



Research Advisory

Hewitt

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Highlights

- Supreme Court upholds employer's amendment of historical plan text, allowing administrative expenses to be paid from the pension fund.
- DB Contribution holidays are permitted, because actuarial discretion is required to determine obligations.
- Surplus can be used to fund employer DB and DC contributions, provided the plan is amended to make DC members beneficiaries of the same trust as DB members.

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Supreme Court Finds in Favour of Employer and Dismisses Appeal in *Kerry* Case

On August 7, 2009, the Supreme Court of Canada released a much-anticipated decision in *Nolan v. Kerry (Canada) Inc.* The case provides important guidance related to pension plan expenses and contribution holidays in plans that contain defined benefit (DB) and defined contribution (DC) provisions. The decision assists pension plan sponsors and administrators across Canada because it confirms the earlier Court of Appeal decision in favour of the employer, Kerry (Canada) Inc. (Kerry).

Overview

The Plan was established in 1954 as a DB plan with employee and employer contributions held pursuant to a trust agreement. By 1985, there was sufficient surplus in the Fund for the company to start taking contribution holidays. Although the Plan was originally silent with respect to the payment of administrative expenses, the employer paid those expenses until 1984. The following year, the Plan was amended to allow third-party expenses for actuarial, investment management and audit services to be paid from the Fund.

In 2000, the Plan was amended again to close the DB provisions to new employees and to introduce a DC component for new employees and any DB members wanting to convert to DC. At this time, Kerry began using the DB surplus to fund its contribution obligations for the DC component of the Plan.

A committee of Plan members challenged the payment of administrative expenses from the Fund and the use of DB surplus for DC contribution holidays, claiming these practices violated the trust. The Financial Services Tribunal of Ontario (FST) sanctioned both practices, except it determined that consulting fees for studying the introduction of a DC component should not have been charged to the Fund, because they did not benefit employees and were for the advantage of the employer. After three appeals, the Supreme Court has also found in favour of Kerry on the major issues, and upheld the FST's ruling.

Payment of Plan Expenses from the Fund Permissible

The Supreme Court found there is no requirement in the *Pension Benefits Act* (PBA), the Plan documentation, or general trust law principles, for Kerry to pay plan administration expenses, despite having previously done so. Although the original pension plan documents were silent with respect to the payment of plan administration expenses, this does not mean the employer is obligated to pay them.

The employer's only obligation is to pay trustee fees and expenses under a 1958 amendment to the trust agreement. Expenses for actuaries, accountants, counsel and other services were deemed to be expenses of the Plan, not the trust, and could therefore be charged to the Fund. Furthermore, the Supreme Court held that Kerry could charge the Fund for its own services as well as third party services, provided those expenses are reasonable and necessary.

***Hewitt Comment:** This finding will give employers comfort if their plan does not state whether the employer or the fund is responsible for the plan's administrative expenses. However, where plans are silent with respect to payment of plan expenses, employers should still consider amending the provisions to provide clarity, particularly since the PBA requires all plans to describe the mechanism for payment of costs for plan and fund administration.*

Where a pension plan historically requires the employer to pay plan expenses, the question of whether the plan can be amended to reduce or eliminate the employer's obligations to pay plan expenses is not addressed by the Kerry case. A careful review of the particular plan and trust provisions should be conducted, with particular focus on amendment powers, before considering such a change.

Plan Expenses from an Exclusive Benefit Trust

The committee of members argued that expenses could not be paid from the Fund because the trust agreement forbids using the Fund for any purpose other than the "exclusive benefit" of the employees. The Court disagreed, concluding that the "exclusive benefit" language is not a bar to charging administrative expenses to the Fund. The Plan was established for the benefit of employees and the payment of plan expenses was "necessary to ensure the Plan's continued integrity and existence." As such, Kerry could charge the Fund for its own services as well as third party services, provided those expenses were reasonable and necessary.

***Hewitt Comment:** The Supreme Court's decision represents a departure from the strict application of trust law principles, which had been the norm in pension disputes. This is so because the Court recognized that legitimate plan expenses remain for the "exclusive benefit" of employees despite incidental employer advantages associated with the establishment and maintenance of an employee pension plan. Similarly, allowing reimbursement of plan expenses incurred directly by the employer, in addition to simply recouping payments to third party service providers, also represents a welcome recognition of the inherent interests of employers in pension funds.*

DB Contribution Holidays Allowed

In 1965, the Plan was amended to clarify that the company could take contribution holidays and the Court was asked to consider whether that amendment was invalid and whether the original plan text prevented contribution holidays. To paraphrase, the original wording required the company to contribute such amounts as would provide for the retirement incomes referred to in the Plan. The 1965 amendment requires the company to contribute such amounts as are certified by the actuary as necessary to provide for the retirement income accruing to members.

The Supreme Court interpreted the original plan text as allowing Kerry to take DB contribution holidays because the use of actuarial discretion is required to determine contribution obligations. Further, the 1965 amendment was acceptable and clearly permits contribution holidays because company contributions are explicitly based on actuarial calculations.

***Hewitt Comment:** Previously, the law was clear that, when plan text provides that funding requirements are to be determined by an actuary, the employer can take contribution holidays unless other provisions of the plan or legislation prohibit it. The Kerry decision now demonstrates this is also true when the plan does not specifically refer to an actuary, but the use of actuarial discretion would be needed to determine contribution obligations.*

DB Surplus Can be Used to Fund DC Contributions

After adding the DC component to the Plan, Kerry announced its intention to use the DB surplus to fund its contributions for DC members. To decide whether this was permissible, the Court questioned whether or not the DB and DC arrangements were part of a single plan and trust. In general, the Court found that the law permits a single plan and trust to have different classes of beneficiaries, numerous accounts and various custodians. The Court further determined there was nothing in the historical plan documents that prevented Kerry from adding a DC component to the Plan and trust.

The Supreme Court ruled that the use of DB surplus to fund employer contributions for the DC component is acceptable, because there is only one Plan. However, the Court did require that the plan documents be retroactively amended to recognize the DC members as beneficiaries under the trust.

Despite closing off the original DB component to new members, the Plan was never terminated. As such, the DB members do not have a vested right to Plan surplus. Once the DC members were added to the trust, the surplus could be used to fund contributions for both DB and DC member benefits.

Two dissenting justices held that the DB and DC components are separate and distinct plans. They wrote that the use of surplus for DC contribution holidays violates the DB Plan's "exclusive benefit" language and amounts to an unlawful cross-subsidization between plans.

***Hewitt Comment:** The majority held that, subject to the need for a retroactive amendment in the Plan documents, the DC members could be beneficiaries of the same trust as the DB members. It would be advisable for plan sponsors to strive toward this type of arrangement if the desire is to use DB surplus to fund employer contributions to DC accounts. Otherwise, DC contribution holidays*

could be considered an unlawful cross-subsidization of one pension plan using the assets of a separate plan and trust.

However, an arrangement like that sanctioned in Kerry may not be possible in every case. All seven Supreme Court justices agreed that a careful analysis of historical plan and trust documents is required. Also, where DC accounts are held under an insurance contract, as in the Kerry case, it is not clear from the majority's comments the extent to which the insurance contract must be tied into the trust. If a definite tie-in is needed, then the logistics for doing so may prove a challenge to plan sponsors, trustees and insurers.

Deference and Costs

The Supreme Court recognized the Tribunal's skill and expertise in interpreting plan documents and pension law generally, and held that considerable respect and deference should be accorded to its decision in this case.

Where a trust fund is not a party before the FST, costs cannot be paid out of the fund at the Tribunal level. As well, on appeal to the courts, litigation costs can only be awarded from a pension fund where the proceedings are "necessary for the due administration of the trust". In *Kerry*, the Supreme Court did not allow the member committee's costs to be paid from the Fund.

Hewitt Comment: Hopefully, together these findings will help stem the flow of future pension litigation. Recognition by the Supreme Court of the FST's skill and expertise should encourage respect for its decisions among future litigants, while knowing that not all costs will be awarded from the pension fund should reinforce this trend and discourage protracted appeals through the court system.

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