

Pensions at Work: Primer on Pension Issues Arising in the Workplace

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Introduction

The administration of pension plans present a variety of legal issues for plan sponsors. In examining registered pension plans in the context of Ontario law, I aim to demystify pension law by providing insight into two of the most basic pension issues that plan sponsors and their lawyers encounter: how a pension plan is governed and what happens to it when the employer decides to sell the business. The first section outlines the role of the plan administrator and gives an overview of different administrative models. The second section explores the way parties deal with pension plans in corporate transactions.

Pension Plan Administration Models

Every pension plan is administered by a plan administrator. Under Ontario's *Pension Benefits Act*, the administrator may be the employer who establishes the plan, a board of trustees, a pension committee or an insurance company, depending on the plan.¹ Whatever the identity of the administrator, every pension plan must have an administrator who is registered under the PBA.

Generally speaking, the PBA charges the administrator with ensuring that the pension plan and pension fund are administered in accordance with the PBA, the regulations thereunder and the terms of the pension plan.² Similarly, the *Income Tax Act* (Canada) recognizes the administrator as having "ultimate responsibility for the administration of the plan."³ Apart from these general duties, the administrator has an array of specific duties, including registering plan documents, investing the assets of the pension fund and submitting annual information returns to the Superintendent of Financial Services (Superintendent).⁴

While carrying out its duties, the administrator must exercise the care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person. The PBA requires an administrator to use all relevant knowledge and skill that it possesses or ought to possess by reason of profession, business or calling.⁵ Administrators with professional experience are therefore held to a higher standard of care. In addition to this statutory standard, administrators must also meet the common law standard imposed upon fiduciaries, since it is "virtually self-evident" that plan administrators stand in a fiduciary relationship to plan beneficiaries.⁶

Though these two duties are similar, they are not necessarily identical. For example, the common law requires only that a fiduciary use the prudence that an ordinary person would in managing his or her own affairs, whereas the PBA requires that an administrator use the prudence that an ordinary person would in dealing with the property of another. An administrator can comply with both these standards by adhering to the more stringent statutory standard. The real difference between the two duties of care is

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¹ *Pension Benefits Act*, R.S.O. 1990, c. P.8 s. 8(1) [PBA].

² *Ibid.*, ss. 19(1), 19(3).

³ *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), s. 147.1(1) [ITA].

⁴ PBA, *supra* note 1, ss. 12, 20(1), 22(1).

⁵ *Ibid.*, s. 22(2).

⁶ Ari N. Kaplan, *Pension Law* (Toronto: Irwin Law Inc., 2006) at 331.

the forum that handles disputes and dispenses remedies.⁷ The Superintendent has the power to remedy breaches of the statutory duty of care, whether or not there is a breach of contract or tort; the courts remedy breaches of the common law fiduciary standard through damages, restitution and equitable relief.

Administrators also owe plan beneficiaries a duty of loyalty, both under the PBA and as fiduciaries at common law. At common law, the duty is to act in the best interests of the plan beneficiaries and to avoid any real or perceived conflicts of interest. Under the PBA, administrators must not knowingly allow their interests to conflict with their duties and powers in respect of the pension fund.⁸ These duties of care and loyalty apply to all administrators regardless of their identity.

Single Employer

The majority of pension plans are administered by the employers that sponsor the plans. Accordingly, the employer must meet all the duties and responsibilities of administrators set out in the PBA and the common law. The PBA does not require that employees or pensioners participate in the administration of single-employer plans. In fact, very few non-unionized single-employer pension plans include employees or pensioners in plan administration.⁹

In the single-employer model, there is a tension resulting from the employer's dual role as administrator and employer. As the administrator, the employer has a duty to act in the best interests of the employees; but those interests may conflict with the interests of the employer. For instance, it is in the best interests of an employer to maximize profits by making only the minimum contributions to the pension fund. To accomplish this, the employer might amend the pension plan to make it more difficult for employees to receive an early pension, thus reducing plan liabilities and employer contributions. Since fewer beneficiaries would qualify for an early retirement benefit, the amendment makes them worse off. This conflict between the employer's interests and the beneficiaries' interests seems to violate the duty of loyalty that the employer owes as plan administrator.

The Pension Commission of Ontario dealt with a similar situation in *Imperial Oil Ltd. v. Ontario (Superintendent of Pensions)* in which it articulated the "two hats" principle of employer administration: "The PBA recognizes that an employer may wear 'two hats' in respect of pension plans. Indeed, section 8 specifically states that an employer may play two roles and it is self-evident that the two roles may come into conflict from time to time."¹⁰ This statement acknowledges and accepts the conflict inherent in allowing an employer to be the plan administrator. Employers must be aware of this conflict and be cognizant of which role they are playing when making particular decisions. In the role of plan administrator – for example, when investing plan assets – the employer must act in the best interests of plan beneficiaries. When the employer creates, amends or winds up the plan, it is acting as an employer and thus owes no fiduciary duty to the beneficiaries. Employers contemplating decisions that might adversely affect plan beneficiaries would be wise to seek legal advice to confirm the extent of their fiduciary obligations so that they do not risk running afoul of their statutory or common law duties as administrators.

⁷ *Ibid.*

⁸ PBA, *supra* note 1, s. 22(4).

⁹ Kaplan, *supra* note 6 at 318.

¹⁰ (1995), 18 C.C.P.B. 198 at ¶ 30-33.

Advisory Committee

Although having an advisory committee is not a model of plan administration in its own right, such a committee would be a mechanism to involve employees and pensioners in the administration of their single-employer pension plan. The PBA permits employees and pensioners to establish an advisory committee by a majority vote.¹¹ Once an advisory committee is established, each class of employees and pensioners is entitled to appoint at least one representative to the committee.¹²

The advisory committee has no power to direct the administration of the plan or the investment of the fund. Rather, its role is limited to monitoring the administration of the plan, recommending changes and improvements to the administrator, and promoting awareness and understanding among plan members.¹³ The advisory committee is also entitled to be notified of the employer's application for withdrawal of surplus.¹⁴ Despite an advisory committee's limited power, it gives employees and pensioners a formal voice, albeit a limited one, in the administration of their plan.

Jointly Sponsored Pension Plan

In a jointly sponsored pension plan (JSPP), governance is shared between the employer and the plan members. In contrast to an advisory committee, plan members have a substantive role in plan governance. For a plan to qualify as a JSPP under the regulations to the PBA, the documents that create and support the plan must make the employer and the members jointly responsible for all decisions regarding the terms and conditions of the plan and any amendments.¹⁵ The employer and members must also be jointly responsible for appointing an administrator or, where the administrator is a pension committee or board of trustees, appointing its members.¹⁶ The documents that create and support the plan must also set out the method whereby these decisions are to be made.¹⁷

Jointly sponsored pension plans are voluntary arrangements. Employees and pensioners must bargain for and attain the right of joint governance. Once a plan meets certain voluntary criteria, including the requirement of joint governance mentioned above, the PBA classifies it as a JSPP. Nothing in the legislation prescribes how to appoint the administrator, how to elect trustees, the powers of trustees or their term of office. As long as the employer and plan members share in the appointment, and the decision-making mechanism is set out in the documents that create and support the plan, all other details of plan administration can be worked out between the parties. Parties have the flexibility to structure the relationship as they choose, and the details vary from plan to plan.

Whomever the parties choose as plan administrator is subject to the common law and statutory duties of care and loyalty. Those who sit on a board of trustees must take their duties seriously and carry out their responsibilities diligently so as to avoid breaching their duties. Lay people who take on this role would be wise to obtain training to assist them with the responsibilities of their office.

¹¹ PBA, *supra* note 1, s. 24(1). Advisory committees are not available for plans administered by a pension committee with members appointed by plan members or for MEPPs established under a collective agreement: PBA, s. 24(6).

¹² *Ibid.*, ss. 24(2)-(3).

¹³ *Ibid.*, s. 24(4).

¹⁴ *Ibid.*, s. 78(2)(d).

¹⁵ *Pension Benefits Act Regulation*, R.R.O. 1990, Reg. 909, s. 3.1(1)(3) [PBA Regulation].

¹⁶ *Ibid.*, s. 3.1(1)(4). The remaining requirements for JSPPs are found in the PBA, *supra* note 1, s. 1(2).

¹⁷ *Ibid.*, s. 3.1(2).

Multi-employer Pension Plan

A multi-employer pension plan (MEPP) is a form of joint governance similar to a JSPP. Unlike a JSPP, however, a MEPP is not a voluntary arrangement: if the mandatory statutory criteria for a MEPP are present, the plan must be administered as a MEPP whether the two sides desire this or not. A pension plan is a MEPP if it is maintained for the employees of two or more employers and contributions are required by an agreement, statute or municipal by-law.¹⁸ Generally, a MEPP is established under a collective bargaining agreement. The administrator of a MEPP established by a collective agreement or trust agreement must be a board of trustees appointed under the pension plan or trust agreement.¹⁹ At least half of the board members must be representatives of the plan members, and the majority of trustees must be Canadian citizens.²⁰ Beyond these requirements, the PBA requires only that the documents that create and support the MEPP set out the powers and duties of the board of trustees. Matters such as design or composition of the board and its powers and duties are left to be negotiated between the employer and the union. The powers and duties can range from the narrow power to comply with the PBA to the broad power to deal with plan design and surplus funds.²¹

One requirement of the *Labour Relations Act* (Ontario) is that if the pension plan is maintained primarily for the members of a local trade union in the construction industry, the union is entitled to appoint a majority of trustees to represent the employees.²² The PBA has no similar requirement that employees appoint employee representatives, but one commentator suggests that the Superintendent would intervene if an employer were to appoint the employee representatives.²³

With a MEPP, as with a JSPP, the board of trustees, however constituted, becomes the administrator and is entrusted with all the attendant duties and responsibilities. The PBA specifically requires that the individual trustees use all relevant knowledge and skill that they have or ought to have by reason of their profession, business or calling to administer the plans.²⁴ Accordingly, a trustee who is a lawyer or an experienced business person would be evaluated according to a higher standard than a lay trustee with no business training. This modifies the common law rule that professional trustees are held to the same standard as lay trustees. Lay trustees must be aware that a court may deem them, as members of the administrative board, to have specialized knowledge and skill, and thus hold them to a higher standard.²⁵ Board members should receive appropriate training so that they can live up to the high standard that the court applies.

The benefit of joint-governance models like the MEPP and the JSPP is that plan members directly influence the way their plan is administered. This benefit comes at a price, with the trade-off being that the PBA exempts MEPPs and JSPPs from certain minimum protections that it affords other plans. Perhaps the most significant of these is the employer's obligation to fund any solvency deficiency or

¹⁸ *Ibid.*, s. 1(3).

¹⁹ *Ibid.*, s. 8(1)(e).

²⁰ *Ibid.*

²¹ Kaplan, *supra* note 6 at 324-25.

²² *Labour Relations Act*, S.O. 1995, c. 1, Sch. A., s. 150.

²³ Kaplan, *supra* note 6 at 321.

²⁴ PBA, *supra* note 1, s. 22(3).

²⁵ *Deraps v. Labourers' Pension Fund of Central and Eastern Canada* (1999), 179 D.L.R. (4th) 168 at 184 (Ont. C.A.).

unfunded liability. The PBA specifically requires JSPPs to set out the members' obligation to contribute, along with the employer, when there is any solvency deficiency or unfunded liability.²⁶ When a MEPP experiences a solvency deficiency or unfunded liability, the choices are to increase contributions or to decrease benefits. Since the collective agreement sets contribution levels, the trustees have no power to unilaterally increase them; only the parties to the collective agreement, the employer and the union, may amend the agreement to increase contribution levels. The remaining alternative for the trustees is to reduce member benefits. The PBA has a general prohibition on reducing benefits but MEPPs are exempt from this prohibition.²⁷ Thus, it is plan members who bear the cost of a solvency deficiency or an unfunded liability in a MEPP.

Another protection that plan members forfeit in order to gain joint governance is participation in the Pension Benefits Guarantee Fund (PBGF). The PBGF was established by the Ontario government to ensure that a minimum level of benefits are paid if an insolvent employer winds up a pension plan. MEPPs and JSPPs do not participate in the PBGF.²⁸ Though this means that they do not have to pay the premiums, it also means that plan members have no protection if their employer winds up the plan in a deficit position and has no money to make up the deficiency.

Pension Issues in Corporate Transactions

This section deals with the sale of the employer's business and the resultant effects on the associated pension plan(s). It is imperative that both the buyer and the vendor are aware of the pension issues in a corporate transaction because pension liabilities can represent a substantial portion of the overall transaction. In fact, pension issues can be the impetus behind a deal and they can also drive companies into insolvency. Dealing with pension issues appropriately in a corporate transaction is the key to avoiding difficulties at a later date. These issues are discussed below in the context of three common corporate transactions: a share purchase, an amalgamation and an asset purchase.

Share-Purchase Transactions

In a share-purchase transaction, an acquiror purchases the shares of the target corporation. The target corporation continues as before, the only change being the identity of the shareholders. This change in share ownership has no effect on the company's pension plan.

Share-purchase transactions are generally simpler than amalgamations or asset purchases because they require no separate transfer of the pension plan. Moreover, since there is no effect on the pension plan, there is no need to seek the Superintendent's prior approval.²⁹ Lawyers must still be cognizant of pension issues, however, because the funded status of the pension plan can directly affect the price of the shares. One reason for this is that the PBA requires that employers make special payments to cover any solvency deficiency or going-concern unfunded liability.³⁰ By stepping into the shoes of the vendor with an underfunded pension plan, the acquiror assumes liability for these special payments. Acquiring this liability reduces the value of the target company to the purchaser. Parties contemplating a share purchase

²⁶ PBA, *supra* note 1, s. 10(3).

²⁷ *Ibid.*, s. 14(2).

²⁸ *Ibid.*, ss. 85(4.)-(5.).

²⁹ Kaplan, *supra* note 6 at 467.

³⁰ PBA Regulations, *supra* note 15, s. 4(2).

should therefore ascertain the funded status of the target's pension plan before negotiating the purchase price.

A pension plan surplus affects the price of the shares as well, but not in exactly the same way. When there is a deficit, the special payments make the employer directly liable for the deficit. When there is a surplus, however, it is extremely challenging for an employer to withdraw money from the plan and thus has difficulty accessing surplus. The purchaser is generally only able to indirectly access the surplus by taking contribution holidays or, in some cases, by merging the acquired plan with a plan that is in deficit (discussed below in more detail). As a result, the purchaser will usually discount the value of the surplus when pricing the shares.

Since the funded status of the plan affects the share price, it is imperative that the purchaser conduct meticulous due diligence to gain a full understanding of the nature and magnitude of the obligations it is buying. Due diligence is also crucial to confirm that the plan has been administered properly in the past. If, for example, the vendor has taken unauthorized contribution holidays, the purchaser becomes liable to repay these if the issue is not dealt with in the purchase agreement. Other issues that the purchaser must be mindful of include past compliance with the PBA and the ITA, and any past payment of plan expenses from the pension fund, withdrawal and use of surplus, asset transfer or plan conversion. Any of these could represent a liability to the employer, thereby reducing the value of the target company.

Vendors as well must conduct due diligence early in the process so that they can identify and resolve any issues that might arise during the transaction. Due diligence also helps vendors ensure the accuracy of their representations and warranties. To avoid liability for inaccurate representations and warranties, the vendor should only make representations and warranties that it can verify through due diligence.

Amalgamations

An amalgamation occurs when two (or more) corporations combine to form one legal entity.³¹ The amalgamated company thus formed inherits all the legal rights and responsibilities, including the assets and liabilities, of the amalgamating companies. Any pension plans of the initial corporations automatically become the responsibility of the unified entity. Much like in a share purchase, no separate transfer of the pension plan is necessary.

It is important to note that despite the corporate merger, the pension plans themselves do not automatically merge. Both plans become the responsibility of the amalgamated company, but they maintain their individual identities and are administered separately with no co-mingling of funds.

Administering two pension plans is more onerous than administering a single plan for all employees of the amalgamated company. A single plan also offers the advantage of uniformity of benefits among all employees. For these reasons, the amalgamated entity may choose to merge the two plans. Plan mergers are especially attractive when one plan has a surplus and the other has a deficit because the surplus of one plan offsets the deficit of the other. This liberates the amalgamated company from the obligation to make special payments to fund the deficit. One caveat is that this practice may have trust law implications, which are discussed below.

³¹ This is also known as a *merger*. Though the term *amalgamation* describes a particular transaction under the corporate statutes, a merger may be any one of a number of transactions whereby two companies join together, including an amalgamation and an asset purchase.

From a pension perspective, merging the two plans is often more complicated than the initial corporate merger. Part of the reason for the complexity is that the Superintendent must consent to the plans being merged before this can be effected.³² A Financial Services Commission of Ontario (FSCO) Policy Statement outlines the circumstances under which the Superintendent will consent.³³ Any company planning to merge two plans should familiarize itself with this document and its contents. Some of the requirements of the policy are procedural – preparing and filing reports and giving the members and any unions notice of the transfer – whereas others are substantive. Perhaps the most important substantive prerequisite to the Superintendent’s consent comes not from the FSCO policy but from the PBA itself, which stipulates that the Superintendent will not consent to a merger unless it protects the benefits of the members and former members of the original plans. This rule ensures that the merger does not deprive members of any benefits originally promised them. All the preconditions to the Superintendent’s consent make a plan merger an arduous task for the company and its legal advisers.

Trust law considerations also add to the complexity of plan mergers. *Aegon Canada Inc. v. ING Canada Inc.* provides an illustrative example.³⁴ In 1969, the Halifax Life Insurance Company of Canada established a pension plan for its employees. The pension plan was funded by a trust agreement that gave Halifax Life employees the right to any surplus. The terms of the trust prohibited amendments that would allow any part of the capital or income to be used for anything other than the exclusive benefit of Halifax Life employees. Halifax Life later merged with the NN Life Insurance Company of Canada. Due to the restrictions imposed by the trust, NN Life gave the Pension Commission of Ontario (the predecessor to FSCO) an undertaking that it would administer the assets of the Halifax Life pension plan separately from the assets of the NN Life plan. While fulfilling the undertaking and administering the funds separately, NN Life nonetheless treated the two plans as a single entity when calculating its funding obligations. Since the Halifax Life plan had a surplus that more than offset the NN Life plan deficit, the two plans together had an overall surplus. NN Life took contribution holidays from both plans on the basis of this combined surplus.

Aegon Canada Inc. bought the shares of NN Life from ING Canada Inc. in 2000. In a corporate shuffle following the sale, NN Life amalgamated with the Transamerica Life Insurance Company of Canada. One of the representations that ING made in the purchase agreement was that the NN Life pension plan had a surplus. It never disclosed the deficit of the NN Life portion of the plan. Aegon had planned to use the surplus to take contribution holidays. By this time, however, the deficit of the NN Life plan was such that Halifax Life assets would soon have to be used to fund the benefits of NN Life employees. Since the terms of the Halifax Life trust did not allow this, Aegon could not use the surplus to subsidize the NN Life deficit and so could not take contribution holidays. Aegon sued ING for breaching its representation that the pension plan had a surplus.

The lower court found in favour of Aegon. NN Life was not entitled to combine the plans when determining the value of the surplus because the terms of the trust prevented the assets from being used to pay the benefits of NN Life employees. ING therefore misrepresented the value of the pension surplus. Furthermore, the Court held that NN Life’s contribution holidays prior to the sale were improper. The Court of Appeal agreed with the trial decision, dismissing the appeal and confirming that the terms of the

³² PBA, *supra* note 1, ss. 80(4), 81(4).

³³ Financial Services Commission of Ontario, Policy Statement A700-200, “Asset Transfers Resulting from the Sale of Business, PBA 1987, ss. 26(1), 79-81” (28 July 1988).

³⁴ [2002] 48 E.T.R. (2d) 170 (Ont. S.C.J.), *aff’d* (2003), 38 C.C.P.B. 1 (Ont. C.A.) [*Transamerica*].

trust prevented the surplus of the Halifax Life plan from ever being used for the benefit of non-Halifax Life employees.

This case raised questions about the legality of plan mergers. In an attempt to shed some light on the issue, FSCO released a policy statement containing a checklist of situations in which the Superintendent would allow asset transfers and plan mergers.³⁵ These situations include that in which neither plan is subject to a trust or, if there are trusts, the transfer does not breach the terms of the trusts. Following *Transamerica*, plan mergers have become more difficult although not impossible. In *Lennon v. Rockwell Automation Canada Inc.*, for example, the Financial Services Tribunal affirmed the decision of the Superintendent allowing a merger of two plans despite both being subject to a trust.³⁶ In a corporate amalgamation in which the parties intend to merge the two plans, the key point to remember is that the parties must know when either plan is funded through a trust. If so, the parties must pay particular attention to the terms of the trust, otherwise their proposed merger may be turned down; worse yet, they may face the prospect of costly litigation.

Asset-Purchase Transactions

Of the transactions discussed thus far, asset-purchase transactions have the most complex pension component. An asset purchase is the sale to the purchaser of some or all of the vendor's assets. Since the purchaser is able to select which assets and liabilities are transferred, the vendor's pension plan is not automatically included in the transaction. The pension plan is transferred only if it is part of the package of assets and liabilities subject to the sale. If the agreement is silent regarding the pension plan, the vendor's plan remains with the vendor. Contrast this with a share purchase whereby if the agreement is silent, the purchaser inherits the target company's pension plan. Note that pension issues generally arise only if some or all of the vendor's employees are transferred to the purchaser or if the vendor lays off employees after the sale. The transaction raises no pension issues if the purchaser simply buys some of the vendor's equipment and no employees are transferred or laid off.

The following subsections discuss the five principal ways in which the parties can deal with pensions in an asset deal.

1. Purchaser Offers No Pension Plan

The purchaser may elect to provide no pension plan for the transferred employees. This is an option when the purchaser has no pension plan for any of its employees or when it has a group registered retirement savings plan (RRSP) that it wishes the new employees to join. Alternatively, the purchaser may not intend to keep the transferred employees for the long term, or it may consider it inappropriate to have a pension plan for a group with their demographics.

This avenue is generally available because the PBA does not require employers to maintain a pension plan. One circumstance in which this option is not available is when the collective agreement covering the transferred employees obligates the employer to provide a pension plan. Otherwise, the parties are free to pursue this option if they so choose.

³⁵ FSCO, "Trust Issues on Plan Transfer/Merger (Transamerica)" (September 2005).

³⁶ Financial Services Tribunal, 20 February 2006, online: <http://www.fstontario.ca/english/decisions/pension/P0051-1999-1.pdf>.

Though this option saves purchasers the cost of funding a plan and the effort of administering it, they should keep in mind that taking a pension plan away from the transferred employees could breed discontent, which in turn could reduce productivity and employee retention. For the vendors, taking away the pension plan may create liability for constructive dismissal on the basis that eliminating pension benefits is a fundamental change in the employment relationship.³⁷ For this reason, the vendor may push for an agreement that compels the purchaser to offer employees compensation and benefits that are no less favourable than what they received from the vendor. Constructive dismissal may not be a concern if the purchaser provides a group RRSP or improves employee benefits in other areas.

Another concern the vendor may have is that this approach may cause the Superintendent to order a windup of the vendor's pension plan so far as it deals with the transferred employees.³⁸ Winding up can be costly to the vendor because it results in full and immediate vesting of entitlements and triggers "grow-in" rights.³⁹ The vendor also has to go through the administrative process of winding up and dealing with any pension surplus or deficit. A vendor will be more amenable to a purchaser's desire to provide no pension plan when there are few grow-in rights and only a minimal surplus or deficit.

2. Purchaser Offers Future-Service-Only Pension Plan

A second option is for the purchaser to provide transferred employees with pension benefits for "future service only." In this scenario, the vendor remains responsible for all pension benefits accrued to the date of the employee transfer, and the purchaser maintains a plan for service after the date of the transfer. The purchaser can either establish a new plan or allow the transferred employees to join an existing plan. Again, the parties must be mindful of any collective agreements that could require the transferred employees to participate in a particular pension plan, rendering this arrangement impermissible.

Simplicity is the principal advantage of this alternative. The PBA does not require the Superintendent's approval since pension plan assets are not being transferred so there are no regulatory steps to go through. This approach also eliminates the need for complex negotiations over how much to transfer on account of each employee. Purchasers might prefer this strategy when the vendor's plan is underfunded because it allows them to start fresh with the transferred employees, not having to deal with any existing unfunded liabilities or solvency deficiencies.

A future-service-only arrangement presents several risks for the vendor. The first is that the vendor faces a potential windup order and its attendant costs if the purchaser fails to establish a successor plan. Another risk is that the vendor may be deemed to be an employer for the purposes of determining pension liabilities long after it ceases to employ the transferred employees. This is precisely what happened in *GenCorp Canada Inc. v. Ontario (Superintendent, Pensions)* in which the parties adopted a future-service-only arrangement in a 1987 transaction. The purchaser closed the business in 1991 and wound up its pension plan.⁴⁰ As a result the Superintendent ordered a partial windup of the vendor's plan. Despite not being the employer for four years and taking no part in the decision to wind up the plan, the vendor was burdened with windup liabilities for the transferred employees. To avoid a similar outcome, vendors should negotiate a covenant in the agreement requiring the purchaser to maintain its plan for a specified

³⁷ Kaplan, *supra* note 6 at 474.

³⁸ PBA, *supra* note 1, s. 69(1)(f).

³⁹ Grow-in rights allow members to collect their pensions at an earlier age so it increases the commuted value of their pension: Kaplan, *supra* note 6 at 536; and PBA, *supra* note 1, ss. 73, 74.

⁴⁰ (1998), 39 O.R. (3d) 38 (Ont. C.A.).

period of time and seek an indemnity for any liabilities that may arise if the purchaser winds up the successor plan. On the other hand, purchasers should be cautious about assuming these potentially significant liabilities.

The vendor also faces the spectre of constructive dismissal because a future-service-only plan reduces the benefit an employee receives in retirement if the pension benefit formula is based on average or final salary. An employee's salary statistics with the vendor crystallize on the date of the transfer so the employee's benefits from the vendor's plan are based on salary to that date. The employee gets no credit in the vendor's plan for any salary increases after the date of the transfer. If the employee's salary increases over time, the transfer between plans makes the employee worse off, even if the two plans have identical benefits formulae.⁴¹ The decrease in the employee's pension benefit may be a fundamental change in employment terms and may therefore be a constructive dismissal. The vendor can avoid liability by requiring the purchaser to provide a wrap-around benefit (discussed below) that offsets the decrease. Despite the cost of providing a wrap-around, the purchaser may be receptive because decreasing employee benefits by offering a future-service-only plan can negatively affect productivity and employee retention.

Future-service-only arrangements are becoming more popular because of the recent trend away from defined benefit plans. Employers increasingly prefer to place the transferred employees who may be coming from a defined benefit plan into a defined contribution plan or group RRSP. To facilitate this preference, both parties should be aware of the potential liabilities so that they can prepare and negotiate accordingly.

3. Purchaser Offers Future-Service-Only Pension Plan with Wrap-Around Benefits

This option is a future-service-only arrangement whereby the purchaser provides a wrap-around benefit to offset the resulting reduction in benefits. The wrap-around is an attempt to simulate the situation the employee would have been in had the transfer between plans not taken place. The purchaser thus recognizes the employee's service and salary while a member of both plans when determining the employee's total pension benefit, which is made up of three components: the employee's entitlement under the vendor's plan, which the vendor pays; the employee's entitlement under the purchaser's plan, which the purchaser pays; and the wrap-around. The wrap-around tops up the employee's pension benefit to what it would have been, based on the employee's total service and salary in both plans. To avoid additional liabilities in the event that the vendor defaults on its obligations, the purchaser should insist that the amount of the wrap-around be based on benefits payable under the vendor's plan rather than benefits actually paid.

A wrap-around avoids a potential constructive dismissal dispute and employee discontent, which is its main advantage over a simple future-service-only arrangement. One advantage of a wrap-around over an asset transfer between plans is that solvency of the vendor's plan is not put at risk by a large one-time payout.

⁴¹ Take for example, an employee who works 30 years, 15 for the vendor and 15 for the purchaser. The employee's salary starts at \$30,000 and is raised by \$1,000 per year until retirement. Given a pension benefit formula of 2% multiplied by years of service multiplied by average salary in the best five years, without the transfer the employee would be entitled to an annual pension benefit of \$34,800. With the transfer, the employee would only be entitled to an annual pension benefit of \$30,300 (\$12,900 from the vendor and \$17,400 from the purchaser).

There are several disadvantages to providing a wrap-around. The obvious disadvantage is the added cost to the purchaser of funding the wrap-around benefit. Another disadvantage is the inconvenience to employees of receiving pension payments from two different sources. Finally, there is the costly administrative duplication that results from both the vendor and the purchaser maintaining pension plans for the same employees.

4. Purchaser Acquires Assets and Liabilities Corresponding to Transferred Employees

This strategy involves the purchaser providing a pension plan to transferred employees for their time with both the vendor and the purchaser. To fund the purchaser's additional liability, the vendor transfers any assets in its pension plan corresponding to the transferred employees. Essentially, the purchaser funds benefits for service with the purchaser while administering the employee's benefits accrued for service with both parties.

An asset transfer is sometimes used when a purchaser buys all the vendor's assets but the employees participate in the pension plan of the vendor's parent company. The purchaser cannot assume sponsorship of the plan because it includes many employees with which the purchaser has no relationship.

Employees may be most satisfied with this arrangement because they receive a full pension benefit from only one source. It is, however, the most complex to carry out. The parties must spend much time and employ many experts negotiating the scope and value of the assets to be transferred. They must also resolve other issues such as who must complete the regulatory filings, what happens if the transfer is not approved and who bears the investment risk between the date of the agreement and the date of the asset transfer. Additional complexity arises from the requirement that the Superintendent must consent to asset transfers. As seen above, this approval is not easy to obtain, especially when there are trust law issues. Because of its difficulty and cost, this is not the most popular strategy for parties in asset-purchase transactions.

5. Purchaser Assumes Sponsorship of Vendor's Pension Plan

The final strategy in an asset-purchase transaction is for the purchaser to assume responsibility for administering the vendor's pension plan. All that is required to effect this is an amendment to the vendor's plan changing the plan sponsor from the vendor to the purchaser. The purchaser then assumes the plan "as is," including all assets and liabilities and any surplus or deficit.

The primary attribute of this strategy is its simplicity. Since it is achieved through a plan amendment, the parties must obtain Canada Revenue Agency and FSCO approval, but such approval is easily obtained. Employees appreciate this option because it has minimal effect on them; it does not decrease their pension benefit and their benefit cheques come from one source in retirement.

Negotiating this type of agreement is easier than negotiating an asset transfer, but the parties must still negotiate a price adjustment to the overall deal based on the funded status of the plan. Other points of negotiation are the representations and warranties. Since the buyer takes the plan "as is," it assumes responsibility for the vendor's prior management. If, for example, the vendor has improperly taken contribution holidays or improperly charged administrative expenses to the plan, the purchaser will be liable to the plan. To avoid any such hidden liabilities, the purchaser should attempt to negotiate extensive representations and warranties regarding past administration and funding of the plan.

Because of this risk to the purchaser, it is more common for the purchaser to assume the vendor's plan if it is a defined contribution plan, which has a much lower financial risk.⁴² Assuming the vendor's plan may also be appropriate where the vendor's employees are subject to a collective agreement that requires them to participate in a particular pension plan. In that case, the only way for the purchaser to abide by the collective agreement is to assume the plan.

Conclusion

This paper is designed to provide a brief overview of pension administration models and pension issues in corporate transactions. Both areas are far more complex than could be covered here and are dynamic, constantly evolving fields of law, especially pensions in corporate transactions. I hope that this overview inspires you to explore these topics in greater detail, but it will have done its job if it allows you to identify the key issues. **1**

⁴² Kaplan, *supra* note 6 at 476.