



## **Distressed Mergers and Acquisitions and Restructuring: Your Guide to Managing Pension Risks in Corporate Transactions**

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Mergers and acquisitions can bring a host of pension and benefits issues to the surface. To minimize the risks associated with acquiring or divesting pension liabilities, each party to a corporate transaction must be aware of its options as well as the consequences that flow from each. Specifically, both buyer and seller must consider how the transaction will affect the rights and interests of the beneficiaries of the pension plans. The transacting parties should also know the types of pension plans available to the affected employees, the manner in which those pension plans are funded and administered, and where the plans are registered. Additionally, the nature of the transaction itself must be considered: specifically, whether it involves a sale of assets, a sale of shares or a merger or amalgamation of companies and potentially of pension plans. Ideally, these issues should be considered before or in the early stages of any business transaction.

In this paper, we identify and analyze pension issues, obligations and risks that arise in corporate transactions. We examine registered pension plans from an Ontario perspective. Such plans must be registered with the Canada Revenue Agency (CRA) under the *Income Tax Act* (Canada) (ITA)<sup>1</sup> and with the Financial Services Commission of Ontario (FSCO) under the *Pension Benefits Act* (Ontario) (PBA).<sup>2</sup>

Federal pension benefits standards legislation applies to federally regulated industries (such as airlines and telecommunications), and every province in Canada (except Prince Edward Island) has its own pension benefits standards legislation. These statutes set out minimum standards for registered pension plans. When a company has employees in more than one province, its pension plan is generally registered in the province where the greatest number of members reside. However, members residing in other provinces are subject to the minimum standards of the applicable legislation of their province of residence to the extent that such minimum standards provide a greater right or benefit. It is important to ascertain the jurisdiction of registration of any pension plan in a transaction and to determine whether employees in other provinces are covered under the plan.

Note that there are many other types of plans that should be considered in corporate transactions, including benefit plans, profit sharing plans, group RRSPs, supplementary executive retirement plans and retirement compensation arrangements. A discussion of these plans is, however, beyond the scope of this paper.

## 1. Introduction to Pension Plans

Generally speaking, there are three principal types of registered pension plans: defined contribution plans, defined benefit plans and multi-employer pension plans. The employer must contribute to all types of plans. Employees may also be required to make contributions, in which case the plans are known as “contributory.” In “non-contributory” plans, the employees are not required to contribute.

### Types of Pension Plans

#### *Defined Benefit Plan*

A defined benefit (DB) plan stipulates the pension benefit that will ultimately be received by the participant without detailing the contributions required to provide the benefit promised. Typically, a DB plan identifies a formula, based on factors such as earnings and years of service or plan membership, that determines what benefit a plan member is entitled to receive upon retirement. For example, the plan may provide a benefit of 2% of the employee’s average salary over a specific period multiplied by the number of years of pensionable service.

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<sup>1</sup> R.S.C. 1985, c. 1 (5th Supp.).

<sup>2</sup> R.S.O. 1990, c. P.8.

### **Defined Contribution Plan**

In contrast to a DB plan, a defined contribution (DC) plan specifies the contributions that the employer (and the employee if the plan is contributory) is required to make but does not specify the benefits ultimately payable to plan members. The contributions made on behalf of a member are contributed to his or her account, which is invested.<sup>3</sup> Upon retirement, the member's pension depends on the balance in his or her account. For example, the employer may contribute 2% of the employee's salary for each year of employment and the pension benefit ultimately payable will be based on the aggregate contribution made in respect of that employee and the investment return on the contribution.

### **Multi-Employer Pension Plan**

A multi-employer pension plan (MEPP) is defined in subsections 1(3) and 1(4) of the PBA as a "pension plan established and maintained for employees of two or more employers who contribute, or on whose behalf contributions are made, to a pension fund by reason of agreement, statute or municipal by-law to provide a pension benefit that is determined by service with one or more of the employers," but it does not include a pension plan in which all employers are affiliates within the meaning of the *Business Corporations Act* (Ontario).<sup>4</sup> MEPPs are often established by unions in industries with significant mobility in their workforces. Contributions to MEPPs are generally the subject of labour negotiations and are entrenched in the applicable collective agreement. The advantage of an MEPP is that even if an employee works for a number of employers who contribute to the MEPP, he or she will always remain a member of the plan and earn credits as if employed continuously by the same employer.

Issues related to MEPPs arise in the context of corporate transactions. As with any other pension plan, it is important to review all relevant documents related to the MEPP, which may include the plan text, a participation agreement, a funding agreement and an applicable collective agreement and/or participation agreement. In addition, the PBA contains certain special rules applicable to MEPPs that must be considered. In the final section of this paper, we elaborate on pension issues specific to MEPPs.

### **Funding of Pension Plans**

Registered pension plans must be funded in accordance with the CRA's requirements, as set out in the ITA, and the applicable pension legislation and regulations. The two most common mechanisms for funding pension plans are trust agreements and insurance contracts.<sup>5</sup> When a trust is used, the plan

<sup>3</sup> Parties often focus only on DB plans because of the funding concerns related to these plans. DC plans, however, have their own potential risks. Specifically, there are potential legal risks if these plans have not been properly and prudently administered. For example, there may be exposure if not enough investment options were provided to plan members, if insufficient information was provided to plan members or if the administrator failed to monitor the investment performance of the various fund managers.

<sup>4</sup> R.S.O. 1990, c. B.16 [OBCA]. Subsection 1(1) of the OBCA provides that "affiliate" means an affiliated body corporate within the meaning of subsection 1(4). Subsection 1(4) of the OBCA provides that "for the purposes of this Act, one body corporate shall be deemed to be affiliated with another body corporate if, but only if, one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person."

<sup>5</sup> *Income Tax Regulation*, C.R.C., c. 945, s. 8502(g) provides that pension fund assets must be held pursuant to an arrangement acceptable to the Minister of National Revenue. Information Circular 72-13R8, section 6(e) provides that

"The pension plan must be funded through:

- (i) a contract for insurance with a company authorized to carry on a life insurance business in Canada;
- (ii) a trust in Canada governed by a written trust agreement under which the trustees are:
  - (A) a trust company, or
  - (B) individuals at least three of whom reside in Canada and one of whom must be independent to the extent that the individual is neither a significant shareholder, partner, proprietor, nor an employee of a participating employer
- (iii) a pension corporation;

sponsor generally prepares a plan document and enters into a trust agreement to make a trust company the trustee of the pension fund. The trustee holds the pension fund assets in trust under the terms set out in the relevant documents. When the pension plan is funded by a trust, classic trust principles generally apply.<sup>6</sup> If the plan sponsor has opted for an insurance policy, the pension plan is established by an insurance contract between the plan sponsor and an insurance company, which will usually hold and invest the assets and administer the plan. Under both arrangements, a wide array of investment options are generally available, including guaranteed investment certificates, segregated funds and specialty pooled funds that may be invested in bonds, equities, venture capital, money market instruments, mortgages or real estate.<sup>7</sup>

### **Surpluses and Deficits in Pension Plans**

In the context of a corporate transaction, the buyer must determine whether the seller's pension plan has excess funding (a surplus) or unfunded liabilities (a deficit). A plan is in a surplus position if the assets of the pension fund exceed the present value of the pension benefits promised under the plan. On the other hand, a pension plan has a funding deficiency when the assets are not sufficient to cover the present value of the accrued pension benefits.

Whether a pension plan has a surplus or an unfunded liability is an important consideration for all parties in a business transaction or reorganization. As discussed later, a plan's funded status may have an impact on the negotiation of the purchase price and the terms of the transaction. So it is important that there be an accurate assessment of the plan, and that both the buyer and the seller fully understand and approve the assumptions that were made in completing the assessment.<sup>8</sup>

### **Pension Plan Valuation**

Two funding tests for pension plans are required under the PBA and are performed by an actuary: solvency and going-concern. The solvency position of a pension plan is determined on the assumption that the plan is wound up on the valuation date. The going-concern valuation is calculated on the assumption that the plan will continue indefinitely.

The actuarial surplus or deficiency of a plan is calculated by an actuary and detailed in an actuarial report, which is prepared using a series of assumptions concerning interest rates, inflation, salary projections, employee turnover, life expectancy, retirement age, industry return, and so on.<sup>9</sup> The Regulations to the PBA<sup>10</sup> generally require such reports to be prepared and filed every three years.<sup>11</sup>

- (iv) an arrangement administered by the Government of Canada or by a government of a province of Canada, or by an agent thereof; or
- (v) combinations of the above funding media.”

<sup>6</sup> *Schmidt v. Air Products Canada Ltd.* (1994), 115 D.L.R. (4th) 631, [1994] 2 S.C.R. 611 [*Schmidt*]. Note that in the case of *Buschau v. Rogers Communications Inc.*, [2001] S.C.C.A. No. 107 (QL), the Supreme Court of Canada dismissed an appeal from the British Columbia Court of Appeal's decision of *Buschau v. Rogers Communications Inc.* (2001), 195 D.L.R. (4th) 257 [*Buschau*] holding that the common law rule of *Saunders v. Vautier*, which generally applies to allow beneficiaries of a trust to terminate the trust if they all agree and are all *sui juris*, does not generally apply to pension trusts. This may signal a departure by the courts from the strict application of trust law principles to pension trusts in every situation.

<sup>7</sup> William M. Mercer Limited, *The Mercer Pension Manual* (Toronto: Carswell, 2005) at 5-5.

<sup>8</sup> Note that a DC plan does not need to have regular actuarial assessments because an employer's financial obligation is fulfilled once the amount specified in the plan text has been paid. Neil Cohen, ed., *A Guide to Pensions in Canada* (Toronto: CCH Canadian Limited, 2005) at 131.

<sup>9</sup> *Ibid.* at 131-132.

<sup>10</sup> *General Regulations to the Pension Benefits Act*, R.R.O. 1990, Reg. 909 [The Regulations].

<sup>11</sup> *Ibid.*, s. 14(1), as amended by O. Reg. 712/92, s. 10; O. Reg. 73/95, s. 4(1).

However, if solvency concerns are disclosed in a report, another actuarial report must be filed the following year.<sup>12</sup> The actuarial report will determine the “normal” contributions required by the employer to fund the benefits promised under the plan. If a pension plan is in surplus, the employer may be able to suspend payments to the plan for a period of time – known as a “contribution holiday.” However, if an actuarial report reveals that a pension plan is underfunded, the employer must make “special payments” over a certain period to rectify the funding deficiency.

Only when a pension plan is wound up, in whole or in part, can it be known whether a pension plan is *in fact* in surplus or in deficit, as opposed to *actuarially* in surplus or in deficit. The entitlement to any surplus remaining when the plan is wound up may also be an issue.

### **Nature of the Transaction**

Several types of corporate transactions can trigger pension issues: purchases of shares, mergers and amalgamations, and purchases of assets. The structure of the deal will directly affect the buyer’s and seller’s pension obligations. In the following section, we briefly describe each type of transaction to lay the groundwork for the subsequent analysis of the specific pension issues arising under each structure.

#### ***Share-Purchase Transactions***

In a share-purchase transaction, the buyer acquires the shares of the target corporation and becomes a shareholder of the corporation, which retains its own assets and liabilities. As a result, the buyer acquires the entire target company “as is,” including the pension plans. While ownership of the shares of the target corporation changes hands, the employer-employee relationship is largely unaffected, and the terms of the employment contract, including pension benefits, remain essentially the same.

#### ***Mergers and Amalgamations***

Mergers and amalgamations involve the combination of two or more corporations into one legal entity with all the rights and obligations of the merging companies continuing in the amalgamated corporation. Thus, much as in a share-purchase transaction, the pension plans of the merging corporations will be the responsibility of the amalgamated corporation. However, pre-existing pension plans of the merging corporations are not automatically merged; the plans will generally continue separately unless active measures are taken to formally merge them. To merge the plans in the amalgamated corporation, the consent of the Superintendent of Financial Services (Superintendent) is required.<sup>13</sup> The Superintendent may refuse consent for a proposed plan merger if the merger does not protect the pension benefits and any other benefits of the members and former members of the original pension plans.<sup>14</sup>

#### ***Asset-Purchase Transactions***

In an asset-purchase transaction, the buyer purchases specified assets relating to the business of the seller. In some cases, a seller may be selling off that portion of its assets related to a specific division. In other cases, there may be tax or other reasons for the sale of substantially all of an entity’s assets instead of the sale of its shares. From a pension perspective, an asset-purchase transaction tends to be more complicated to structure and document than a share transaction or a merger. Unlike the other two transactions, an asset transaction does not automatically result in the assignment of the seller’s or target company’s pension liabilities and corresponding assets to the buyer. Absent any specific collective agreement requiring the buyer to provide a plan (and subject to any agreement reached between the parties), the buyer has the discretion to determine what type of pension plan, if any, to provide to affected employees.

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<sup>12</sup> The Regulations, *supra* note 10, ss. 14(2)-(3).

<sup>13</sup> PBA, *supra* note 2, s. 81. See also FSCO Policy A700-251.

<sup>14</sup> *Ibid.*, s. 81(5).

## 2. Managing Pension Risks in Corporate Transactions

Pension issues can be big-ticket items in a corporate transaction and, therefore, companies are increasingly concerned about pension liabilities and risks. Registered pension plans may present complicated legal, actuarial or other issues. As a result, it is essential for both the buyer and the seller to conduct thorough due diligence and negotiate the appropriate representations and warranties to be incorporated into the agreement of purchase and sale.

### Due Diligence

Acquiring or disposing of pension plans and their associated liabilities in the context of corporate transactions can have a significant impact on a company's financial viability as well as on employee morale and productivity. Accordingly, it is important for both the buyer and the seller to conduct due diligence before entering into any business deal. Although the type and level of due diligence required will vary depending on the nature of the transaction and the party's role in the transaction, some type of review must be performed so that both parties fully comprehend their obligations.

The following outline of the due diligence process is relevant in a share-purchase transaction, a merger or an asset-purchase transaction in which the buyer is assuming pension liabilities. The various pension options available to the buyer in an asset-purchase transaction are discussed later in this paper.

#### ***Step 1: Signing a Confidentiality Agreement***

The due diligence process opens a window for the prospective buyer to acquire information about the seller's business. If the transaction fails to materialize for any reason, the seller (or any successive buyer) is placed in the undesirable position of having another player in the market acquainted with its intimate business and financial details. Therefore, the first stage in the transaction process will often be to execute a mutual confidentiality agreement whereby the parties bind themselves not to disclose any private information that may be acquired during the due diligence process. Typically, a confidentiality agreement specifies classes of information that are to remain confidential and stipulates expiration dates after which each class loses its protected status.

#### ***Step 2: "Valuing" the Pension Plan***

Because a pension plan's assets and liabilities may affect the value of the shares of the target corporation or the price a buyer is willing to pay for the company's assets, it is important that both parties know the funded status of any pension plans. If a pension plan has a surplus or a funding deficiency, one of the parties may wish to seek a purchase price adjustment. However, with an ongoing pension plan, the value of any surplus or funding deficiency is difficult to quantify precisely. This is because the actual value of the assets in the fund will vary depending on factors such as investment performance and distributions paid out of the fund and the actuarial assumptions used to determine a pension plan's funded status may change. Another consideration is that since surplus generally cannot be withdrawn from an ongoing plan, the value of any surplus can be realized only through contribution holidays. Thus, if any value is to be attributed to any surplus, it will generally be discounted.

#### ***Step 3: The Seller's Obligations***

Due diligence in a corporate acquisition is often seen as principally a buyer's concern. However, the seller should also be fully informed of the nature and history of all of its pension plans. If the seller conducts its due diligence early in the transaction, it can identify problems promptly and work toward resolving them before the transaction has progressed too far. Another key reason for the seller to conduct due diligence is to ensure the accuracy of the representations and warranties it makes in the agreement of purchase and sale. The *Aegon* case, described below, illustrates this point well.

#### **Step 4: The Buyer's Obligations**

Although a prudent buyer will obtain representations and warranties from a seller to guard against unpleasant surprises even after due diligence has been completed, such representations and warranties generally expire relatively quickly (often on closing in the case of a share purchase or merger). The buyer must carefully examine all documents and other relevant information to understand the nature of the proposed investment.

The buyer should request the following documents from the seller in respect of each pension plan:

- all pension plan texts and amendments (including all historical documents since the plan's inception);
- all funding agreements (since the plan's inception);
- the three most recent financial statements, accounting statements and actuarial reports;
- the most recent investment information summary;
- all annual information returns and professional opinions;
- all material internal memoranda;
- all collective agreements;
- the statement of investment policies and procedures;
- all contracts with any service providers;
- all material correspondence with the CRA and the provincial pension regulator; and
- all booklets, summaries, manuals and written communications of a general nature distributed to employees or former employees.

The importance of reviewing all historical plan and funding documents since the plan's inception cannot be overstated, because when the buyer assumes a pension plan, it assumes the plan's history. Legal counsel must examine all historical documents to assess key issues, such as payment of plan expenses, prior mergers and other potential misapplications of surplus. However, from a practical point of view, there are times when these historical documents are not accessible. When this is the case, the buyer should ensure that those key issues are covered in the representations and warranties and that adequate indemnity language (and survival periods) is included.

Moreover, in considering the funded status of a pension plan, the buyer must review the actuarial reports for the plan. In this regard, the expertise of the actuary is crucial. If the buyer does not have an actuary, legal counsel conducting pension due diligence should advise the client to retain an actuary to review the reports. It is important to consider the appropriateness of the methods and assumptions used in each report. The party conducting due diligence must also pay attention to the date of the report, because factors such as market fluctuations and plan experience may have changed the funded position of the plan since the report was filed.

Additionally, recent case law suggests that a buyer must go further in its review. A prudent buyer should attempt to obtain the following information in any due diligence process regarding a pension plan:

- the jurisdiction of plan registration;
- the jurisdiction of employment for plan participants;
- the class(es) of employees eligible for membership;
- whether participation in the plan is mandatory or voluntary;
- whether the plan is an MEPP, a DB, a DC, a hybrid or formerly DB converted into DC;
- for MEPPs, whether there is any potential withdrawal or other liability;
- for MEPPs, whether the plan terms permit the reduction of benefits;

- for DB plans, the type of benefit formula and level of benefit;
- for DC plans, the employee and employer contribution formulas;
- for DB and converted plans, the funded status on both a going-concern basis and a solvency basis, and the actuarial assumptions used to determine this status;
- for DB and converted plans, the plan language governing contribution holidays and employer surplus entitlement;
- for DC and converted plans, the annual contribution costs; and
- the nature of the funding arrangement (for example, whether the plan has ever been subject to a trust).

#### **Step 5: Signing a Letter of Intent**

If due diligence has not revealed any issues worrisome enough to undermine the transaction, the buyer will generally sign a letter of intent. This rudimentary document provides a basic understanding of the deal between the potential buyer and seller and sets out a negotiation structure for reaching the eventual deal. Once the ground rules have been established, the parties can begin more serious negotiation of the particulars that will, ideally, lead to an agreement of purchase and sale.

#### **Step 6: Retaining Pension Counsel at an Early Stage**

It is best to involve pension counsel in a corporate transaction as early as possible. For example, a buyer may want the letter of intent to provide that employees will be offered employment on terms substantially similar to those provided to the buyer's employees. However, if the seller has a registered pension plan, it will want the letter of intent to provide that the buyer will provide a registered pension plan to the transferred employees to prevent triggering a partial windup of the seller's plan. These types of structural issues can be addressed early in the transaction if pension counsel is retained.

In a cross-border transaction, counsel is generally retained in all relevant jurisdictions. Differences in the law in each jurisdiction require local expertise and a unique understanding of national statutory and regulatory regimes. Parties who are negotiating pension mergers would find it extremely helpful to retain counsel as early in the process as possible. Anticipating potential problems at an early date provides the necessary time to make the changes required to gain plan merger approval. The significant differences between pension regimes around the world mean that a one-size-fits-all approach to this area is not possible.<sup>15</sup>

#### **Negotiation of Representations and Warranties**

Once the prospective buyer and seller have completed the necessary due diligence, the representations and warranties with respect to the pension plans must be determined. This process often involves considerable negotiation, because the buyer's counsel will want to include a long and detailed series of representations and warranties whereas the seller's counsel will seek to limit and qualify them by reference to materiality and/or knowledge of the seller.

The buyer will generally ask the seller to make broad representations and warranties with respect to the following:

- the provision to the buyer of copies of all documents relating to all pension plans (see Step 4 above);

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<sup>15</sup> Mitch Frazer, "Pensions in the Context of Cross-Border Merger and Acquisitions: A Canadian Perspective." *Eleventh International Pension and Employee Benefits Lawyers Association Conference* (Seville, Spain: May 20-23, 2007) at 7, online <<http://www.torys.com/Publications/Documents/Publication%20PDFs/AR2007-20T.pdf>>.

- the existence and registration of any registered pension plans;
- the establishment, maintenance, funding, investment and administration of any pension plans in accordance with the plan terms, any employee communications, any collective agreements and all applicable laws;
- the performance of material obligations of the seller with respect to the pension plans;
- the payment of all required contributions under the pension plans;
- the absence of any taxes or penalties;
- the absence of any breach of fiduciary duties;
- the absence of any outstanding or threatened actions or claims;
- the adequacy of funding of the pension plans;
- the absence of any promises of benefit improvements; and
- the absence of any MEPPs (or prior participation in any MEPPs).<sup>16</sup>

Depending on the nature of the transaction, the buyer may request that the seller make more specific representations and warranties with respect to the following:

- whether contribution holidays are permitted and/or have been taken in respect of the pension plan;
- whether any surplus has been withdrawn or used to pay plan expenses;
- whether the plan has been previously converted;
- whether there have been any prior mergers or partial windups of the pension plan; and
- whether any event has occurred that would entitle any person to cause the windup (in whole or in part) of the pension plan.

The 2003 decision of *Aegon Canada Inc. v. ING Canada Inc.*<sup>17</sup> confirmed that a seller cannot make broad representations and warranties regarding its pension plans without ensuring the accuracy of such representations. In this case, ING Canada Inc. had warranted that all required contributions were made to a pension plan belonging to a life insurance company that it had previously purchased (NN Life Insurance Company of Canada) and was now selling to Aegon Canada Inc. However, NN Life's plan was the product of a merger of two other plans. The assets of one of those plans were subject to a trust, and upon the merger of the two plans, the Pension Commission of Ontario (the predecessor to FSCO) ordered that this plan's assets be maintained in a separate account. Because these funds were, ultimately, improperly administered by NN Life, ING was found to have breached its warranty to Aegon.

A seller must be particularly prudent in making representations regarding plan mergers and asset transfers between plans. Because the courts will not necessarily accept that a merger of pension plans is valid, a seller may have difficulty making the representation that its current pension plan is, in fact, the product of a valid merger of predecessor pension plans.<sup>18</sup>

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<sup>16</sup> If there are MEPPs, specific representations and warranties related to such plans will be required (discussed later in the text).

<sup>17</sup> (2003), 179 O.A.C. 196, [2003] O.J. No. 2755 (C.A.) (QL), leave to appeal refused, [2004] S.C.C.A. No. 50 (QL) [*Aegon*].

<sup>18</sup> *Ibid.* See also *Baxter v. Ontario (Superintendent of Financial Services)*, [2004] O.J. No. 4909 (QL); *Lennon v. Superintendent of Financial Services* (2006), 51 C.C.P.B. 140 (F.S.T.) and *Sutherland v. Hudson's Bay Co.*, [2007] O.J. No. 2979 (S.C.J.) (QL) [*Sutherland*]. In the recent *Sutherland* decision, the Court commented, *in obiter*, that the *Aegon* decision's findings regarding "merger" were unique to the facts of that case and should not be of general application.

Furthermore, a seller should be prudent in making representations regarding any uses of surplus. In the decision of *Nolan v. Kerry*,<sup>19</sup> the Supreme Court of Canada held that the employer was permitted to pay most of the plan expenses from the pension fund. The Court also found that the employer could use a surplus in the DB component of a pension plan to cross-subsidize its DC contribution obligations. The Supreme Court of Canada in *Kerry* clarified the rights of employers in these areas, noting that there is currently no legislative or regulatory prohibition on cross-subsidization, paying expenses from the fund or taking contribution holidays in Ontario. Absent such prohibition, the permissibility of any of these activities will be determined with reference to the plan documentation and contract and trust law. Therefore, the parties to a purchase agreement should be cautious when making representations regarding the permissibility of such practices. The *Kerry* decision should not be interpreted to generally validate any of these practices as the decision was based largely on the wording of the plan documentation in that case.

Often the determination of which representations and warranties are appropriate for the seller to make will come down to the allocation of risk between the parties. When the seller cannot provide the requested documents to the buyer, it is reasonable for the buyer to request representations and warranties on matters it cannot determine. For example, if all prior funding agreements and plan texts are not disclosed by the seller, it is unlikely that the buyer can satisfy itself that any prior uses of surplus were appropriate and the buyer may request representations and warranties.

The parties will also need to make a decision as to the survival of the representations and warranties. Clearly, the seller will prefer a shorter survival period, whereas a buyer will generally want a longer survival period.

#### **Other Provisions in an Agreement of Purchase and Sale**

In addition to the representations and warranties, the parties must pay attention to the “definitions” section of the agreement of purchase and sale. For example, the definition of “Plans” (or “Benefit Plans,” “Seller Plans” or “Employee Benefit Plans”) must be examined to confirm that it covers all types of plans (pension, benefit, compensation, etc.) that the parties wish to include. Generally, the broad definitions of “Plans” will exclude certain types of plans, such as statutory plans (like CPP/QPP) and multi-employer plans, and there will be separate definitions for these other classes of plans.

In an asset-purchase agreement, the sections dealing with assumed liabilities and excluded liabilities should also be carefully examined to ensure that they reflect the business deal. For example, when the buyer is not assuming any pension plans or liability associated with any plans, this must be clearly stated in the asset-purchase agreement.

The buyer may also request covenants from the seller with respect to the pension plans. One that is often included is a covenant not to adopt, enter into, terminate or amend any plans (other than as required by law) between the date of the agreement and the closing date.

Finally, the parties should also consider the indemnity provisions of an agreement.

### **3. Evaluating Options and Obligations in Complex Corporate Transactions or Restructurings**

When determining what type of transaction to enter into, a buyer and seller must evaluate the potential pension issues that may arise under each structure and their corresponding options and obligations. This section outlines the issues that a buyer and seller can expect to encounter when entering into each type of transaction.

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<sup>19</sup> 2009 SCC 39 [*Kerry*].

### Pension Issues Specific to Share-Purchase Transactions

In a share-purchase transaction, the buyer essentially “steps into the shoes” of the seller. The corporation continues as the same legal entity but under the control of the new shareholder(s). Unless stipulated otherwise, all pension plan assets and liabilities remain with the corporation following its sale.

From the plan members’ perspective, a share-purchase transaction is beneficial because the employer-employee relationship continues unaltered amid the corporate change. The obligation of the purchased company to continue to provide pension and benefit plans will not be affected by the change of ownership.

From the perspective of a buyer or seller, a share-purchase transaction is advantageous from a pensions/benefits point of view because it is much less complex and does not require regulatory approval. However, because all assets and liabilities relating to the pension and benefit plans remain owned by the corporation, they directly affect the value of the shares. Therefore, it is crucial that both parties complete the meticulous due diligence process discussed above. More specifically, the buyer must fully comprehend the nature and magnitude of the obligations it is undertaking and determine whether the plan has been administered in accordance with its terms. Similarly, the seller must understand the implications of the funded status of the plan to ensure that the purchase price reflects any overfunding or underfunding in the plan.

### Pension Issues Specific to Mergers

In a pension plan merger, two or more pension plans are amalgamated into a single plan through a transfer of pension plan assets from one plan to another with the consent of the Superintendent. This scenario may be in the best interests of the amalgamated corporation as well as the plan members for several reasons.

From the plan members’ perspective, in the case of a DB plan, a merger is generally preferable because most of these in Canada use years of service as part of the formula to calculate employee entitlement. If the plans are not merged, the combined pension that a plan member collects will likely be reduced.<sup>20</sup>

From the amalgamated corporation’s perspective, merging pension plans can ensure uniform benefits among all employees, reduce plan administration costs and streamline regulatory compliance obligations. In addition, plan mergers are very attractive to amalgamated corporations when one of the pre-merger plans is underfunded and the other has excess funding. In certain situations, plan sponsors may be able to use the surplus in one plan to offset their contributions to the other. However, recent jurisprudence (discussed above) has cast doubt over whether plan mergers of this sort continue to be legally permissible.

Despite these advantages, merging pension plans is not a simple process. Before the plans can merge, the amalgamated corporation must undertake a complex review of plan documents, legislation, regulatory policies and case law. Additionally, the applicable funding agreements must be analyzed to ensure that a merger is permitted and, if so, to determine the parameters under which a merger can occur. Moreover, if the plan is subject to a trust, a more extensive review must be conducted since case law is unsettled in this area.<sup>21</sup>

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<sup>20</sup> Frazer, *supra* note 15 at 2.

<sup>21</sup> Some mergers have been recognized while others have been denied. Mergers that have been recognized include *Schmidt; Buschau; Re National Trust Co. and Sulpetro Ltd.* (1990), 66 D.L.R. (4th) 271 (Alta. C.A.) and *Re Heilig v. Dominion Securities Pitfield Ltd.* (1989), 59 D.L.R. (4th) 394 (Ont. C.A.).

## Pension Issues Specific to Asset-Purchase Transactions

In an asset-purchase transaction, the seller's pension plan is not necessarily transferred to the buyer. The negotiations may address whether the buyer will even offer a pension plan to the transferred employees. If the buyer decides to offer a pension plan, it has several options including assuming the seller's pension plan, and having the transferred employees participate in a new or previously existing pension plan offered by the buyer. Because the parties to this type of transaction have many alternatives, the resulting arrangements are often complex.

In determining whether to transfer the seller's pension plan to the buyer or choose another course of action, the following factors should be taken into consideration:

- whether the buyer already has a pension plan in place that could cover the transferred employees or accept a transfer of assets from the seller's pension plan in respect of the transferred employees;
- whether the transferred employees represent only a portion or all of the members in the seller's pension plan;
- whether there is a collective agreement in place with respect to the transferred employees that references certain pension benefits or a specific pension plan; and
- the funded status of the seller's pension plan (whether there is a surplus or deficit).

Five general options for dealing with pension plans in an asset-purchase transaction are discussed below.

### ***(i) Buyer does not offer pension plan***

The buyer may not want to offer a pension plan to the transferred employees. Although this may seem like an attractive option for the buyer, since it reduces costs and limits exposure to risk because there are no concerns regarding funding liabilities or representations and warranties, it has several negative implications.

First, this option is generally unattractive from the seller's perspective since a full or partial windup of the seller's pension plan may be ordered.<sup>22</sup> This is generally not in the seller's best interest because the seller must deal with any surplus<sup>23</sup> or deficit<sup>24</sup> issues as of the windup date. In addition, a plan windup will trigger certain rights of the affected employees, which may be costly to the seller.<sup>25</sup>

Second, for the buyer, the initial impression of advantage may be outweighed by the prospect of dissatisfaction among the transferred employees. In addition, wrongful/constructive dismissal issues can arise if the buyer does not offer employment on terms (including pensions and benefits) similar to those provided by the seller. Since the contract of employment is with the seller prior to the transaction, generally the seller is responsible for termination or severance costs in respect of any employees who do not accept the buyer's offer of employment (unless agreed otherwise). Accordingly, the seller will generally require the buyer to offer employment to any non-unionized transferred employees on terms

<sup>22</sup> PBA, *supra* note 2, s. 69(1) (f) provides that the Superintendent, by order, may require the windup of a pension plan in whole or in part if "all or part of the employer's business or all or part of the assets of the employer's business are sold, assigned or otherwise disposed of and the person who acquires the business or assets does not provide a pension plan for the members of the employer's pension plan who become employees of the person."

<sup>23</sup> *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, [2004] S.C.J. No. 51, (2004), 242 D.L.R. (4th) 193.

<sup>24</sup> PBA, *supra* note 2, s. 75.

<sup>25</sup> See, for example, *ibid.*, s. 73 (immediate vesting) and s. 74 (grow-in rights).

that are substantially similar in the aggregate to those provided by the seller.<sup>26</sup> When the buyer will not agree to this term, the parties may negotiate that any termination or severance costs shall be the buyer's responsibility.

Third, from the employees' perspective, this is clearly not an attractive option.

**(ii) Seller retains past-service liability and buyer offers plan for future services only**

Another option is for the seller to retain responsibility for past service related to the transferred employees and for the buyer to either establish a new pension plan for the transferred employees or permit these employees to participate in an existing pension plan. In this situation, the seller remains responsible for all accrued liabilities of the transferred employees in the seller's pension plan until the closing date of the transaction. At that point, the transferred employees become members of either an existing plan or a new plan sponsored by the buyer, which is responsible for their benefits as of the closing date.<sup>27</sup>

From the buyer's point of view, this option may be preferable, especially if the seller's pension plan is underfunded, because the buyer assumes no accrued pension liability for the transferred employees. Furthermore, because this option does not require a transfer of assets, it is unnecessary to obtain regulatory approval. However, if there is a collective agreement in place that references a specific pension plan, this option may not be available.

From the seller's perspective, this option may address the potential windup concern. As the buyer provides a pension plan for the transferred employees,<sup>28</sup> their employment will be deemed not to be terminated.<sup>29</sup> However, the seller should consider requesting a covenant that the successor plan be retained by the buyer for a fixed period. This covenant may help protect the seller from being considered an employer after the transaction closes; as an employer, the seller could be responsible for liabilities arising from the windup of the buyer's pension plans. This was the case in *GenCorp Canada Inc. v. Superintendent of Pensions for Ontario*,<sup>30</sup> in which the Ontario Court of Appeal found that GenCorp Canada Inc. was caught by the definition of "employer" in the PBA<sup>31</sup> and was subject to the windup order even though the employees affected had been transferred to General Tire of Canada Inc. four years before the windup. However, it is not clear how long a covenant a seller should request to avoid this situation.

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<sup>26</sup> Unionized employees are transferred by operation of law as where an employer sells its business, the purchaser is bound by the collective agreement as if the purchaser had been a party to the collective agreement pursuant to section 69 of the *Labour Relations Act, 1995*, S.O. 1995, c. 1, Sch. A.

<sup>27</sup> PBA, *supra* note 2, s. 80 governs this type of arrangement and states that a transferred employee who becomes a member of a pension plan provided by the buyer is entitled to: (i) the benefits provided under the seller's plan to the effective date of the sale; (ii) credit in the pension plan of the buyer for the period of membership in the seller's plan for the purposes of determining eligibility for membership in and entitlement to benefits under the buyer's plan; and (iii) credit in the seller's pension plan for the period of employment with the buyer for the purposes of determining entitlement to benefits under the seller's plan.

<sup>28</sup> *Supra* note 21. However, in the case of *AIG v. Sutton*, FST File No. PO245-2004 (September 6, 2005), the FST concluded that section 81 of the PBA does not affect the Superintendent's jurisdiction to order a windup where it is appropriate to do so. Furthermore, the FST noted that the Superintendent has jurisdiction under paragraph 69(1)(a) of the PBA to order a windup where there has been a "suspension or cessation of employer contributions" and it may be appropriate for the Superintendent to exercise this jurisdiction if the members are in jeopardy of losing their positions or future pension.

<sup>29</sup> PBA, *supra* note 2, s. 80(3).

<sup>30</sup> (1994), C.E.B. 8199 (Ont. Pension Comm.), *aff'd* (1995), 26 O.R. (3d) 696, 10 C.C.P.B 289, (1998), 39 O.R. (3d) 38 (C.A.), leave to appeal to S.C.C. dismissed, [1998] S.C.C.A. No. 206 (QL).

<sup>31</sup> PBA, *supra* note 2, s. 1(1) defines employer as follows: "in relation to a member or a former member of a pension plan, means the person or persons from whom or the organization from which the member or former member receives or received remuneration to which the pension plan is related, and "employed" and "employment" have a corresponding meaning."

The buyer should also be careful when communicating plan amendments. The Ontario Court of Appeal's decision in *Kerry (Canada) Inc. v. DCA Employees Pension Committee*<sup>32</sup> appears to have placed a heightened responsibility on employers to communicate plan amendments clearly and accurately to employees. In *Kerry OCA*, the employer was held to have given inadequate notice to employees about a one-time opportunity to convert from a DB to a DC arrangement.<sup>33</sup> This issue was not argued on its subsequent appeal to the Supreme Court of Canada.

From the employees' perspective, this option may be unattractive because they will receive their pensions from two sources upon retirement. In addition, if the pension promised is a DB based on final or career average earnings, the employees' total pension will likely be reduced because the calculation in the seller's plan will be based on lower earnings (assuming that employees' salaries continue to increase during their employment). This issue can be resolved by a wraparound arrangement, discussed below.

### **(iii) Wraparound arrangement**

A wraparound arrangement is similar to option (ii). The buyer's plan provides employees with a single benefit based on each employee's final (or career) average earnings with the buyer and combined service with the buyer and the seller, and the pension benefits that are payable under the seller's plan are offset. This arrangement corrects the problem identified in option (ii) with DB plans that are based on final or career average earnings and service.

If the wraparound option is used, the seller should consider requesting a covenant under which the buyer guarantees the continued existence of the successor pension plan for a fixed period.

### **(iv) Carve-out arrangement**

Another option is for the assets and liabilities related to the transferred employees to be carved out of the seller's pension plan and transferred to an existing plan or a new plan offered by the buyer. The buyer assumes all pension liabilities related to the transferred employees for all their years of service. However, negotiating a carve-out arrangement can be quite an extensive process and obtaining regulatory consent can take years.<sup>34</sup> Because of the complexities of these arrangements, the parties will often negotiate a separate agreement dealing only with the terms of the pension carve-out, which is incorporated by reference into the asset-purchase agreement. The parties have many questions to consider, including the following:

- What is the value of the assets and liabilities to be transferred or assumed?
- What actuarial assumptions will be used to determine the amount to be transferred from the seller's plan to the buyer's plan?
- Who will be responsible for preparing and filing the necessary regulatory filings?
- What happens if regulatory approval for the transfer is not granted?
- Who has responsibility for the administration of the pension plan until the transfer occurs?
- How will the assets related to the transferred employees be invested in the interim period, and who will bear the risk of any investment gains or losses?

If the seller's plan is in surplus, depending on the plan and trust terms, it may be necessary to transfer a pro-rata portion of the surplus. In the case of *Burke v. Hudson's Bay Company*,<sup>35</sup> there was no

<sup>32</sup> (2007), 86 O.R. (3d) 1 (C.A.) [*Kerry OCA*].

<sup>33</sup> *Ibid.*

<sup>34</sup> FSCO now has a policy under which parties that wish to withdraw a pending application can apply to FSCO: Policy A700-301, "Withdrawal of Application for Consent to a Transfer of Assets."

<sup>35</sup> (2008), 67 C.C.P.B. 1, 40 E.T.R. (3d) 157, [2008] O.J. No. 1945 (C.A.) (QL) [*Burke*].

requirement to transfer a portion of the surplus. However, this case makes it clear that whether or not surplus must be transferred will depend on the plan and trust terms. In *Burke*, Hudson's Bay Company (HBC) sold a division and transferred employees to the buyer. Assets and liabilities related to the transferred employees were carved out and transferred to the buyer's pension plan. HBC's pension plan was in surplus at the time of the sale but no portion of surplus was transferred to the buyer's plan. HBC's plan was subject to a trust. The Court of Appeal cited *Schmidt* for the proposition that members' entitlement to surplus is governed by the plan documentation, which in this case was the plan text and the trust agreement. The trust agreement provided that the pension fund could be used only for the members' exclusive benefit; however, the Court noted that the plan text was the dominant document. The plan text limited members' entitlement on plan termination to the value of their defined benefits and gave HBC the right to surplus. The Court held that since the members were not entitled to the surplus on plan termination, HBC was not required to transfer a portion of the surplus in the carve-out.

From the employees' perspective, the carve-out is advantageous since their pensions upon retirement will be paid from one source.

However, the carve-out is generally not an attractive option for the buyer because costs can be high and transferring assets between pension plans requires regulatory approval.<sup>36</sup> In fact, FSCO's policy regarding plan transfers is a significant hurdle to the carve-out. Following the *Aegon* decision, FSCO released a policy statement about approval of asset transfers where one or more of the plans is subject to a trust. The policy was essentially a moratorium on plan transfers unless the proposed transfer fit within one of the exceptions enumerated in the policy or was otherwise satisfactorily distinguishable from *Aegon*.

FSCO's most recent comment dealing with this issue, titled "Trust Issues on Plan Transfer/Merger (Transamerica),"<sup>37</sup> provides that the Superintendent will consider applications for asset transfers in the circumstances set out in a checklist released by FSCO. The checklist is designed to identify issues related to trusts that may need to be considered in asset transfers. Although the checklist is not mandatory, an applicant who elects to use it must certify that the information provided is accurate to the best of its knowledge and belief. The checklist appears to take a pragmatic approach to these issues and to have assisted in expediting the approval process in appropriate cases.

#### ***(v) Transfer of pension plan***

The final option is for the buyer to assume all the assets and liabilities of the seller's pension plan. In this case, the buyer will generally take the pension plan "as is," meaning that the buyer will assume sponsorship of the plan with a deficit or a surplus. Furthermore, the buyer will assume any liabilities associated with prior plan administration. For example, if the seller had been paying plan expenses from the pension fund and this was contrary to the terms of the plan or the trust, the buyer, as the new sponsor of the plan, would likely be liable for the breach. In certain cases, a collective agreement may require that the specific plan be provided to the transferred employees, which may necessitate a plan transfer.

The main advantage of transferring the entire plan is that it is reasonably straightforward. The transfer of the pension plan's sponsorship is done by an amendment to the plan that merely changes the plan sponsor. Like all plan amendments, the amendment must be filed and approved by both CRA and FSCO; however, approval is generally not difficult to obtain. When this option is selected, the buyer or seller may wish to negotiate a purchase price adjustment, depending on the funded status of the plan, to take into consideration the overall effects of transferring it. The parties will need to resolve various issues in the agreement, including the question of responsibility for preparing and filing the necessary filings, and the transfer of employee data.

<sup>36</sup> PBA, *supra* note 2, s. 80(4).

<sup>37</sup> Online: Financial Services Commission of Ontario  
<<http://www.fSCO.gov.on.ca/english/pensions/transamerica/trustissues.asp>>.

From the employees' perspective, this is generally an attractive option because they will receive pension benefits upon retirement from only one pension plan.

#### 4. Cross-Border Considerations<sup>38</sup>

Additional cross-border considerations may arise in the context of an M&A transaction. In particular, plan sponsors must be made aware of section 409A of the *U.S. Internal Revenue Code*,<sup>39</sup> which regulates pension entitlements and other deferred compensation arrangements. These provisions were added to the Code under the *American Jobs Creation Act of 2004*<sup>40</sup> and cast a wide net by virtue of the fact that U.S. citizens are subject to tax on their worldwide income, regardless of residency.

The extraterritorial nature of these provisions means that they ensnare Canadian pension plans that count U.S. citizens among their beneficiaries. In the context of a merged pension plan, the successor plan administrator will have to ensure compliance by determining the status of beneficiaries from the original pension plans. Otherwise, participation by U.S. citizens in Canadian plans may result in certain prescribed penalties discussed below.

The *Jobs Creation Act* is designed to make deferred compensation arrangements transparent and regulate the timing of such compensation. It requires members of non-qualified deferred compensation plans to elect, the year prior to beginning to receive deferred compensation, the date when they will receive payments and the form those payments will take (e.g., lump sum, monthly, annually). This law was the U.S. Congress's response to compensation abuses coming to light in the wake of highly public corporate scandals.

Accordingly, failure to comply with section 409A brings with it harsh penalties to the non-complying taxpayer, including (i) inclusion of all deferred compensation amounts in gross income back to the time of deferral; (ii) calculation of interest at the underpayment rate plus 1 percent; and (iii) assessment of an additional 20 percent tax.<sup>41</sup> As a cross-border issue, this is significant for the individual U.S. taxpayer. Nevertheless, plan sponsors will want to be aware of the consequences of non-compliance and would be well-advised to identify these individuals, identify all deferred compensation arrangements and proactively resolve the situation.

#### 5. Strategies for the Successful Conversion of Pension Plans

Over the past decade, the number of pension plans "converted" from DB to DC has increased.<sup>42</sup> Employers tend to prefer DC plans because there is virtually no risk of their being underfunded, and it is relatively easy for employers to cap their pension costs.

The PBA does not expressly refer to pension plan conversions. Instead, FSCO policies<sup>43</sup> and case law provide guidance on how the process is governed. Typically, there are three methods by which an employer that sponsors a DB plan can convert to a DC plan. First, an employer can convert a plan by winding up the DB plan, discharging all accrued pension benefits and registering a new DC plan.<sup>44</sup> Second,

<sup>38</sup> Frazer, *supra* note 15 at 6-7.

<sup>39</sup> U.S.C. Title 26 [Code].

<sup>40</sup> Pub. Law No. 108-357, 118 Stat. 1418 [*Jobs Creation Act*].

<sup>41</sup> Code, *supra* note 39 at § 409A.

<sup>42</sup> Ari N. Kaplan, *Pension Law* (Toronto: Irwin Law, 2006) at 457 [Kaplan].

<sup>43</sup> For a DB to DC conversion, see FSCO Policy C200-101, "Conversion of a Plan from Defined Benefit to Defined Contribution." For a DC to DB conversion, see FSCO Policy C200-150, "Defined Contribution to Defined Benefit."

<sup>44</sup> Although this option may be the cleanest from a legal and regulatory perspective, it would increase the aggregate value of the pension benefit liabilities in the DB plan given the statutory enhancements conferred to employees upon plan windup, such as automatic vesting and grow-ins. Because a full plan windup also involves the liquidation of the

an employer can apply to transfer the assets and corresponding pension liabilities in the DB plan to a new or an existing DC plan.<sup>45</sup> Finally, an employer can amend the DB plan to freeze benefit accruals in the plan as of a certain date and require new employees and employees formerly accruing service in that plan to participate in a new or an existing DC plan from then on.<sup>46</sup>

Because a pension plan conversion involves a significant change to the pension benefit formula, it usually requires one or more pension plan amendments. Moreover, because DC conversions create uncertainty and risk for the plan members, this type of amendment is considered “adverse” under pension legislation. Consequently, employers must give plan members advance notice of the conversion.<sup>47</sup> More specifically, the *Kerry OCA* decision appears to have set a high standard for communications with plan members in this type of transaction, placing an onus on plan sponsors to communicate clearly and accurately with plan beneficiaries or risk having those amendments declared invalid.<sup>48</sup>

Another issue that has recently been raised with respect to plan conversions is the permissibility of cross-subsidization – that is, using DB surplus to offset DC contribution obligations after a conversion in which the pension plan is funded pursuant to a trust. In *Kerry*, the Supreme Court of Canada provided much-needed clarity on the law in this area. In *Kerry*, the original trust agreement prohibited the use of trust funds for purposes other than for the “exclusive benefit” of the pension fund’s beneficiaries. Accordingly, when the plan was amended to introduce a DC component and the employer used the DB surplus to offset its DC obligations, the plan members argued that the trust was breached. However, the Supreme Court held that there was one trust in which all DB and DC members are beneficiaries. Therefore, the use of trust funds for either DB or DC members would still be for the “exclusive benefit” of the members. Accordingly, cross-subsidization was permitted and there was no breach of the trust.

The *Kerry* decision affirms that cross-subsidization is permissible in certain cases. However, the decision emphasizes that this permissibility often hinges on the wording of plan documentation. Therefore, before executing a conversion, plan sponsors must carefully review the wording of all plan and trust documents to ensure that the plan is properly structured. Additionally, plan sponsors should ensure that communications to beneficiaries about the conversion are consistent with pension legislation and the plan documents, and that these communications properly describe the legal effects of any changes or rights concerning the pension plan.

## 6. Issues Related to Multi-Employer Pension Plans in Corporate Transactions

As described earlier, an MEPP is a pension plan with two or more unrelated participating employers. Most MEPPs are structured for employers in a common industry or drawing from the same workforce. Generally, the required employer contributions are fixed by a collective agreement, even if the benefit provided to the employees is based on a DB model.<sup>49</sup>

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pension plan, any surplus existing in the plan is crystallized as of the windup date and must be distributed to the proper recipients. *Ibid.* at 458.

<sup>45</sup> If employees elect to transfer their commuted values, the employer must get the consent of the Superintendent to transfer the assets from the DB plan and merge them into the DC plan. This method is desirable when an employer, in conjunction with the pension asset transfer application, can transfer any surplus assets from the DB plan and use them to take contribution holidays in respect of the employer’s normal contribution costs under the DC plan. *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> PBA, *supra* note 2, s. 26(1).

<sup>48</sup> In its reasoning in *Kerry OCA*, *supra* note 32, the Ontario Court of Appeal was highly critical of the communications provided to plan members about the plan conversion because they did not properly describe the legal effects of the conversion.

<sup>49</sup> Kaplan, *supra* note 42 at 97.

From an employer's perspective, MEPPs are advantageous because funding obligations are generally limited to a fixed schedule (except in Quebec) and administration costs are shared across the entire group. From a plan member's perspective, an MEPP provides a predictable, targeted benefit at retirement without the individual return and longevity risks of DC plans. This pooling means that members can generally expect to receive greater benefits than they would if they were participating in a DC plan of equivalent cost.

As with single-employer pension plans, a series of issues, obligations and considerations arise with respect to MEPPs in corporate transactions.

### **MEPP Issues Specific to Share-Purchase Transactions**

The considerations that a buyer and seller should take into account when dealing with an MEPP are very similar to those relating to a single-employer pension plan.

The seller will likely be asked to provide representations and warranties with respect to any MEPPs and will also be required to undertake some level of due diligence, including identifying all relevant MEPPs and the jurisdiction of employment of seller employees who participate in the MEPP.<sup>50</sup> The seller will need to review the plan text, the trust agreement and the applicable collective agreement or participation agreement to identify how any MEPPs should be dealt with in the share-purchase agreement.

The buyer will be interested in uncovering all the potential unfunded liabilities or other sources of liability in order to proceed with and price the transaction. The buyer will often seek the following representations and warranties:

- that the obligations of the seller in respect of any MEPPs are restricted to the contribution, reporting and audit obligations set out in the applicable collective agreement or participation agreement;
- that all plans are listed in a schedule and the seller has delivered to the buyer true, complete and up-to-date copies of the plan texts and all amendments together with, as applicable, all funding agreements, all summary descriptions of the benefit plans provided to past or present participants, the most recent actuarial report, the financial statement, if any, and evidence of any plan registration;
- that all employer or employee payments, contributions and premiums required to be remitted, paid to each plan or paid in respect of each plan have been paid or remitted in a timely fashion in accordance with the plan's terms and all applicable legislation, and no taxes, penalties or fees are owing or exigible under any plan; and
- that there are no pending or, to the knowledge of the seller, threatened material actions, suits, claims, trials, demands, investigations, arbitrations or other proceedings with respect to the plans against the corporation, the funding agent, the insurers or the fund of the plans.

Given the time constraints often imposed in a corporate transaction, sellers are sometimes unable to obtain and provide the key MEPP documentation. If this is the case, the buyer may seek a representation that all material documents pertaining to the MEPPs have been provided. This enables the buyer to pursue a breach of warranty if the seller omits a document that would have disclosed a problem. Alternatively, the buyer should seek some form of indemnity.

### **MEPP Issues Specific to Asset-Purchase Transactions**

If a seller's participation in an MEPP is the subject of collective bargaining (which is almost always the case), it will typically be impossible for the buyer, as a successor employer, to unilaterally withdraw from

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<sup>50</sup> If there are Quebec members in the MEPP, regard must be had to the potential impact of Quebec's Bill 68.

the MEPP. If a buyer is a successor employer for the purposes of an MEPP, the discussion in the share-purchase section of this paper will apply.

## 7. Conclusion

Pension issues are usually not the first concern of the parties involved in a purchase and sale transaction. However, because of the potential effect of pension liabilities on the bottom line, companies are increasingly concerned about pension plans in corporate transactions. As examined in this paper, pension issues can affect the amount of due diligence required, the purchase price, the representations and warranties, and the obligations of the buyer to transferred employees. The keys to dealing with pension-related concerns in a complex corporate transaction are to obtain as much information as possible about the pension plans involved and to seek expert pension advice as early as possible in the process. **T**

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