

# advisory

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## **A** closer look at the Kerry decision: Clarity and direction for stakeholders

On August 7, 2009, the Supreme Court of Canada rendered a majority decision (with two of the seven judges dissenting) to dismiss the appeal in *Elaine Nolan et al. v. Kerry (Canada) Inc.* This means that the June 5, 2007, decision of the Court of Appeal for Ontario stands.

This issue of *Advisory* summarizes the Supreme Court decision and explains what it means to plan stakeholders. We include a brief history of the case, and the specific responses of the Supreme Court justices to each of the arguments raised by the employee-formed Pension Committee. For advice specific to your own circumstances, you should talk to your actuary or consultant.

### **Elaine Nolan et al v. Kerry (Canada) Inc.**

The Supreme Court of Canada arrived at the following important conclusions:

- Plan expenses can be paid from the pension fund provided that (a) the legislation does not prohibit it, (b) nothing in the plan documents requires expenses to be paid by the employer, and (c) they are reasonable and bona fide expenses necessary for the integrity and continued existence of the plan. On this basis, the Supreme Court ruled that the administrative expenses at issue were properly payable from the pension fund.
- Unless the terms of the plan do not permit contribution holidays, either explicitly or implicitly by removing actuarial discretion, an employer is entitled to take contribution holidays. On this basis, the Supreme Court ruled that Kerry's pension plan text allowed contribution holidays.

- If there is one trust in which all defined benefit (DB) and defined contribution (DC) members are beneficiaries, the use of trust funds for either DB or DC members would (a) not constitute a partial revocation of the trust (as there is only one trust), and (b) not infringe any exclusive benefit provisions, as both DB and DC members are beneficiaries of the same trust. On this basis, the Supreme Court ruled that it was permissible for Kerry to take contribution holidays under the DC component by using surplus under the DB component to satisfy its DC contribution obligations.

The Supreme Court of Canada is the final court of appeal in Canada, and the last resort to seek relief from lower court decisions. Therefore, this decision has significant implications for all pension plan sponsors, administrators and stakeholders and the Court's decision and findings are binding.

## Background

### *History:*

The Kerry pension plan was originally established in 1954 as a DB pension plan and its assets were held under a trust. The original plan documents provided that the employer was required to pay for trustee expenses but was silent with respect to other administrative expenses, and contained language which prohibited the use of the trust fund for purposes other than the exclusive benefit of plan members. Until 1984, the Company paid the plan expenses directly.

The plan was subsequently amended in 1985 to specifically permit contribution holidays and the payment of plan expenses from the trust fund. Following these amendments, third-party plan expenses for actuarial, investment management and audit services were paid from the trust fund and also in 1985, the Company started taking contribution holidays from its DB funding obligations.

In 1994, the Company accepted that it was responsible for certain trustee fees and reimbursed approximately \$235,000 to the trust fund. The remaining administrative expenses charged from the fund, totalling approximately \$850,000 from 1984 through 2002, were in dispute.

In 2000, the plan was amended to add a new DC component. Existing DB members were given the option of continuing to participate in the DB component or converting their DB benefit to be transferred to the DC component.

The Company announced its intention to take contribution holidays from its obligations to DC members by using the surplus accumulated in the trust fund from the DB component, which still covered DB members.

***Proceedings:***

A group of former employees established a Pension Committee and raised its concerns to the Superintendent of the Financial Services Commission of Ontario with respect to the payment of plan expenses from the trust fund and with respect to the contribution holidays taken by Kerry. The Superintendent did not require Kerry to reimburse the trust fund in respect of the contribution holidays and only required Kerry to reimburse certain expenses paid from the trust fund. As a result of the split decision, the Pension Committee requested a hearing before the Financial Services Tribunal (FST) concerning contribution holidays and Kerry requested a hearing before the Financial Services Tribunal concerning expenses.

In March 2004, the FST released a decision concerning the use of the trust fund to pay for plan expenses. The decision disallowed certain settlor expenses – consulting and legal fees relating to the introduction of the DC component of the plan (in the amount of \$6,455) that were charged to the pension fund but were “not incurred for the exclusive benefit of the members of the Plan.” The Company was ordered to repay these amounts to the pension fund.

In a subsequent hearing, the FST ruled on whether Kerry could use surplus generated in the DB portion of its pension plan to fund contributions under the DC portion of the plan. The DC portion of the plan was introduced on January 1, 2000. The FST decision (dated September 1, 2004), ruled that under the terms of the 2000 plan, the company could not use the DB surplus to fund the DC employer contributions unless the plan was retroactively amended to make the DC members beneficiaries of the trust fund.

The FST also refused to award costs from the Fund to cover the Pension Committee's expenses.

The Pension Committee appealed the FST decision to the Ontario Divisional Court who reversed many of the FST's findings. The Company subsequently appealed the Divisional Court's decision to the Court of Appeal for Ontario. In the June 5, 2007, decision the Court of Appeal unanimously ruled in favor of the employer (Kerry). The Pension Committee then appealed that decision to the Supreme Court.

## Supreme Court of Canada Decision

### *Plan Expenses*

The Supreme Court agreed with the analysis and conclusion reached by the Court of Appeal for Ontario which found that nothing in the Ontario *Pension Benefits Act*, the common law, or the Kerry plan documents required the employer to pay plan expenses.

Three main arguments were advanced by the Pension Committee in support of its position that Kerry was responsible for the payment of plan expenses:

- (a) Because the original plan documents did not expressly permit plan expenses to be paid from the trust fund, expenses must be paid by the employer.
  - Although the original plan documents did not *expressly* permit plan expenses to be paid from the trust fund, the Supreme Court reiterated the Court of Appeal's statement that "silence does not create an obligation on the employer to pay plan expenses".
- (b) The "exclusive benefit" language contained in the plan text prohibits the employer from using trust funds to pay plan expenses.
  - The Supreme Court held that because the payment of plan expenses is necessary to ensure the plan's continued integrity and existence, it is to the exclusive benefit of employees that such expenses be paid from the trust fund.

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- (c) The payment of plan expenses from the trust fund constitutes a partial revocation of the trust.
- The Supreme Court also rejected the contention that allowing plan expenses to be paid out of the trust fund constitutes a partial revocation of the trust. The Supreme Court held that *"so long as nothing in the plan texts requires the paying of expenses by the employer, funds in the pension trust can be used to pay reasonable and bona fide expenses"* and this does not constitute a partial revocation of the trust because *"the Company did not purport to control the use of funds it had placed in the trust"*.

On the issue of expenses, the Supreme Court also commented that it is immaterial whether the expenses relate to services provided by third parties or the employer itself, so long as the expenses charged are reasonable and the services rendered are necessary.

### ***What this means to stakeholders***

In light of the Supreme Court's decision, plan stakeholders should review existing expense payment practices and ensure that plan texts and trust agreements clearly align and authorize the practices being followed. Where necessary and legally permissible, plan documents should be amended to reflect the historical intent of stakeholders.

## DB Contribution Holidays

The Supreme Court confirmed that when plan documents provide that funding requirements are determined by actuarial practice, the employer is permitted to take a contribution holiday, unless other wording or legislation prohibits it. The Supreme Court referred to its previous decision in *Schmidt v. Air Products Canada Ltd.* where it stated that

*“any provision which places the responsibility for the calculation of the amount needed to fund promised benefits in the hands of actuary should be taken to incorporate accepted actuarial practice as to how that calculation will be made...that practice currently includes the application of calculated surplus funds to the determination of overall current service cost” and conversely, “the right to take a contribution holiday can be excluded either explicitly or implicitly in circumstances where a plan mandates a formula for calculating employer contributions which removes actuarial discretion”.*

The Supreme Court found that the provisions of Kerry’s 1954 plan text allowed contribution holidays to be taken by the employer on the basis that actuarial discretion is clearly called for, as the plan text required the employer to contribute “such amounts as will provide” for the employees’ retirement incomes and does not specify how these amounts will be determined.

## DC Contribution Holidays

This issue centered on having two benefit components under the same pension plan covering the same members – a DB and DC component – which the Divisional Court held created two separate and distinct plans and trusts. The Court of Appeal agreed with the FST that this could be rectified by retroactively amending the plan to make DC members beneficiaries of the DB trust.

The Supreme Court confirmed that the DB and DC arrangements could be components of a single plan and that the plan could be amended retroactively to create a single trust by including DC members as beneficiaries of the original DB trust as there are no legislative restrictions which prevent this.

The Supreme Court ruled that once the plan has been retroactively amended in this manner,

*“members of both parts of the Plan will be beneficiaries of the Trust; use of funds in the Trust to benefit either part is allowed because the Trust explicitly provides that the funds can be used for the benefit of the beneficiaries.”*

In other words, the Supreme Court reasoned that if there is only one trust in which all DB and DC members are beneficiaries, the use of trust funds for either DB or DC members would not constitute a partial revocation of trust and would not infringe any exclusive benefit provisions.

The Supreme Court further commented that assets of the DB and DC components would not be prevented from belonging to the same trust merely because the assets were held by different custodians.

Also of interest is the Supreme Court’s response to the argument that DB member benefits would be affected by making DC members beneficiaries of the DB trust. The argument is that amending the plan to do that, and to allow the employer to take contribution holidays in respect of DC members, would reduce the assets in the pension fund. The Supreme Court commented that

*“absent legislation stating otherwise, DB members have no right to require surplus funding of the Plan in order to increase their security” and “nothing in the plan documents or trust law gives the DB members a vested interest in the actuarial surplus of the Trust Fund or prevents the use of the actuarial surplus for Plan expenses or DB or DC contribution holidays”.*

### **What this means to stakeholders**

Based on the circumstances of this case, the higher court has again confirmed an employer’s right to take DB contribution holidays. The court found that the provisions of Kerry’s 1954 plan text allowed the employer to take contribution holidays, since the contribution amounts were determined actuarially.

Any right to take DC contribution holidays would be subject to the plan documents creating the DC component and the unique facts and circumstances of an employer’s

benefit plan structure. Plan stakeholders need to pay attention to the structure of DC plans and, in particular, to the "Policyholder" of underlying insurance contracts in addition to whether DC and DB components are structured as one plan and trust, or separately into two separate plans and trusts. Where there is only one trust but several components and/or custodians, in order to provide proper authorities, insurance contracts need to be issued to the trust, not the employer, in order to ensure that DC members are correctly designated as beneficiaries of the original trust.

## **Conclusion**

The Supreme Court's decision provides clarity and direction to plan stakeholders in the correctness of structuring new DC pension options. Plan stakeholders will have some homework to do in re-confirming their expense payment policies and ensuring that DC plan documents are properly structured.

Stakeholders should involve both consulting and legal expertise when structuring and implementing a new DC component which forms part of an existing DB plan so that the intent to create one single plan is clear in the plan, trust, and investment documentation. Non-trust custodians need to pay attention when issuing insurance contracts for DC plans and ask if it is unclear who the Policyholder should be.



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