

**PENSION TENSION:  
SCC WEIGHS IN ON DISPUTE OVER EMPLOYER  
PENSION PLAN OBLIGATIONS**

**PAUL A. YOUNG**

**BONNEA CHANNE**

This paper is for general discussion purposes and does not constitute legal advice or an opinion.

For legal advice regarding your particular circumstances, please contact us.

## TABLE OF CONTENTS

INTRODUCTION: PENSION PLAN DISPUTES.....	1
TWO BASIC FORMS OF PENSIONS .....	1
Defined Benefit Plans.....	2
Defined Contribution Plans .....	2
NOLAN V. KERRY (CANADA) INC.: BACKGROUND .....	2
PROCEDURAL HISTORY .....	4
Financial Services Tribunal.....	4
Ontario Divisional Court .....	4
Ontario Court of Appeal.....	5
THE SUPREME COURT OF CANADA’S DECISION.....	5
Payment of Administrative Expenses from the Trust Fund.....	5
DB Contribution Holidays.....	8
DC Contribution Holidays .....	9
CONCLUSION .....	11
PRACTICAL CONSIDERATIONS .....	12

## **INTRODUCTION: PENSION PLAN DISPUTES**

Many employers that sponsor pension plans will no doubt have had their share of pension plan disputes. A running theme in many disputes is whether an employer is permitted to use pension funds, including trust funds and surpluses, toward certain purposes that relate to the pension plan and its administration. For example, where the terms of a pension plan do not specify who is responsible for paying the expenses incurred in the administration of the pension plan, employers may wish to use the pension trust fund to pay for such expenses rather than directly assuming the cost themselves or shifting the cost directly onto employees. Another example, although not a common one in today's economy, is where a surplus has accumulated in a pension trust fund and an employer wishes to take a contribution holiday from its funding obligations. Employers often find that using pension trust funds and surpluses for such purposes is met with resistance from employees or unions, even though the intended uses would not appear to negatively affect employees and may, in some instances, benefit employees.

Over the last couple of decades, a number of high profile court decisions have generally restricted an employer's ability to use pension funds and surpluses. Given these developments, it is not surprising that many employers, when faced with the question of what it can do with pension funds or surpluses, will approach the issue with extreme caution.

While many employers have learned to think of pension trust funds and surpluses as untouchable, employers may also breathe a small sigh of relief in light of the Supreme Court of Canada's most recent decision on pension trust funds and actuarial surpluses. The Supreme Court of Canada's decision in *Nolan v. Kerry (Canada) Inc.*, [2009] 2 S.C.R. 678, sheds lights on the type of pension plan language that will allow an employer to use pension trust funds to pay for pension plan administrative expenses. The decision also sheds light on the type of plan language that will permit an employer to use actuarial surpluses to fund an employer contribution holiday from its premium obligations.

## **TWO BASIC FORMS OF PENSIONS**

There are two basic forms of private pension plans: defined benefit ("DB") and defined contribution ("DC").

## **Defined Benefit Plans**

Defined benefit plans provide a fixed benefit upon retirement. Depending on the terms of the pension plan documents, employees may or may not be required to contribute. The employer contributes the balance, based upon actuarial valuations, necessary to fund the plan's defined benefits. The employer bears the risk of poor fund performance. If the fund performs poorly, the employer's funding obligation may increase. If the fund performs better than expected, or if contributions are greater than necessary to cover the defined benefits, then the potential for surplus arises. It is under DB plans that the issue of surplus entitlement most often arises.

## **Defined Contribution Plans**

Under a defined contribution plan, an employer will contribute a fixed amount or a percentage of an employee's earnings to a retirement fund for the employee's credit. The employee may or may not be required to contribute, depending on the terms of the pension plan documents. The accumulated value of the contributions are applied at the employee's retirement to provide a pension plan. Under such a plan, the contributions are known and specified, whereas the benefits those contributions will buy will not be known until the employee retires. The level of pension benefit will depend on how well the fund has been invested over the term of employment and on annuity purchase rates at the time of retirement. As the amount of income at retirement is not guaranteed by the employer, it is the employee who bears the risk of whether the pension fund performance will provide sufficient income for retirement.

### **NOLAN V. KERRY (CANADA) INC.: BACKGROUND**

The Employer, Kerry (Canada) Inc. ("Kerry" or the "Company"), through its predecessors, began administering a pension plan in 1954. The terms of the pension plan (the "Plan") were contained in a number of documents, including a pension plan text (the "Plan text") and a separate trust agreement (the "Trust Agreement"), both dated in 1954. The Plan text required the Company and its employees to make premium contributions to the Plan, and the Trust Agreement required those contributions to be paid into trust (the "Trust") and held in a trust fund.

The Plan text and Trust Agreement were amended on a number of occasions over the years. Prior to 1985, Kerry had paid for certain

administrative expenses incurred in relation to the pension plan. The administrative expenses consisted of actuarial, investment management and audit services. As a result of amendments made to the Plan documents in 1985, the Company stopped directly paying for the administrative expenses and began using the trust fund to cover those expenses. By 2002, more than \$850,000 from the trust fund had been used to pay for these expenses.

As well, beginning in 1985, the Company began taking contribution holidays from its premium obligations. By 2001, the Company's contribution holidays were worth approximately \$1.5 million. Throughout this period, employees did not receive a corresponding contribution holiday and, therefore, employees continued to pay their share of premium obligations.

Prior to 2000, the Plan existed solely as a DB plan. In 2000, the Plan was amended and a DC component was added. Existing employees were given the option of either continuing their participation in the DB plan or joining the DC plan. All new employees were required to join the DC plan.

The trust fund was re-arranged into two separate funding vehicles, one to fund the DB component and the other to fund the DC component. Each funding vehicle had its own separate trustees. In 2001, it was determined that the DB component of the trust fund had been in an actuarial surplus position for a number of years.

In light of the surplus position of the DB component of the trust fund, Kerry announced that in addition to the Company's contribution holiday in respect of the DB plan, it would take a contribution holiday in respect of the DC plan. The Company intended to use the surplus accumulated in the DB component of the trust fund to pay for the employer's contribution obligations under *both* the DB and DC plans, thereby giving the Company contributions holidays in respect of both plans.

A committee consisting of former and current employees objected to a number of the Company's pension plan practices, namely: the Company's use of the trust fund to cover the administrative expenses; and the Company's use of the DB actuarial surplus to fund its DB and DC contribution holidays. As they were unable to resolve their dispute, the committee and Kerry eventually requested a hearing before the Financial Services Tribunal (the "Tribunal") to determine the issues in dispute.

## PROCEDURAL HISTORY

### Financial Services Tribunal

The Tribunal held that the Company could use the trust fund to pay for the administrative expenses and that the Company was entitled to use the actuarially-determined surplus to fund its DB and DC contribution holidays. However, the Tribunal stated that in order for the Company to take contribution holidays in respect of the DC component, the Company would have to retroactively amend the Plan provisions to designate the DC members as beneficiaries of the original Trust.

### Ontario Divisional Court

The Divisional Court ruled Kerry was not entitled to use the trust fund to pay for administrative expenses. Specifically, the Divisional Court stated that the Company's use of the trust fund to pay for the administrative expenses constituted a partial revocation of the trust. The Divisional Court cited the Supreme Court of Canada's decision in *Schmidt v. Air Products Canada Ltd.*, [1994] 2 S.C.R. 611, for the proposition that a trust cannot be revoked unless the power to do so was reserved at the time that the trust was constituted.

On the issue of contribution holidays, the Divisional Court held that the Company could take contribution holidays with respect to the DB component but not the DC component. In the Divisional Court's view, the DB contribution holidays were permitted as there was nothing in the Plan text that precluded the company from taking a DB contribution holiday.

The Divisional Court stated, however, that Kerry could not use the surplus accumulated in the DB component of the trust fund to give itself a DC contribution holiday. The court found that the amendments made in 2000 to the Plan, which introduced the DC component, created, at law, two distinct pension plans with two distinct trusts. The legal effect of the court's conclusion that there were 2 separate plans each with their own separate trust was that DC members could not be beneficiaries of the DB trust. Accordingly, the surplus accumulated in the DB trust could not be used by the Company to fund the DC plan. In other words, as the Divisional Court concluded, the Company could not use the DB surplus to give itself a DC contribution holiday.

## **Ontario Court of Appeal**

The Court of Appeal reversed the Divisional Court's ruling and held that the trust fund could be used to cover the administrative expenses. On the issue of DB contribution holidays, the Court of Appeal, the Divisional Court and the Tribunal all agreed that the Company was permitted to take DB contribution holidays. On the issue of DC contribution holidays, the Court of Appeal reversed the Divisional Court's ruling and held that the Company was permitted to take DC contribution holidays by using the surplus accumulated under the DB fund.

## **THE SUPREME COURT OF CANADA'S DECISION**

### **Payment of Administrative Expenses from the Trust Fund**

The Supreme Court first considered whether Kerry was obligated to pay for the administrative expenses at issue. If such an obligation existed, the Company would not be permitted to escape its obligation by using the trust fund to pay for the administrative expenses.

The Supreme Court agreed with the Divisional Court's ruling that neither the *Pension Benefits Act* nor the common law imposed a requirement on the employer to pay for the administrative expenses at issue. Accordingly, the Company's obligation in relation to the administrative expenses would be contained in the Plan documents. However, neither the Plan text nor the Trust Agreement expressly required the Company to pay for such expenses. The Supreme Court emphasized that silence did not impose an obligation on the Company to pay for the administrative expenses.

Although the Company was required under the Trust Agreement to pay for certain expenses incurred in relation to the Trust, the Supreme Court found that this also did not create an obligation on the Company to pay for the administrative expenses of the pension plan. Under the Trust Agreement, the Company was expressly required to pay for expenses "incurred by the Trustee in the performance of its duties" and for expenses incurred "in the execution of the Trust." The Supreme Court stated, however, that expenses incurred in relation to the Trust do not include expenses incurred in the administration of the pension plan outside the execution of the Trust. Although the Trust was part of the pension plan, the preamble of the Trust Agreement made it clear that the purpose of the Trust was limited to holding contributions for the payment of pension benefits.

The Supreme Court observed that based on the various Plan documents, the Plan itself was a broader document which set out other things such as eligibility criteria, contribution requirements, the form of benefits and what happens upon termination. More specifically, according to the Supreme Court, the proper administration of a pension plan requires other services other than those of the trustee, including actuarial, accounting and investment services. In fact, the Plan text specifically stated that a Retirement Committee would be responsible for such services and, by implication, the expenses incurred for those services. Accordingly, the Company's obligation to pay for expenses incurred by the Trustee and in the execution of the Trust did not include administrative expenses for the Plan.

The Supreme Court then considered the argument that certain amendments to the Trust Agreement had created an implied obligation on the employer to pay for the administrative expenses. However, the Supreme Court found that any obligation of the Company, under the Trust Agreement, to pay for such expenses would have to be expressly stated. The Court made this statement in light of a provision added in 1958 to the Trust Agreement. The provision created in 1958 provided that the Trust Agreement could be amended, subject to two provisos. The first proviso was that any amendments could not be construed as enlarging the employer's original obligations under the Plan. The second proviso was that no amendment shall permit trust funds from being used for any purpose "other than for the exclusive benefit" of employees or their beneficiaries. Since the proviso added in 1958 included language that protected the Company's original obligations under the Trust Agreement from being enlarged in the absence of express language, the Supreme Court rejected the argument that subsequent amendments to the Trust Agreement created an implied obligation on the Company to pay for administrative expenses.

The Supreme Court went on to rule that the Company was not obligated under the Plan documents to pay the administrative expenses. The Court then considered whether the Plan documents prohibited the use of trust funds to cover the administrative expenses.

In particular, the Supreme Court considered whether amendments made in 1985 to the Trust Agreement, which permitted the use of trust funds to pay for administrative expenses, violated the second proviso introduced in 1958 that no amendments shall permit the use of trust funds for any purpose other than for the exclusive benefit of employees or their

beneficiaries. The Supreme Court found that the 1985 amendments did not violate the proviso because the funds were in fact being used for the exclusive benefit of employees. The Court explained as follows:

Nor can the term “exclusive benefit” be construed to mean that no one but the employees can benefit from a use of the trust funds. Many persons will benefit indirectly from a use of pension funds. Notably, the employee’s family would benefit from the employee’s long-term financial security.

...

Here the existence of the Plan is a benefit to the employees. The payment of Plan expenses is necessary to ensure the Plan’s continued integrity and existence. It is therefore to the exclusive benefit of the employees, within the meaning of s. 11, that expenses for the continued existence of the Plan are paid out of the Fund.

Finally, in respect of the Divisional Court’s ruling that the use of the trust fund to pay for administrative expenses constituted a partial revocation of the Trust, the Supreme Court found that there had been no revocation of the Trust. The Supreme Court stated as follows:

Paying plan expenses out of the trust fund is not a matter of the settler (the Company in this case) exercising a power of control on a part of the property it has transferred to the trust. So long as nothing in the plan texts require the paying of expenses by the employer, funds in the pension trust can be used to pay reasonable and bona fide expenses. In the absence of an obligation on the employer to pay the plan expenses, to the extent that the funds are paying legitimate expenses necessary to the integrity and existence of the plan, the employer is not

purporting to control the use of funds in the trust.

[Emphasis added]

The Supreme Court noted that because the Company was not obligated to pay the administrative expenses, the Company did not, and could not have, attempted to escape its obligation to pay the expenses by shifting that obligation onto the trust fund. Accordingly, the Company was permitted under the Trust Agreement to use the trust fund to cover the administrative expenses, provided that those expenses were bona fide and necessary to the administration of the Plan. There was no dispute that the administrative expenses incurred were bona fide and necessary to the administration of the Company's pension plan.

### **DB Contribution Holidays**

The Supreme Court re-iterated the principles enunciated in *Schmidt, supra*, that an employer is entitled to take a contribution holiday unless the terms of the pension plan specifically preclude it. In *Schmidt*, the Supreme Court stated that the right to take contribution holidays may be explicitly given in a plan or it may be implied from the wording of the employer's contribution obligation. The Supreme Court in *Schmidt* stated that an employer's right to take a contribution holiday may be implied where there is a provision that provides that an actuary is responsible for determining the amount of contributions needed to fund promised benefits. The Court explained that where this responsibility is given to an actuary, it is understood that the actuary will apply accepted actuarial practice and that accepted actuarial practice includes the application of calculated surplus funds to the determination of overall current service cost. Accordingly, where the plan documents provide that funding requirements will be determined by actuarial practice, the employer may take a contribution holiday unless other wording or legislation prohibits it.

Similarly, the Supreme Court in *Schmidt* stated that the right to take a contribution holiday can be excluded either explicitly or implicitly by a plan. The Court in *Schmidt* observed that where a plan mandates a formula for calculating employer contributions, this removes actuarial discretion and, absent language that provides otherwise, the employer's right to take a contribution holiday is also removed.

Applying the principles in *Schmidt*, the Supreme Court found that the Plan text provided that contributions are to be determined by actuarial calculations. The Plan text did not mandate a formula for determining employer contributions, nor was there any language removing actuarial discretion in calculating the required calculations. Further, there was nothing in the Plan text that expressly prevented the Company from taking a contribution holiday. Accordingly, given that an actuary had determined that no contributions were required from the Company to provide the promised retirement benefits to members of the DB plan, the Company was permitted to take contribution holidays with respect to the DB plan.

### **DC Contribution Holidays**

As stated earlier, the Company intended to fund its DC contribution holidays with the actuarial surplus accumulated in the DB plan. Therefore, as the Court had determined that the Plan documents permitted the employer to take contribution holidays, the narrow issue to be determined by the Supreme Court was whether members of the DC plan could be beneficiaries of the DB component of the Trust. The Divisional Court had ruled that DC members could not benefit from the DB trust as the DB and DC plans were, at law, separate pension plans with separate trusts. The Trust Agreement specifically prohibited the original trust fund (which, according to the Divisional Court, was now the DB trust fund) from being used for a purpose that was not for the exclusive benefit of plan members or their beneficiaries. Accordingly, if the DB and DC plans were separate plans with separate trusts, the use of surpluses from the DB plan to fund the employer's DC contribution holiday would violate the Trust Agreement. Specifically, the Trust Agreement would be violated since the surplus from the DB trust fund would be used for a purpose that was not for the exclusive benefit of DB plan members.

The Supreme Court, however, held that the DB and DC plans were both components of a single plan whose members were beneficiaries of the same trust. The Court noted that the amendments in 2000, which introduced the DC component, could reasonably be interpreted as intending the DB and DC components to be under one single plan. The relevant portion of the amendments stated as follows:

The Plan is hereby amended and restated  
... to:

(c) change the Plan from one having defined benefit provisions only to a pension plan with a defined benefit component and a defined contribution component, effective January 1, 2000.

In the Supreme Court's view, the above portion of the 2000 amendments indicated that the intention was to have the DB and DC components as a single plan. The Supreme Court further supported its conclusion with the following observations:

Section II defines "Plan" as "the Pension Plan for Employees of Kerry (Canada) Inc., as Revised and Re-stated at January 1, 2000, the terms of which are as set forth in this document, and as it may be amended from time to time." Members of the Plan are defined as employees who meet the applicable eligibility requirements and continue to be entitled to benefits under either section of the Plan. Section 18.08 specifically provides that actuarial surplus can be used for "either Part 1 or Part 2 [members]." These provisions demonstrate that the 2000 amendments to the Plan text evince the intention that there be a single plan.

The Court found that the legal effect of the amendments made in 2000 was that it retroactively established that DC members were beneficiaries of the same Trust as DB members. Accordingly, and as neither the applicable legislation nor the Plan documents prohibited this, the DC members could be designated as beneficiaries of the original Trust. The Company could therefore use the actuarial surplus accumulated in the DB component to fund its DC contribution holidays.

The Court further noted that the use of the actuarial surplus accumulated in the DB plan to fund the Company's DC contribution holidays did not deprive DB members of any vested property rights, if any, in the surplus. The Court emphasized that the surplus accumulated in the DB component was not an actual surplus; rather, it was an *actuarially-determined* surplus. In *Schmidt*, the Supreme Court had stated that where a surplus is an actuarial surplus, neither the employer nor the employees

have a specific interest in this amount, since it only exists on paper. It is only when the plan is terminated that the actuarial surplus becomes an actual surplus and employees' interest in the surplus vests. In the case at bar, the Supreme Court found that because the DB plan had not been terminated, the DB surplus remained an actuarial, rather than an actual, surplus. As such, DB members did not have a vested interest in the actuarial surplus. Furthermore, the Company's use of the actuarial surplus to fund its DC contribution holidays did not deprive DB members' right to the defined benefits provided for under the Plan.

## CONCLUSION

In sum, the Supreme Court's decision confirmed the following:

- The Company was not obligated under the Plan documents to pay for pension plan administrative expenses. The trust fund could be used to pay for such expenses;
- The Company was permitted under the Plan documents to take both DB and DC contribution holidays by using the actuarial surplus accumulated in the DB component of the Plan; and
- The DB surplus could be used to fund the Company's DC contribution holidays because the DB and DC components were part of a single pension plan and the Plan had been amended retroactively so that DC members were beneficiaries of the original Trust.

Although the above conclusions of the Supreme Court were specific to the terms of the Plan documents and Trust Agreement applicable to Kerry, the Supreme Court's ruling in *Nolan v. Kerry (Canada) Inc.* is nonetheless a welcome decision for employers. Of course, in today's economy, many employers may think of pension surpluses as a tale of the past. There is, however, always a possibility that the conditions that previously led to pension surpluses may return in the future. Furthermore, for some employers, pension surpluses that occurred in the past may have resulted in lengthy, ongoing litigation. The Supreme Court's ruling with respect to pension surpluses and contributions holidays may therefore be relevant or potentially relevant to employers.

While employer should continue to approach the issue of accessing and using pension funds and surpluses with extreme caution, this decision

may provide employers with some reason to be less pessimistic about their current or future ability to use pension funds to pay for certain expenses associated with the pension plan or to use actuarial surpluses to provide itself with contributions holidays. Depending on the terms of an employer's pension plan, the plan documents may expressly or impliedly permit an employer to use pension funds and actuarial surpluses for such limited purposes.

## **PRACTICAL CONSIDERATIONS**

In deciding whether it can take contribution holidays or whether certain pension plan expenses must be paid for by the employer or can be paid out of a pension trust fund, employers will need to know their rights and obligations under their pension plan. This will mainly depend on the specific terms of the applicable pension plan documents, which may include trust agreements. Employers should also determine if the plan documents may be amended and, if so, under what circumstances and the process that needs to be followed.

Many employers have introduced defined contribution plans while providing employees who are members of a defined benefit plan with the option of joining the DC plan or remaining in the DB plan. If the plan documents allow an employer to take contribution holidays, an employer may wish to broaden its opportunity for taking contribution holidays, specifically by ensuring that an actuarial surplus in respect of one plan (usually the DB plan) can be used to fund contribution holidays for the other plan (usually the DC plan), as was the case in *Nolan v. Kerry (Canada) Inc.* In this regard, where the pension plan takes the form of a trust, the DB and DC plans need to be components of a single plan in which DB and DC are members of beneficiaries of the same trust. Employers should review their plan documents to determine whether its DB and DC plans are a single plan with a single trust. In some cases, retroactive amendments may be necessary to achieve this result and enable an employer to use DB actuarial surpluses to fund DC contribution holidays.

Finally, employers should review the employer's pension plan documents to determine whether there is any language that protects the employer's existing obligations from being enlarged in the absence of express language to that effect. The need for such language is crucial where amendments to the plan documents are permitted. For example,

where amendments to plan documents are permitted and where the plan documents have been amended to expressly provide that certain expenses, such as taxes, interests and penalties, are to be paid from a trust fund, there is a risk that an adjudicator may conclude that by implication, all other expenses, including any pension plan administrative expenses, are the responsibility of the employer.

To protect itself from the risk of enlarging, implied obligations flowing from amendments to plan documents, employers and their legal counsel will need to determine whether there is language that sufficiently protects the employer's interests or if the plan documents can be amended to include such language. In some cases, as was the case in *Nolan v. Kerry (Canada) Inc.*, an employer's interest may be sufficiently protected with language that states that amendments are "not to be construed to enlarge the obligations of the Company beyond those assumed by it under the [original] Plan." However, the type of language that is required to sufficiently protect an employer's existing obligations from being enlarged will depend on the overall terms of the particular plan documents of the employer's pension plan.