



**M E R G I N G P E N S I O N P L A N S
I N C A N A D A : W H E R E D O
W E G O F R O M H E R E ?**

By [*Mitch Frazer*](#)*

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MERGING PENSION PLANS IN CANADA: WHERE DO WE GO FROM HERE?

A lack of clarity in the case law, coupled with minimal legislation and restrictive policies established by the regulatory bodies, have limited pension plan mergers in many Canadian jurisdictions. Recent legal developments have made pension plan mergers in Canada more complicated. In light of these developments, plan sponsors considering a pension plan merger need to be particularly aware of a number of key issues. The purpose of this paper is to analyze the problems of merging pension plans in Canada, determine how these problems are dealt with and propose solutions to the problems. This paper will focus primarily on registered pension plans from an Ontario law perspective.

The Problems of Merging Pension Plans

Although there are good reasons to be cautious when contemplating a plan merger, it is in both the employer's and the employee's best interest that such transactions be possible. When two businesses combine, if no merger of the plans is possible, employees may be disadvantaged. This is because many pension plans in Canada use calculations for entitlement which take years of service into account. Where plans are not merged, the combined pension an employee collects may be reduced and he or she has the inconvenience of collecting from two different plans.

From an employer's perspective, prior to the recent developments in the case law, it was common for plan sponsors to merge a plan in surplus with a plan in deficit and to use the surplus in one plan to off-set the funding obligations in the other. Furthermore, the synergies a company may achieve with another company are usually an important business consideration in a merger or acquisition. Thus, the ability to merge plans in order to make use of surplus, to transfer plan assets when undergoing corporate reorganization and to reduce administrative costs can be important to the employer's ability to conduct its business.

Most pension plans contain different provisions regarding plan mergers and the language of the plan text will help determine the ease with which a plan merger may take place. However, there are certain problem areas of which plan sponsors need to be aware when considering mergers and reorganizations. Primarily, a plan sponsor needs to determine whether its plan is impressed with a trust, as this will affect whether and to what extent the plan can be amended. Secondly, if there is a trust, the plan sponsor needs to examine the trust instrument in order to determine whether there is any language in the instrument which might affect a plan merger or reorganization. In *Schmidt v. Air Products*¹ the court held that the power of revocation must be expressly reserved in order for any amendments to be made to the trust instrument.² Finally, the plan sponsor needs to consider whether the plan is open or closed since the beneficiaries of a closed plan have certain rights that will affect the ability of the plan sponsor to deal with the plan.

One of the biggest problems facing plan sponsors and employers contemplating the merger of two or more pension plans is a subject that is sparsely addressed, if at all, in pension legislation. The regulatory control over the merger process in most Canadian jurisdictions is derived from the regulator's general authority to consent to, or deny approval for, the transfer of assets from one plan to another. In Ontario, legislation provides that where assets are transferred from one plan to another, the consent of the Superintendent is required.³ That consent cannot be given unless the pension benefits and other benefits of the members of the transferring plan are protected.⁴

* With assistance from Gillian Dingle, student-at-law, *Torys LLP*.

1 [1994] 2 S.C.R. 611 [hereinafter *Schmidt*].

2 *Ibid.* at 635.

3 *Pension Benefits Act*, R.S.O. 1990 c. P-8, ss. 80(4) and 81(4) [hereinafter PBA].

4 *Pension Benefits Act*, R.S.O. 1990 c. P-8, ss. 80(5) and 81(5).

Another problem is that historically, there has been little Canadian case law on the issue of pension plan mergers. However, recently, there has been case law which has restricted plan mergers. Two cases in particular illustrate the issues that plan sponsors and employers face when contemplating plan mergers.

Buschau v. Rogers Cablesystems Inc.⁵

This case involved the merger of a plan for employees of Premier Cablevision Ltd. (“Premier”). The Premier Communications Ltd. Pension Plan (the “Premier Plan”) was established in January 1974 and funded pursuant to a trust agreement. Under the trust agreement, money from the Premier Plan was to be used for the “exclusive benefit” of the Premier Plan beneficiaries, and no amendment was permitted to the Premier Plan which derogated from that right. Furthermore, any surplus that existed was to be used to provide enhanced benefits to Premier Plan members.

In 1980, Rogers Cablesystems Inc. (“Rogers”) acquired Premier, and began to administer the Premier Plan. Under Rogers’ administration, a new section was added to the Premier Plan text which specified that, upon termination of the Premier Plan, any surplus was to be returned to Rogers. By 1984, the Premier Plan had been in surplus for a number of years. As a result, Rogers decided to close the Premier Plan and begin taking contribution holidays. The contribution holidays continued until 1992, when Rogers decided to merge the Premier Plan with four other plans, three of which were in deficit, in order to form an amalgamated plan (the “RCI Plan”). The RCI Plan provided that all surplus was to revert to Rogers. In 1995, a number of the beneficiaries of the Premier Plan commenced an action against Rogers claiming a return of all withdrawn surplus and contribution holidays and claimed that they should be able to unilaterally terminate the plan pursuant to the rule in *Saunders v. Vautier*.⁶

At the British Columbia Court of Appeal, Newbury J.A. followed the Supreme Court of Canada’s reasoning in *Schmidt* and determined that “classic” trust principles, such as the rule in *Saunders v. Vautier*, ought to be applied to pension trusts. As a result, Newbury J.A. held that not only would the beneficiaries of the Premier Plan be able to terminate the plan against Rogers’ wishes, but that despite the merger, the members of the Premier Plan retained rights which were separate and distinct from those held by beneficiaries of the other plans. Because the original text of the Premier Plan had stipulated there were to be no amendments to the Premier Plan unless they were for the benefit of Premier Plan members, Newbury J.A. held that the Premier Plan had not in fact been merged and still existed as a separate trust, which required Rogers to separately account for it on a continuing basis. *Buschau* provides an important example of how difficult it can be to deal with pension trusts, both because classic trust principles are made to apply to an atypical trust format, and because trust law restricts the ability to amend a trust plan.

It is important to note that the rule in *Saunders v. Vautier* may only be applied where a trust is closed. With the extension of this rule to pension law, it is unclear how much effect it will have as plan sponsors generally have the power to re-open a plan. However, it is clear that Canadian regulators need to clarify the current uncertainty in order for plan sponsors to be able to administer their plans appropriately.

Aegeon Canada Inc. v. ING Canada Inc.⁷

Transamerica is the most important case dealing with asset transfers decided in the past few years. In this case, Aegeon Canada Inc. and Transamerica Life Canada had arranged to enter into a share purchase transaction with ING Canada Inc. (“ING”) for the shares of NN Life Insurance Company of Canada (“NN Life”). Under the share purchase agreement, ING had warranted that all required contributions had been made to the NN Life Pension Plan (the “NN Life Plan”), and the plan was fully funded on a going concern and solvency basis.

5 (2001) 26 C.C.P.B. 47 (B.C.C.A.), [2001] B.C.J. No. 50 (B.C.C.A.), online: QL (BCJ) [hereinafter *Buschau*].

6 (1841) 49 E.R. 282 (U.K. Ch. Ct.). This case set the groundwork for a principle of trust law which holds that beneficiaries who together are entitled to all the rights of beneficial ownership, actual and possible, in the trust property may, if they are of full capacity, call for the extinguishment of the trust, notwithstanding the settlor’s expressed wishes.

7 [2003] O.J. No. 4755 (Ont. C.A.), online: QL (OJ) [hereinafter *Transamerica*].

The NN Life Plan was the product of a merger between a Halifax Life Insurance Company of Canada pension plan (the “Halifax Plan”) and an NN Life Insurance Company of Canada pension plan. At the time of the merger, the Halifax Plan was impressed with a trust, the terms of which stipulated that no amendment to the trust could authorize the use of the funds in the trust for anything other than the “exclusive benefit” of the plan beneficiaries. Pursuant to the PBA, NN Life had sought plan merger approval from the Pension Commission of Ontario (“PCO”) prior to the merger. In order for the merger to be approved, NN Life was required to provide an undertaking that all transferred assets and associated liabilities of the Halifax Plan would be maintained in an account separate from the NN Life Plan. NN Life abided by the terms of the undertaking and made a separate accounting. However, for the purpose of determining whether it could take contribution holidays, NN Life treated the two plans as one. For a number of years, the Halifax Plan was in surplus and the NN Life plan was in deficit; however, based on the combined accounting, NN Life did not make any employer contributions to the NN Life Plan.

Upon examining the trust agreement, the Court of Appeal held that the terms of the trust prevented any part of the fund from being diverted to any purpose other than to the “exclusive benefit” of the Halifax Plan beneficiaries. Moreover, as a result of both the trust instrument and NN Life’s undertaking to the PCO, NN Life was required to maintain the Halifax Plan assets separate from those of the NN Life Plan.⁸ Ultimately, the court held that there was no legal basis for NN Life to consider the Halifax Plan surplus when determining its funding obligations for employees who were not members of the Halifax Plan.⁹ As a result, the court determined that ING had breached its warranties to Aegeon Canada Inc. and Transamerica Life Canada.

Solutions to these Problems

In response to *Transamerica*, the Financial Services Commission of Ontario (“FSCO”), the successor to the PCO, drafted a new policy on how it would approach pension asset transfers. Although this policy only pertains to Ontario registered pension plans, the direction taken by FSCO may influence the regulators in other Canadian jurisdictions. FSCO’s position drastically restricts plan mergers between defined benefits plans unless the merger can be distinguished from the facts of *Transamerica*.

A recent court decision, *Baxter v. Ontario (Superintendent of Financial Services)*¹⁰, has provided some welcome news for plan sponsors and employers who are contemplating plan mergers despite *Transamerica* and FSCO’s subsequent policy.

Baxter v. Ontario (Superintendent of Financial Services)

Baxter deals with the merger of two pension plans. The National Steel Car Corporation Limited Pension Plan (the “Original Plan”) was established in 1952 and covered both salaried and hourly employees. The Original Plan was funded through a group annuity policy with the Mutual Life Assurance Company of Canada and annuity contracts with the Canadian government. The Original Plan’s terms expressly permitted plan mergers. In 1965, the Original Plan was split into a plan for salaried employees (the “Salaried Plan”) and a plan for hourly employees (the “Hourly Plan”). Subsequently, in 1972, the Salaried Plan was amended to provide that any surplus was to revert to National Steel Car Limited (“NSC”). Finally, in 1994, the funding structure of both plans was changed to a pension trust.

In 2000, NSC announced that it intended to merger the Salaried Plan with the Hourly Plan by transferring the Salaried Plan to the Hourly Plan. At this time, the Hourly Plan was in deficit while the Salaried Plan was in surplus. The Superintendent of Financial Services consented to the transfer. However, members of the Salaried Plan applied to the Financial Services Tribunal to review the Superintendent’s decision. The Tribunal upheld the Superintendent’s decision and the members appealed to the Divisional Court.

8 *Ibid.* at para. 7.

9 *Ibid.* at para. 8.

10 [2004] O.J. No. 4909 (Div. Ct.), online: QL (OJ) [hereinafter *Baxter*].

The argument of the Salaried Plan beneficiaries was that the merger did not protect their benefits because the Salaried Plan surplus might be used to enable NSC to take contribution holidays despite the Hourly Plan's underfunded status. The Salaried Plan beneficiaries argued that their plan was subject to a trust prior to the amendment in 1994 and that, as a result, the amendment permitting the reversion of surplus made in 1972 was invalid. Finally, the beneficiaries of the Salaried Plan argued that *Transamerica* was binding on the court. In analyzing these arguments, the court made a number of important points. First, the court re-affirmed the trust law principle that in order for a trust to be created, there must be a clear intention to do so.¹¹ Second, the court held that, consistent with the finding in *Schmidt*, the beneficiaries of a plan do not have any rights in the surplus of a plan while the plan is ongoing. Finally, the court clearly distinguished *Transamerica* on its facts because unlike in *Transamerica*, in this case the plan text expressly permitted mergers.¹² This is significant because it potentially limits the scope of the *Transamerica* decision, and suggests that plan mergers may still be possible even where one plan is in deficit and the other in surplus.

The *Baxter* decision is welcome news for plans sponsors as it confirms that the FSCO's merger policy does not prohibit pension plan mergers and that there is nothing in general trust law which prevents such mergers. The facts in *Baxter* were quite different from the predecessor cases. Unlike *Buschau*, plan membership was not closed. Unlike *Transamerica*, there was no undertaking to keep plan assets separate. Therefore, plan sponsors and employers should be aware that a situation with less favourable facts may not yield the same results.

Where Do We Go From Here?

Pension mergers and asset transfers will always be case-specific. Thus, when approaching any pension plan merger in Canada, it is important to focus on the original plan text and any subsequent amendments to determine whether a merger is prohibited. Plan sponsors must be well prepared to demonstrate on a case-by-case basis that *Transamerica* and the regulator's asset transfer policy have no application to their asset transfer. In some cases, this may entail a legal review of the plan's historic language to assess whether the issues and the kind of language noted in *Transamerica* are present. This is especially important when dealing with a pension plan which is subject to a trust.

The recent cases dealing with pension mergers and asset transfers in Canada have left a significant number of questions for companies wishing to reorganize their pension structures. This uncertainty, delay and/or refusal to permit the transfers of assets and liabilities on sale of business transactions and in plan mergers does not benefit plan sponsors or plan members. Given the importance of pension plans to both the employer and the plan beneficiaries, it is crucial that Canadian governments and regulators step in and provide consistent direction on how these transactions may be effected without resorting to the judicial system.

Baxter is welcome news to pension plan sponsors who feared that pension plan mergers would be severely limited by *Transamerica*. However, while this decision clearly demonstrates that plan mergers are possible, each decision will turn on its own facts making it impossible to state that this case has paved the way for all plan mergers. *Transamerica* and FSCO's asset transfer policy will continue to significantly restrict the ability of plan sponsors to merge pension plans.

11 *Ibid.* at para. 71.

12 *Ibid.* at para. 69.