

THE LAST WORD ON *KERRY*:

THE SUPREME COURT OF CANADA'S DECISION ON PENSION PLAN EXPENSES, PENSION PLAN CONVERSIONS AND CONTRIBUTION HOLIDAYS IN ONTARIO

On Friday, August 7, 2009, the Supreme Court of Canada released its decision in the case of *Nolan et al. v. Kerry (Canada) Inc.* Although the *Kerry* case deals with an Ontario pension plan subject to the Ontario *Pension Benefits Act*, the *Kerry* case has important implications for all Canadian employers with pension plans and for pension plan sponsors generally.

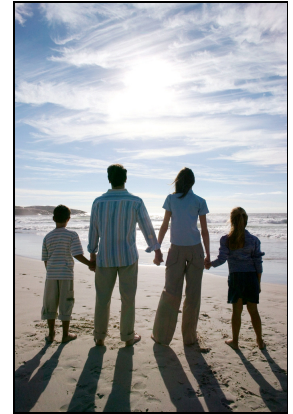
Background:

In 1954, the Kerry Pension Plan (the "Plan") was established as a defined benefit ("DB") pension plan for employees of the company that is currently known as Kerry Canada Inc. ("Kerry"). Funding for the Plan was provided by company and employee contributions to a pension trust fund (the "Trust Fund").

Until 1985, Kerry paid for the Plan's expenses, including actuarial, investment management and auditing expenses. However, in 1985, Kerry amended the Plan so that the Trust Fund would pay the Plan's expenses.

In 1985, based on the fact that the Plan was in surplus (ie. the funds in the Trust Fund were actuarially determined to be greater than the amount needed to cover future benefits for the Plan's beneficiaries) Kerry also started taking "contribution holidays" with respect to company contributions that would otherwise have been payable by Kerry to the Plan.

In 2000, Kerry once again amended the terms of the Plan to create a defined contribution ("DC") component within the Plan. Existing employees who were enrolled in the Plan had the option of converting to the DC component of the Plan or remaining in the DB component. New employees were required to participate in the DC component.



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Kerry continued to take contribution holidays after the DC component of the Plan was created. Kerry notified the Plan members that it intended to use the surplus that had accumulated when the Plan was a DB-only Plan to fund Kerry's contributions to the DC component of the Plan.

After Kerry made the 2000 amendments to the Plan, a number of the Plan's members (the "Member Committee") objected to Kerry's actions. They asserted that Kerry was required to pay the Plan's expenses. They also asserted that Kerry did not have the right to take contribution holidays. In addition to these issues, the Supreme Court also addressed the issue of the payment of legal costs resulting from the litigation of the case.

The Supreme Court's Decision

1. Responsibility for Payment of Plan Expenses

The Supreme Court found that there is nothing in any applicable statute or the common law that requires an employer to pay the expenses of the pension plan it establishes for the benefit of its employees. Therefore, the obligations of the employer are determined by the text and context of the pension plan documents.

The Kerry Plan did state that Kerry was responsible for paying all "expenses incurred in the execution of the Trust". However, the Supreme Court found that expenses incurred in the execution of the Trust were separate and distinguishable from the expenses incurred in administering the Plan. The Plan did not state that Kerry was responsible for paying expenses incurred in administering the Plan itself. In short, the Court held that a pension plan's expenses could be paid from the plan's funds unless the plan text says otherwise.

A 1958 amendment to the Kerry Plan provided that Trust funds could not be used for purposes "other than for the exclusive benefit" of the employees, and the Committee argued that this language prohibited the use of Trust funds to pay Plan expenses. However, the 1958 amendment also stated that this proviso was

"not to be construed to enlarge the obligations of the Company" beyond those assumed by it under the Plan. The Supreme Court stated:

"While it is true that the employer did pay the expenses at issue for a number of years, it was never under any obligation to do so. In light of there being no obligation on the Company and of the expenses at issue being essential to the administration of the Plan, subsequent amendments allowing the expenses to be paid out of the Trust Fund do not infringe the exclusive benefit language."

The Court went on to state that the existence of the Plan was a benefit to the employees, and the payment of the Plan's expenses was necessary to ensure the Plan's continued integrity and existence. Therefore, it was to the "exclusive benefit" of the employees that expenses for the continued existence of the Plan be paid for with Trust funds. The Court held that this is the case whether the services are provided by third parties, as they were in the Kerry case, or by the employer itself, so long as the expenses charged are reasonable and the services are necessary. Indeed, the Court indicated that the mere fact that other parties, such as accountants or actuaries, might also benefit from a use of the Plan's funds did not necessarily mean that the "exclusive benefit" requirement had been breached. Thus the Court gave a fairly flexible interpretation to the term "exclusive benefit" which appears in many older pension plans.

2. Contribution Holidays

(a) *The DB Component*

The Supreme Court upheld the principle that unless the terms of a pension plan specifically preclude contribution holidays, the employer is entitled to take such holidays. In other words, when pension plan documents provide that funding requirements will be determined by actuarial practice, the employer may take a contribution holiday when the plan is in surplus.

The Supreme Court reviewed the language of the Kerry Plan and determined that contributions holidays were permitted under the terms of the Plan where it was actuarially certified that no contributions were necessary to

provide the required retirement income to members.

(b) *The DC Component*

Once again, The Supreme Court focused on the language of the Plan text to determine the whether Kerry was entitled to take contribution holidays with respect to the DC component by applying the surplus in the Trust Fund generated by the DB component of the Plan.

The Member Committee argued that if Kerry was allowed to use the surplus of the Plan to fund its DC contributions, Kerry would be breaching the provisions of the Plan which stated that the Trust funds were to be used for the “exclusive benefit” of the Plan’s members. However, the Supreme Court noted that the 2000 amendments which created the DC component of the Plan did not necessarily create a separate trust or a separate DC plan. Rather, the language of the 2000 amendments could reasonably be interpreted as intending a single plan which could consist of DB and DC components.

The Supreme Court noted that Kerry had not “terminated” the original Plan when it closed the DB component to new members and created the DC component. Kerry had simply amended the original Plan, as it was entitled to do under the terms of the Plan. The Court went on to say that nothing in the relevant statutory or common law prevents the creation of a combined DB and DC plan in which all DB and DC members are beneficiaries. Therefore, with the appropriately-worded amendment to the Plan, the use of the Trust funds for the benefit of either the DB or the DC members would not infringe the “exclusive benefit” provision. As the Court stated: “Surplus funds applied to the DC accounts would simply move funds within the Trust.” As long as the plan documents and/or legislation did not forbid it, there was nothing wrong with Kerry taking contribution holidays with respect to the DC component of the Plan.

The Supreme Court also concluded that there was nothing wrong with the Plan’s surplus being used to fund Kerry’s DC contribution

holidays even if that surplus had been generated by the DB contributions. Since the Plan had not been terminated, the surplus in the Plan was “actuarial” rather than “actual”. Therefore, there was no actual surplus that could have vested with the employees. When a pension plan is terminated, contributions cease being made, benefits cease being paid out and the assets of the plan are distributed. Closing a plan’s membership, in contrast, does not mean that its assets are liquidated. A closed plan continues to pay benefits to its members and may continue to require contributions, but it will no longer accept new members. In the case of the Kerry Plan, the DB component was closed to new members by the 2000 amendments, but it was not terminated. Contributions to the Trust Fund continued to be made on behalf of the DB members, as well as on behalf of the new DC members. As a result, the surplus Trust funds could be used for the benefit of the Plan’s beneficiaries, which included DC members.

In reaching this conclusion, the Supreme Court noted that the Ontario *Pension Benefits Act*, which expressly permits the conversion of a DB plan to a DC plan, provides that on such a conversion, a surplus can be applied to offset contributions to the DC plan. The Supreme Court recognized that while the *Kerry* case did not involve a conversion, the *Pension Benefits Act* did suggest that a surplus accumulated under a DB component of a pension plan can be applied to a DC component of a plan. Therefore, there was no absolute prohibition in law against applying a DB surplus to a DC plan.

3. Costs

The issue the Supreme Court had to address was whether to award costs to the Members Committee to be paid from the Trust Fund. While the Court has the discretion to make such an award, the Court held that in the circumstances of *Kerry* case it was not appropriate to do so.

First, the Supreme Court noted that costs may be awarded from a pension trust fund when the issue that was litigated was not adversarial in nature but rather arose as a result of a

legitimate uncertainty as to how to properly administer the trust. In the *Kerry* case, the Court held, the litigation was adversarial in nature because it was ultimately about the propriety of Kerry's actions. In addition, the *Kerry* litigation was adversarial because it pitted the interests of some of the pension plan members against those of other pension plan members. The Member Committee wanted funds in the Trust Fund to be used only for the benefit of DB members, and not DC members.

Second, the Supreme Court noted that Kerry had been successful in the litigation, as a result of which Kerry did not have to pay into the Trust Fund to cover Plan expenses and was permitted to take contribution holidays. If the Member Committee was awarded costs out of the Trust Fund, this would effectively penalize Kerry by reducing the surplus in the Trust Fund and thus reducing Kerry's opportunity to take contribution holidays.

In the result, the Supreme Court did not award any costs payable to the Member Committee from the Trust Fund. However, the Court did indicate that costs should be payable by the Member Committee in favour of Kerry.

The Lesson for Employers Who Sponsor Pension Plans

The *Kerry* case demonstrates that, unless applicable legislation provides otherwise, a

pension plan may be drafted or amended to permit an employer to:

- pay a pension plan's expenses from the plan's trust funds;
- take contribution holidays with respect to defined benefit contribution obligations;
- add a defined contribution component to an existing defined benefit plan; and
- take contribution holidays with respect to the defined contribution component using surplus funds generated by the defined benefit component of the plan.

The *Kerry* case also demonstrates that employers should take care in drafting and amending pension plan documents, because the language of the documents will determine the employer's rights and obligations, except where statutory or common law provides otherwise. The case also illustrates the importance of retaining accurate and complete copies of all the documents which established or amended the pension plan. Such documents may include a Trust Agreement, a Group Annuity Insurance Contract, the Plan text (including rules and regulations, if any) and all amendments to those documents.

Pensions & Benefits Practice Group

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