



**PENSION PLAN EXPENSES: IMPLICATIONS OF  
THE *KERRY* CASE ON YOUR EXPENSE  
PRACTICES**

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## Introduction

The increasing cost of pension plan administration has many employers asking whether pension plan expenses may be paid from the pension fund. The answer remains unclear, despite several high profile court cases. The state of the law on pension plan expenses is further muddled by the complex nature of pension plans, which are often based on agreements first executed decades ago and amended many times. As a result, the courts are faced with interpreting lengthy and ever-changing document trails and a complex area of law that is grounded in pension, contract, trust and employment principles.

On March 15, 2006, the Ontario Divisional Court released its decision in *Nolan v. Superintendent of Financial Services and Kerry (Canada) Inc.*<sup>1</sup> The decision in *Kerry* is an important statement on the subject of plan expenses; however, it should be noted that the decision is currently under appeal. To thoroughly explain the *Kerry* decision, we need to review the current pension plan expense framework as set out in the relevant legislation, regulatory policy and case law. We consider both the similarities and the ambiguities in the law to highlight unanswered questions. Then we contrast the findings and effects of the *Kerry* decision with predecessor legal principles and statements, focusing on registered pension plans from an Ontario law perspective.

## Provincial Legislation and Administrative Policy

### ***Pension Benefits Act (Ontario)***

In Ontario, the *Pension Benefits Act (Ontario)*<sup>2</sup> sets out the general principles applicable to pension plan administration and contains several provisions regarding the payment of administrative expenses. First, the PBA requires that pension plan texts contain a provision regarding the payment of administrative expenses. The relevant provisions of the PBA are as follows:

s. 10(1) The documents that create and support a pension plan shall set out the following information:

...

9. The mechanism for payment of the cost of administration of the pension plan and pension fund.

Accordingly, all pension plan texts should specify which party is responsible for paying the costs of administration. A broadly worded or vague provision on plan expenses may result in a dispute because each party may have a different interpretation of the provision.

Second, section 22(9) of the PBA limits the payment of administrative expenses from a pension plan to fees and expenses related to the administration of the plan and permitted by the common law or provided for in the pension plan.

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1 *Nolan v. Superintendent of Financial Services (subnom Kerry (Canada) Inc. v. Ontario (Superintendent of Financial Services))*, [2006] O.J. No. 960 [*Kerry*]. The appeal of the Divisional Court decision was held in the Court of Appeal on January 10 and 11, 2007.

2 R.S.O. 1990, c. P.8 [PBA].

Third, the PBA requires that the administrative expenses of a plan administrator's agent be "usual and reasonable":

s. 22(11): An agent of the administrator of a pension plan is not entitled to payment from the pension fund other than the usual and reasonable fees and expenses for the services provided by the agent in respect of the pension plan.

Therefore, in any dispute, a plan sponsor must be able to demonstrate that expenses paid from the pension fund are usual and reasonable, and are related to the administration of the plan.

### **FSCO Policy**

The Financial Services Commission of Ontario (FSCO) provides the regulatory framework for adjudicating pension plan disputes, and publishes policy statements on a variety of issues, including treatment of plan expenses. FSCO has indicated its views, by way of policy statements, on whether certain specified expenses, particularly certain types of fees, may be charged to the fund established by a pension plan. For example, FSCO's position is that actuarial or consulting fees, such as those incurred during collective agreement negotiations, are *not* "usual and reasonable expenses."<sup>3</sup> With respect to finder's fees and insurance broker commissions, FSCO's position is that these expenses are permissible provided that they are "related to the administration of the pension plan" and "a usual and reasonable fee and expense for the services provided."<sup>4</sup> If an assessment fee is incurred in determining whether an actuarial surplus exists, FSCO's view is that this expense is not an administrative, but an employer's, expense and thus cannot be charged to the fund.<sup>5</sup>

The above examples all permit the pension fund to be charged expenses related to administration, and prohibit charging expenses classified as employer-related. This assumption also underlies FSCO Policy A300-175, titled "Handling of Plan Fund Expenses and Maintenance of Plan Records", which provides guidance on the charging of administrative fees. In particular, the administrator's ability to recover expenses from a pension fund requires that the following test be satisfied:

The Administrator must first determine whether payment of the applicable fees and expenses would constitute a prudent use of the plan funds (i.e., whether the service rendered to the pension plan is appropriate and whether it would provide value to the pension plan when compared to the cost of the service). Consideration must also be given to the provisions of the pension plan document(s).

If the administrator decides that a charge against the fund is reasonable and appropriate but the plan documents do not provide a mechanism for making the payment, no payment may be made from the plan fund.<sup>6</sup>

Unless the pension plan itself provides a mechanism for paying the administrative fees and expenses, FSCO policy dictates that no such payments may be made from the pension fund.

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3 A200-100: Consulting and Actuarial Fees for Bargaining Purposes not Payable from Pension Fund (July, 1991). Note that the full text of active FSCO pension policies are available online at [www.fSCO.gov.on.ca](http://www.fSCO.gov.on.ca).

4 A200-400: Finders Fee or Insurance Broker Commissions Payable from Pension Fund (May, 1990).

5 Section 37(1) of Regulation 909 under the PBA specifically states that the employer shall pay the PBGF assessment. However, subsection 7(4) permits an actuarial gain in the pension fund to be used to pay the PBGF assessment in certain circumstances.

6 A300-175: Handling of Plan Fund Expenses and Maintenance of Plan Records - PBA, 1987 s. 22, s. 27 (Fall 1994) at 2.

From these FSCO policy statements, we can distill two related principles. First, as in the PBA, expenses related to the administration of the pension fund may be paid from the fund. Second, expenses for which the employer is responsible comprise expenses that are incurred in relation to the plan but are clearly the employer's responsibility under statute or are for the benefit of the employer. However, some expenses may not be clearly categorized as either administrator- or employer-based. This problem is echoed in the PBA, which also relies upon the administrator/employer distinction to determine which expenses are chargeable to the plan.

Collectively, the PBA and FSCO policies provide that a plan (i) must provide for plan administration, (ii) that certain administrative expenses may be refunded to the plan administrator, and (iii) that expenses must be reasonable. As the case law relating to plan expenses has developed, the following questions have arisen and are not answered by the PBA and FSCO policies:

- What types of fees fall into the category "related to the administration of the pension plan"?
- What types of expenses are considered "reasonable" and under what circumstances?

### **Paying Expenses from a Pension Fund Impressed with a Trust**

The uncertainty under the PBA and FSCO policy regarding the appropriate treatment of plan expenses has been the focus of debate in the growing body of case law relating to pension plan expense. Although a number of decisions have touched on the issue of plan expenses, three decisions in particular have been at the centre of this discussion. Each of these three decisions will be discussed under separate headings below.

#### ***Schmidt v. Air Products of Canada Ltd.***

The Supreme Court of Canada's decision in *Schmidt v. Air Products of Canada Ltd.* was a landmark case that addressed, among other things, whether administrative expenses may be charged to a pension fund.<sup>7</sup> Although *Schmidt* specifically addressed the issue of surplus ownership, general remarks from the case about the nature of pension trusts are relevant to the issue regarding the way assets in pension funds may be used, and more specifically to the issue whether administrative expenses may be properly paid out of such funds. The SCC began its analysis in *Schmidt* by noting that pension funds can be structured in several different ways, with insurance contracts and trust funds being the most common forms of funding. Thus, in determining whether administrative expenses are properly payable out of a pension fund, one must first review the original plan text and funding documents to determine whether contract law or trust law applies.

If a pension plan is not subject to a trust, it will be governed by the law of ordinary contract. In that case, the question whether a particular expense may be paid out of the pension fund is to be resolved by interpreting the construction of the clauses of the pension plan.

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<sup>7</sup> *Schmidt v. Air Products of Canada Ltd.*, 115 D.L.R. (4th) 631 (S.C.C.) [*Schmidt*].

If a pension plan is subject to a trust, any payment from the pension fund must be made in accordance with the original terms of the trust or a valid amendment to that trust. The SCC commented on the significance of this in *Schmidt*:

Firstly, the employer will not be able to claim entitlement to funds subject to a trust unless the terms of the trust make the employer a beneficiary, or unless the employer reserved a power of revocation of the trust at the time the trust was originally created.<sup>8</sup>

Thus, if plan documentation contains a power of amendment, the amendment provision and any amendments providing for return of funds to the employer will be ineffective unless the plan documents include a provision specifically providing for revocation of the trust.

### ***Markle v. Toronto (City of)***

In *Markle v. Toronto (City of)*,<sup>9</sup> the Ontario Court of Appeal applied the *Schmidt* principles to the issue of charging administrative fees and expenses to the pension fund. In *Markle*, the original plan provided that the City of Toronto (the City) would be responsible for the payment of plan expenses. The plan also restricted the City's power to amend the plan to recover contributions or to reduce accrued benefits. The plan was amended on three separate occasions to permit administrative expenses to be paid from the pension fund. The City also made an amendment to the plan that enabled the pension fund to be used to pay for administrative staff and services provided by the City in relation to the administration of the pension fund. The trustees of the plan requested that the court determine if the City could lawfully require the trustees of the plan to pay the City's costs for administration of the plan.

The Court of Appeal concluded that the pension fund was a trust fund for the benefit of employees, that the City did not have the power to revoke the trust and that the amendment constituted a partial revocation of the trust and was thus a breach of trust.<sup>10</sup> The Court of Appeal also held that although the City could amend the plan, it could not fully or partially revoke the trust. The Court of Appeal found that since the "essential element" of revocation is "removal of property or assets from the trust fund," the provisions of the amendment, which required the trustees of the plan to pay administrative expenses out of the pension fund, amounted to a partial revocation.<sup>11</sup>

### ***Kerry (Canada) Inc. v. Superintendent of Financial Services***

#### Background

In this case, the pension plan, funded via company and employee contributions, was impressed with a trust established in 1954 and restated in 1958. The original trust agreement stipulated that most expenses incurred by the trustee were to be paid by the company. Further, the settlor did not reserve a power of revocation under the terms of the original trust agreement. From the establishment of the plan to December 1984, the company paid all the expenses relating to the plan and the fund. However, beginning in 1985, the company began to pay plan expenses from the pension fund.

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<sup>8</sup> *Ibid.* at 643.

<sup>9</sup> *Metropolitan Toronto Pension Plan (Trustees of) v. The City of Toronto* (2003), 63 O.R. (3d) 321 (C.A.). Application for leave to appeal to S.C.C. dismissed, [2003] S.C.C.A. No. 138 (QL) [*Markle*].

<sup>10</sup> *Ibid.* at 50.

<sup>11</sup> *Ibid.* at 39.

In 2002, the Ontario Superintendent of Financial Services issued a Notice of Proposal to make orders requiring the company to repay all amounts paid by the fund since January 1, 1985. Specifically, repayment was sought for the administrative expenses that were not incurred for the exclusive benefit of the members and beneficiaries of the plan. Additionally, the Notice of Proposal required that amendments be made to the plan and the trust, requiring that only expenses that were for the exclusive benefit of plan members could be charged to the fund. In response, the company requested a hearing before the FST.

#### Ontario Financial Services Tribunal

The Ontario Financial Services Tribunal (FST) held that (i) when a trust agreement provides that the company is required to pay all expenses relating to the plan and a trust agreement, the company is responsible for ensuring that the trustee's expenses are paid, but it does not prevent those expenses from being paid from the fund; and (ii) the "exclusive benefit" language in a trust agreement means that the fund must be used for the "primary benefit" of plan members. With respect to the *Kerry* decision specifically, the FST concluded that the trustee fees, investment management fees and auditing fees could be charged to the fund. Further, actuarial and pension consulting fees could be charged to the fund, except those fees incurred in determining the feasibility of adding a defined contribution component to the plan.

#### Ontario Divisional Court

The Divisional Court rendered its decision on March 15, 2006. It effectively reversed the FST decision and 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 Court followed *Markle* and held that once an employer has irrevocably parted with assets to be placed in the trust, any attempt to regain control over the assets would ostensibly constitute a revocation of the trust unless this was expressly allowed for in the original trust document. The Divisional Court also concluded that having the administrative fees paid by 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 the plan's rate of return, for all administrative expenses paid from the fund since 1985.

#### Ontario Court of Appeal

On June 19, 2006, Kerry Canada Inc. obtained leave to appeal the Divisional Court decision in *Kerry*. The appeal was heard January 10 and 11, 2007, and the decision is, at the time of writing, still awaited.

### **Charging Administrative Expenses Where No Trust Exists**

*Schmidt*, *Markle* and *Kerry* are all based on pension plans impressed with a trust. Some plans are, however, subject to the general law of contract. In determining what area of law governs a particular plan, the SCC in *Schmidt* stated:

In the absence of provincial legislation providing otherwise, the courts must determine competing claims to pension surplus by a careful analysis of the pension plan and the funding structures created under it. The first step is to determine whether the pension fund is impressed with a trust. This is a determination which must be made according to ordinary principles of trust law.

...

If the pension fund, or any part of it, is not subject to a trust, then any issues relating to outstanding pension benefits or to surplus entitlement must be

resolved by applying the principles which pertain to the interpretation of contracts to the pension plan.<sup>12</sup>

Where the plan is found not to be impressed with a trust, the employee and the employer are bound by the terms of the contract, including any payment obligations and powers of amendment. If the contract does not provide for amendments to the plan, any subsequent amendments could be invalid by reason of breach of contract.

### **Comparing Kerry with Case Law on Prior Plan Expense**

*Kerry*, like *Schmidt*, examines all the historical plan documents in order to interpret the intentions of the parties and to determine whether amendments to the plan documents are valid. The need to examine all plan documents remains a critical step in deciding whether expenses may be charged to a pension fund.

The Divisional Court decision in *Kerry* assisted in reconciling the case law concerning the issue of plan expenses, given its treatment of the amendment of the trust. *Schmidt* and *Markle* clearly set out the principle that to amend a pension plan to provide for payment of expenses from the pension fund, an express power of revocation must be reserved by the settlor at the time the trust is formed. In the absence of this reserved power, an amendment will be invalid and could constitute a breach of trust. In *Kerry*, the settlor did not reserve a power of revocation, a fact that played virtually no role in the FST's decision. The Divisional Court disagreed with the FST and concluded that the plan expenses amendments and the payment of the plan expenses from the pension fund constitute a partial revocation of the trust.

After determining that amendments to the plan were invalid, the Court of Appeal in *Markle* enforced the original terms of the plan, which provided that the expenses would be paid by the plan provider, and required the City to pay the expenses. The Divisional Court in *Kerry* effectively followed *Markle* and determined that the amendments to the plan were invalid on the basis that the amendments purported to revoke the trust agreement in whole or in part. The Court held that *Kerry* was required to reimburse the fund for the amounts incurred to administer the plan from January 1, 1985 onward.

Case law prior to *Kerry* supports the principle that plans impressed with a trust may contain provisions for the payment of expenses from the fund. The Court in *Kerry* reviewed the trust agreement and determined that the administrator was not authorized to make payments out of the trust, except for the payment of taxes, interest and penalties. The Court concluded that administration fees were deliberately excluded from this list, creating a fair and reasonable belief that such expenses were not to be covered by the fund. Further, the Court determined that whether the expenses were internal to the administrator or paid to third parties was irrelevant.

### **Policy Issues Posed by Kerry**

The *Kerry* decision creates the potential for expanded litigation in the area of plan expenses. The decision also places significant restraints on many plan sponsors who currently pay plan expenses from their pension funds. Their ability to pay even routine expenses from the pension fund may be limited if historical pension plan and trust documents contain restrictive language. If the decision is upheld on appeal, plan sponsors will have to review their current plan expense practices to ensure that they comply with both applicable pension legislation and common law. This will require an examination of all

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<sup>12</sup> *Supra* note 7 at 666.

historical pension plan and trust documents, as well as of all past procedures. One question that remains is how these additional restraints, increased administrative burden and financial costs will affect plan sponsors' decisions to maintain their defined benefit pension plans.

Sections 22(9) and 22 (11) of the PBA were not analyzed by the Divisional Court, leaving uncertain the relationship between the statute, common law and the trust principles that have been developed in that context. Government action to amend the PBA could clarify the courts' decisions and provide certainty regarding payment of plan expenses.

Will *Kerry* result in expanded litigation regarding plan expenses? The decision may create significant liability for plan sponsors on the basis of past practice. This is particularly problematic in light of the recent increase in mergers and acquisitions in Canada, which have resulted in a number of employers acquiring past pension liabilities for which they may not be aware.

Since a pension plan is established to provide benefits to members, should the payment of expenses for administering the plan be prohibited, particularly in the absence of specific language requiring the employer to pay those expenses?

### **What Expenses Are Permitted?**

The question of what constitutes a "reasonable" expense to be paid in respect of the administration of the fund under PBA section 22 has not been squarely addressed by *Kerry* and its predecessors. However, a few clear principles may be identified when determining whether a particular expense may be charged to a fund:

- Where there is, and has always been, clear language enabling the charging of expenses to the fund, this is likely to be upheld.
- Historical plan documents will be carefully scrutinized by courts to determine whether plan expenses may be charged to the fund.
- The reservation of the power of revocation is key to determining whether the amendment of a trust to permit the payment of plan expenses is valid.
- Practitioners should consider the application of the expense when determining whether the payment of that particular expense is permissible.

### **Conclusion**

The appeal of *Kerry* was held on January 10 and 11, 2007. The decision is highly anticipated in the hope that the court will provide greater clarity regarding the issue of plan expenses. *Schmidt* and the cases leading up to *Kerry* continue to be relevant in assessing whether an expense may be charged to a pension fund. As plan expense issues gain momentum, it is expected that the case law in this area will be further developed as the courts increasingly address matters involving individual members and their disputes with plan sponsors or administrators. In anticipation of the Court of Appeal decision, practitioners should tread carefully in this highly contested area of pension law.

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