in respect of a new category of plan member. Finally,

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[4] The Court also noted that, had the standard been one of correctness, it would not have interfered with the decision finding the result at the Tribunal correct in law.

[5] R.R.O. 1990, Reg 909 (the "**Regulations**")

[6] Section 9 of the Regulations states: *If an amendment to a pension plan with defined benefits converts the defined benefits to defined contribution benefits, the employer may offset the employer's contributions for normal costs against the amount of surplus, if any, in the pension fund after conversion.*

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5) Cross-subsidization is not prohibited by the trust fund documents establishing the Fund. Once the Part 2 members are designated Fund beneficiaries[7], use of the Fund's surplus by way of contribution holidays in respect of the Part 2 members meets the requirement that the Fund be used exclusively for the benefit of Fund beneficiaries.[8]

This reasoning is slightly different from that of the Tribunal, but no different in result.

The Court also expressly rejected the Divisional Court's assertion that the introduction of the DC component created a second plan.[9]

> *Did Kerry give proper notice to Plan members of the conversion option? If the notice was not sufficient, must Kerry issue a new notice and must the Superintendent refuse to register the 2000 Plan?*

In November 1999, Kerry gave notice to its employees that they had a one-time option to convert the accrued value of their DB benefits to follow the DC component. The conversion would take effect on January 1, 2000. Citing inadequate notice among its reasons, the Committee asked the Superintendent to refuse to register the 2000 amendments, which the Superintendent rejected The Committee then raised this issue with the Tribunal, who, although it found "shortcomings" in the

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[7] The trust agreement provided that the beneficiaries are those persons designated by the Plan. The Plan permits Kerry to designate Plan members.

[8] At paragraph 109, the Court noted, "I recognize that the present case was not simply the introduction of a new category of Plan member – it also created a new funding arrangement for the payment of pension benefits for the Part 2 members. Thus, it must be asked, does that change the foregoing analysis? The answer to that question is "no", so long as the Part 2 members are made Fund beneficiaries." At paragraph 110, it noted, "Because employment is not static so neither is membership in the Plan. It does not matter whether new members arrive one at a time or as a group, the Plan was designed to permit them to become Plan members and Fund beneficiaries."

[9] At paragraph 111 the Court noted, "Control, management and administration of the Plan remained with the retirement committee and the company, as Plan administrator. The fact that the pension benefits were payable from the Fund in the case of Part 1 members and from annuities in the case of the Part 2 members does not lead to the conclusion that there were two different plans, particularly as both Part 1 and Part 2 members have a claim to any Fund surplus remaining on Plan termination."

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disclosure process since it was concerned that the employees weren't given adequate information about the conversion, it found that these shortcomings weren't sufficient to refuse registration of the 2000 amendments. It then found it unnecessary to determine whether Kerry was obligated to give notice at all.

The Divisional Court found, on the other hand, that Kerry, as the Plan administrator, did have a duty to give notice to its employees of all proposed changes and found that Kerry did not give adequate notice.[10] It further found that failure to give proper notice was a failure to properly administer the Plan. Therefore, it held that the Superintendent erred with failing to refuse registration of the 2000 amendments and it ordered it to do so.[11]

On appeal, the Court stated that three questions must be answered to determine the issue: 1) Was Kerry, as administrator, required by the *Act* to give notice of the amendment?; 2) If so, was adequate notice given?; and 3) Was the Divisional Court correct in ordering the Superintendent to refuse to register the 2000 amendments?

The Court quickly concluded that Kerry, as administrator, had a statutory obligation to give notice of the amendment that gave rise to the conversion option since it was an "adverse amendment" within the meaning of the *Act*.[12] Although a member was not required to convert

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[10] It relied on section 22 and subsection 26(1) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8, as am. (the "***Act***")

[11] According to sections 18 and 87 of the *Act*.

[12] *Notice of proposed amendment*

26.(1)If the administrator of a pension plan applies for registration of an amendment to the pension plan that would result in a reduction of pension benefits accruing subsequent to the effective date of the amendment or that would otherwise adversely affect the rights or obligations of a member or former member or of any other person entitled to payment from the pension fund, the Superintendent shall require the administrator to transmit to such persons as the Superintendent may specify a written notice containing an explanation of the amendment and inviting comments to be submitted to the administrator and the Superintendent, and the administrator shall provide to the Superintendent

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their defined benefits and participate under the defined contribution provisions, the Court found the amendment adverse since it gave rise to uncertainty and risk for a plan member. The Court determined that in order to meaningfully exercise the conversion option in light of "potentially adverse consequences", Plan members needed proper information and, thus, notice.[13]

When looking at whether adequate notice was given, the Court looked at both whether the content of the notice was accurate and sufficient and whether all affected parties were given notice. Applying a reasonableness standard, the Court found that the notice given was misleading and possibly incorrect because it stated that members who elected to convert would not longer have any entitlements under the Fund. Therefore the Tribunal's decision that the notice was adequate was not reasonable.[14]

Notwithstanding that the Court found that the notice was inadequate, the Court determined that the Tribunal's other two reasons for finding that the Superintendent was not required to refuse registration of the amendments were reasonable: 1) that the *Act* does not provide that failure to give the required notice of an adverse amendment results in the amendment being void or otherwise non-registerable; and 2) that any deficiencies in the notice would not constitute sufficient grounds for the Superintendent to refuse registration of the 2000 amendments. The Court noted that, even if the notice given was inadequate, subsection 26(2) of the *Act* gives the Superintendent the discretion to register the amendments, where notice of an adverse amendment

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a copy of the notice and shall certify to the Superintendent the date on which the last such notice was transmitted.

[13] *Supra,* note 1 at para. 145.

[14] The Court noted at para. 150 that the conversion election form specified that if the member elected to transfer to the DC component, the member would "have no further rights and entitlements under the defined benefit plan". It stated that if it was intended that exercise of the option would extinguish not only a member's pension entitlement but also all other rights in the Plan and Fund, including the right to future Plan enhancement and to claim entitlement to surplus on Plan termination, then the information was misleading and incorrect.

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was required, after a period of 45 days has lapsed. The deficiencies did not result in the Plan text no longer complying with the *Act*.

Therefore, the Tribunal's decision not to order the Superintendent to refuse registration of the 2000 amendments was reasonable and ought to stand.

Must Kerry remit contributions in respect of the defined benefit component of the Plan?

On cross appeal, the Committee argued that the Divisional Court erred in finding that Kerry was entitled to take contribution holidays in respect of the DB component of the Plan. However, as confirmed by the Court, *Schmidt* established that an employer may take a contribution holiday when a DB plan has actuarial surplus unless the plan documentation expressly states otherwise. So long as an employer's contribution is determined by an actuarial calculation of the amount required to fund the promised benefits, as opposed to a specific formula for calculating the employer's annual contribution, a contribution holiday is permissible.

Paragraph 14(b) of the early Plan document stated:

> *In addition to contributing the full cost of providing the Past Service retirement incomes…, the Company shall also contribute, in respect of Future Service benefits, such amounts as will provide, when added to the Member's own required contributions, the Future Service retirement incomes … of the Plan.*

Since Kerry's funding obligation only required it to contribute the amount necessary to fund current and future benefits, Kerry was permitted to take contribution holidays when the Plan was in a surplus position. This is fundamentally different, the Court noted, from plans containing a formula requiring a certain employer contribution.

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The Plan's funding section was amended in 1965 to explicitly refer to contributions being made with the advice of an actuary, and to explicitly refer to Kerry's right to take contribution holidays. The Court held that this amendment was not invalid, because it merely made explicit a right that Kerry already had under the original language.

In a statement that appears to address a concern some employers have expressed, the Court, following Schmidt, clarified that, since members are entitled only to the promised benefits and in certain cases, to any surplus that exists on plan wind up, an employer is not required to take specific action, such as increasing contributions, to preserve or increase actuarial surplus.

The cross-appeal was dismissed.

Post-*Kerry* Decisions

There have been four reported decisions in Canada that have applied the principles established in *Kerry*: 1) *Professional Institute of the Public Service of Canada v. Canada (AG)*[15]; 2) *Lennon v. Ontario (Superintendent of Financial Services)*[16]; 3) *Sutherland v. Hudson's Bay Co.*[17]; and 4) *Smith v. Michelin North America (Canada) Inc.*[18]

In *Professional Institute*, the plaintiff employees were members in three DB pension plans established by the federal government employer. In the 1990's, the employer began amortizing surpluses within the plans in order to reduce its annual pension expense. The plaintiffs claimed an equitable interest in the surpluses and claimed that the amortization process was improper and illegal. It framed their claims as a breach of trust, breach of fiduciary duty and breach of statutory

[15] [2007] O.J. No. 4577 ("***Professional Institute***")
[16] [2007] O.J. No. 4228 ("***Lennon***")
[17] [2007] O.J. No. 2979 ("***Sutherland***")
[18] [2007] N.S.J. No. 437 ("***Smith***")

obligations. The Ontario Superior Court of Justice found that the employer was not in a fiduciary position with respect to plan members. The governing legislation gave the defendant no discretion as to compliance; the accounting practices related to the amortization had no effect on the government's obligations under the plans. Referring to *Kerry*, it that stated if an employer's contribution is to be determined by actuarial calculation of the amount necessary to fund benefits, a contribution holiday is permissible.[19]

In *Lennon*, the Divisional Court of the Ontario Superior Court of Justice considered an appeal by plan members where two employer corporations merged to form one corporation ("**Newco**"). Each predecessor corporation had a pension plan. After the merger, both plans continued into one plan, which was sponsored by Newco. Newco then took a six-year contribution holiday. The appellant plan members asserted that the merger was illegal as it revoked an irrevocable trust and argued that it contravened trust terms to permit the transfer of the pension plan's assets (that being considerable surplus) to the merged pension plan. Essentially, the appellant submitted that the surplus was used for the benefit of persons who were not beneficiaries of that trust. However, the Tribunal determined that trust documents worked together and permitted the merger.[20]

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[19] *Supra* note 15 at para 194.

[20] There were two trust documents that worked together, the first was dated in 1965 and the second in 1980. The 1965 trust document provided for the exclusive benefit provisions. The 1980 trust agreement further provided the following relevant provisions:

- The Company reserves the right ... to amend ... this Agreement ... provided further that no such amendment shall authorize or permit, at any time prior to the satisfaction of all liabilities with respect to the members and their beneficiaries under the Plan, any part of the Trust Fund to be used for or diverted to purposes other than those provided for under the terms of the Plan ... .
- If, pursuant to the Plan, subsidiaries and/or affiliates of the Company are included thereunder, the Trustee shall be advised. ...
- Wherever in this agreement the word "Company" is used, it shall be deemed to mean and shall include any other company with which the company may amalgamate ... whether under its present name or any other. ...

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The Divisional Court rejected the claims of the appellant. Newco was allowed to use the surplus since there was no term prohibiting this use and the employees had no entitlement to the surplus while the fund was ongoing; therefore, the trust was not revoked. The Divisional Court reiterated the five principles of *Kerry* to support that the use of surplus that has accrued with respect to one group of pension plan members to fund contribution obligations for another group is not a revocation of the trust.[21]

In *Sutherland*, the plaintiff employees (formally of Simpsons) were members of a Plan that was established as a DB pension plan; all plan assets were held by a trust fund. HBC, the defendant

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- Adoption of Plan by Affiliated Companies: Divisions. An Affiliated Company or a Division may adopt this Plan for itself and its eligible Employees. ... In such event the word "Company" herein shall also refer to such Affiliated Company or Division. ...
- Amendment. The Company... shall have the right to amend or change the Plan at any time ... in any respect; provided, however, that no amendment shall be effected to deprive a Pensioner or a member of a benefit which has accrued.

[21] Note *Buschau v. Rogers Cablesystems Inc. (2001),* 83 B.C.L.R. (3d) 261 ("***Buschau***"), where the Court determined that although the merger itself was valid, that members of the Premier Plan (one of the merged plans) retained rights that were distinct from those of members of the other plans and they were entitled to receive all the benefits under the original plan (in this case, the Premier Plan had a significant surplus at the time of the merger and the three plans with which it merged were in deficit positions). The Court determined this based on the particular language of the Premier Plan trust documents and said at para. 66, "these rights cannot be done away with by unilateral action of the employer without crystal-clear authority in the trust terms. Such terms may appear either in the trust agreement itself or in the plan, … but they must be stated somewhere in the original documentation." The Supreme Court of Canada denied leave to appeal on this issue. Some of the relevant terms in the Premier Plan were:

Bonus Pensions

If, as a result of any actuarial valuation, it is determined by the Committee on the advice of the Actuary that there is a surplus in the Trust Fund which is available for distribution, the said surplus may be used to allocate additional pensions and pension entitlements to existing Retired Members and/or Members respectively, in proportion to the amount of the pension or pension entitlement existing as at the date of allocation in respect of each Retired Member or Member.

Amendment or Termination of Plan

The Company reserves the right to amend, modify or change the Plan at any time in the future, in the event that, in the judgement of the Company, such action is warranted. However, any such amendment, modification or change will not affect the rights and/or benefits earned by any Member or Retired Member in respect of his Continuous Service and Earnings up to, and under the provisions of the Plan in effect as at, the date of any such amendment, modification or change of or to the Plan.

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employer (and a successor to Simpsons), amended the plan to add a DC component and added employees from its subsidiaries to the plan, following the DC component. HBC then used surplus from the trust fund to take contribution holidays in respect of both the DB and the DC components. The plaintiffs claimed, among other things, that HBC was not allowed to take contribution holidays using the surplus from the trust fund in respect of the DC component of the plan as this amounted to a breach of trust.

The Superior Court rejected their claims. Looking at the terms of the trust, the Superior Court determined that the trust was in favour of both the DB and the DC members. Looking at the terms of the plan, the Superior Court found that the subsidiary employees were properly included under the plan since the term "Company" was said to mean: "Simpsons, Limited and its successors…" and it further stated, "each Employee of the Company is eligible to become a Member of the Plan". The Superior Court interpreted "Benefit" broadly, as used in the exclusive benefits provision[22] interpreting it to include benefits under the plan as amended from time to time. It found that using surplus was not an encroachment upon a pension trust fund or a reduction of benefits that have accrued to any member. Using *Kerry* as a model, it found that a trust fund can support separate classes of membership in one pension plan and that an employer is entitled to take contribution holidays using the assets of a trust fund in respect of DC obligations.[23]

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[22] Such provision stated:

…no part of the Trust Fund may be used for, or diverted to any purposes other than those connected with the exclusive benefit of members of the Plan and their beneficiaries".

[23] Also, the Employer's funding requirements were as follows:

The Company will pay to the Trustee such amount as in the opinion of the Actuary will be sufficient to cover the current service costs of the benefits to be provided hereunder."

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Lastly, at issue in *Smith*, a decision of the Nova Scotia Supreme Court, was whether the amendments to an original pension plan permitting the employer to take contribution holidays were valid or, alternatively, whether the original plan permitted it to so. Referencing the conclusions of *Kerry*, that an employer is entitled to take contribution holidays so long as the employer is only obliged to provide contributions as determined by an actuary (as opposed to a fixed formula), the Nova Scotia Supreme Court determined that the amendments were valid. The amendments did not affect vested rights (members had no right to actuarial surplus) and did not encroach on accrued benefits. Further, it found that the original plan documents implicitly permitted the employer to take contribution holidays.

Post-*Kerry* Environment

There is essentially not a great deal about the DB contribution holiday aspects of the *Kerry* decision that is surprising. All levels had agreed that Kerry's actions were valid, and the law appears to be quite well settled in this area. The Supreme Court of Canada decision in *Schmidt* continues to be the leading case.

The Court's decision on the cross-subsidization issue provides some clarity with respect to using DB surplus to pay DC contributions, a widespread practice. However, this practice may not be appropriate in all circumstances. Each employer will need to examine its trust agreement and plan language, particularly any exclusive benefit language.

Subsequent decisions, relying on *Kerry*, appear to be offering many ways in which *Buschau* and *Aegon* can be distinguished, which may, in the right circumstances, allow employers to more easily merge plans together.

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The aspect of the decision which addressed the notice of the plan conversion that was provided to members confirms that advance notice under section 26 of the *Act* is required, providing teeth to FSCO's existing policy. However, it reminds employers that notice must be clear, understandable, and accurate if they wish to avoid further liability. Also of interest is the Court's comments suggesting that, if employers wish to use DB surplus to fund DC contributions after a conversion, the trade-off will likely be that DC members will be entitled to share in DB surplus at plan wind up. Some employers may not expect this result.

While the Court of Appeal's decision has generally been welcomed by employers, it is not time to forge ahead without caution. Application for leave to appeal the decision was submitted to the Supreme Court of Canada on November 26th, 2007.

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