

## FOCUS ON LABOUR AND EMPLOYMENT LAW

# Decision makes paying plan expenses out of pension funds more difficult

By Mitch Frazer

In its recent decision in *Nolan v. Superintendent of Financial Services* (Court File Nos. 178/04 and 520/04 (Ont. Div. Ct.), March 15, 2006 [*Kerry*]), the Ontario Divisional Court overturned parts of a Financial Services Tribunal (FST) decision and made it more difficult for employers to pay plan expenses out of pension funds. The decision also limits the practice by certain pension plan sponsors of hybrid pension plans (plans with both defined benefit and defined contribution components) of using defined benefit plan surplus to fund employer contributions for the defined contribution component.

### Background

A pension plan was established pursuant to a trust. The original trust agreement provided that the trust fund could be used only for the exclusive benefit of plan members or their beneficiaries. The agreement also required the employer to pay most expenses incurred by the trustee. The employer did not reserve the power to revoke the trust in the

original trust agreement. In 1985, the employer changed its practice and began to authorize the payment of various administration expenses from the pension fund and began taking "contribution holidays" under the pension plan. In 2000, the employer amended the pension plan to add a defined contribution component and provide its employees with a one-time option to convert their defined benefit entitlement to a defined contribution account balance.

A group of former employees requested that the superintendent of financial services order the employer to reimburse the pension plan for certain expenses paid out of the fund, require the employer to reimburse the pension plan for contribution holidays taken since 1985 and refuse to register the 2000 plan conversion amendment. Through a series of appeals, these issues were considered by the FST, which rendered a decision generally favourable to the employer (see "Can plan expenses be paid from the fund?" in the March 24 issue of *The Lawyers Weekly*). The former employees appealed to the

Divisional Court.

### Plan expenses

The Divisional Court held that amendments made by the employer to permit the payment of administrative fees from the fund were invalid because the employer had not initially reserved a power to revoke the trust, and the amendments constituted a revocation of that trust. The Divisional Court also concluded that having the administrative fees paid out of the pension fund was not for the "exclusive benefit" of the employees. The Divisional Court ruled that the employer had to reimburse the fund, with plan rate of return, for all administrative expenses paid out of the fund since 1985.

### Contribution holidays

The Divisional Court held that, as a result of the plan conversion, the employer had created two pension plans, two pension funds and two classes of members, regardless of the language employed in the plan amendment. Therefore, the employer could not use surplus from the original defined benefit plan to fund its contributions under

the defined contribution component of the plan. Unfortunately, the Divisional Court decision contained little analysis of this "cross-subsidization" issue.

### Implications of *Kerry*

*Kerry* is likely to significantly affect the payment of plan expenses from a pension fund and the practice of using defined benefit surplus to fund employer contributions under a defined benefit component of a hybrid pension plan. Specifically, the decision creates the potential for expanded litigation in the area of plan expenses and opens the door to potential for litigation regarding past uses of defined benefit surplus to fund defined contribution obligations.

The decision also places significant restraints on many plan sponsors who currently pay plan expenses from their pension fund. Their ability to pay even routine expenses from the pension fund may be limited if historical pension plan and trust documents contain restrictive language.

Plan sponsors who convert a defined benefit plan to a defined contribution plan often use the existing surplus in the defined benefit component to take contribution holidays in the defined contribution component of the plan. *Kerry* severely limits this practice.

An application for leave to appeal has been filed in *Kerry*. If



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the decision is upheld on appeal, plan sponsors will have to review their current plan expenses practices to ensure they comply with both applicable pension legislation and common law. This will require a review of all historical pension plan and trust documents and a review of all past procedures. Sponsors of hybrid pension plans will also need to carefully review the way in which their plan is structured. Plan sponsors considering converting their defined benefit plan to a defined contribution arrangement should obtain legal advice on the impact of *Kerry* on their proposed plan conversion.

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