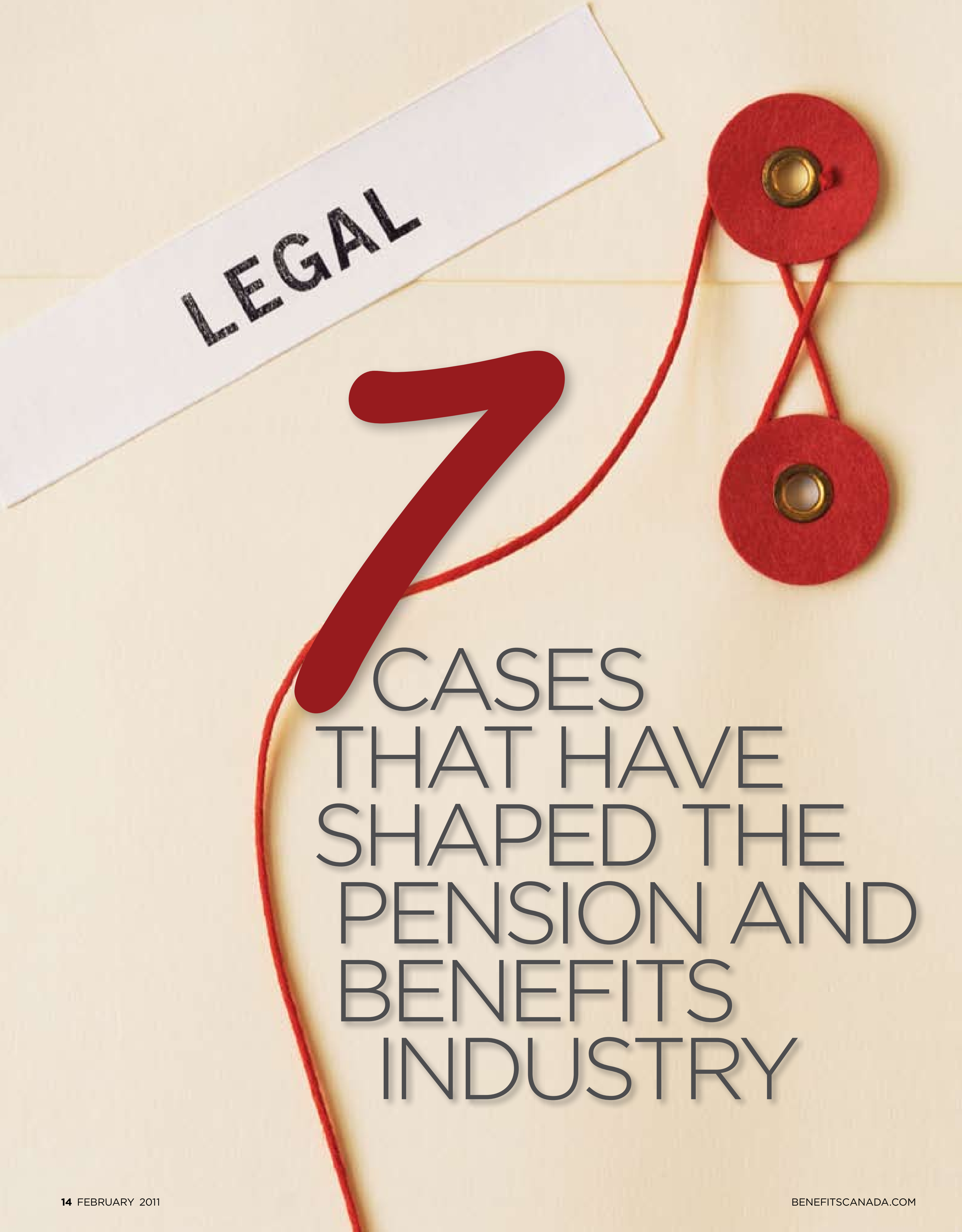

7 CASES THAT HAVE SHAPED THE PENSION AND BENEFITS INDUSTRY

Over the last two decades, the pension and benefits industry has had its share of legal issues. Following is a look at some of the important cases and what they mean for plan sponsors now and in the future.

BY SONYA FELIX

PENSION: SCHMIDT V. AIR PRODUCTS CANADA LTD. (1994)

In Schmidt, the employer merged two defined benefit pension plans and used surplus that had accumulated in the prior plans to take contribution holidays. When the merged plan was terminated, the employer claimed that it was entitled to the surplus. The plan members commenced an action, arguing that they were entitled to the surplus and that the employer had to pay back the surplus it had used to fund its contribution holidays.

After a series of appeals, the case reached the Supreme Court of Canada, which established the legal framework for analyzing pension plans that continues to be applied today. More significantly, the Court held that a pension plan funded pursuant to a trust is a classic trust and, as such, is subject to all common law trust principles.

Based on these principles, the Court found that surplus is always included in the trust unless the original trust agreement says it is not. Where surplus is part of the trust, the employer will be entitled to it only if the following occurs:

(i) the employer was made a beneficiary of the trust from the outset;
(ii) the employer reserved a power to revoke the trust when it was established; or
(iii) the doctrine of the resulting trust is applicable.

At the same time, the Court held that contribution holidays and other uses of surplus in an ongoing plan are not a revocation of trust, because in an ongoing plan, actuarial surplus exists only on paper. This compromise resulted in stringent restrictions on employer entitlement to surplus on windup but gave employers more latitude when dealing with surplus in the context of an ongoing plan.

Canadian courts have struggled to implement this compromise in subsequent cases. What was supposed to end all surplus ownership disputes instead fuelled another 10 to 15 years of litigation. This litigation was primarily centred on how to apply classic trust law principles to pension plans, which are not well suited to many of these common law principles, because pensions are also subject to pension standards legislation and are a component of the employment law (contractual) relationship between employee and employer.

— **PAUL LITNER,** PARTNER, PENSIONS AND BENEFITS, OSLER, HOSKIN & HARCOURT LLP

PENSION: BURKE V. HUDSON'S BAY CO. (2010)

In 1987, the Hudson's Bay Company (HBC) sold the assets of its Northern Stores Division (NSD) to the North West Company (NWC). The NWC made offers of employment to the NSD employees and agreed to provide a defined benefit plan with equivalent benefits and recognition of prior years of service. HBC transferred the plan assets attributable to the transferred employees to the NWC pension plan but did not transfer a proportionate share of the surplus. The transferred employees alleged that the pro-rata share of surplus should have been transferred as well.

The Supreme Court of Canada noted that plans may impose stricter requirements than specified by the legislation. In this case, however, the plan text expressly limited members' entitlements to their defined benefits. Although the 1984 trust agreement contained exclusive benefit and non-diversion language, the Court held that the trust agreement must be read with the then-existing terms of the plan, which (unlike *Schmidt v. Air Products Canada Ltd.*) expressly gave HBC the right to any surplus on plan termination. Therefore, the company was not required to transfer a pro-rata share of surplus. Interestingly, the Court commented on the legitimacy of the transaction, noting that the purchase price of the assets, including the pension plan surplus, was negotiated and the NWC was not willing to pay for the surplus.

The Court also affirmed its decision in *Nolan v. Kerry (Canada) Inc.* (2009), stating that without a statutory or common law requirement for the employer to pay plan expenses, any obligation to do so must arise from the text and context of the plan documentation. The plan documentation did not impose this obligation and, accordingly, plan expenses could be paid from the fund.

— **ADRIENNE DiPAOLO,** ASSOCIATE, TORYS LLP

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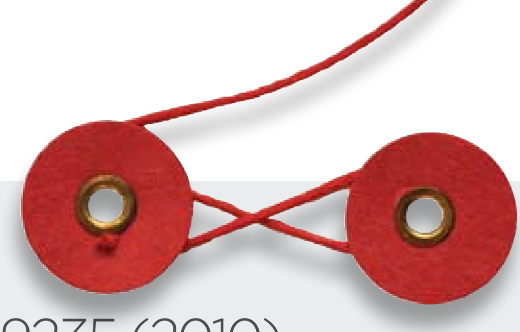

PENSION: ST. MARYS CEMENT V. UNITED STEELWORKERS, LOCAL 9235 (2010)

IT has long been generally believed that when a pension plan is incorporated into a collective agreement, the sponsoring employer is all but precluded from making significant changes to that plan without union consent. In particular, the understanding has been that an employer could not unilaterally convert a bargained defined benefit (DB) plan into a defined contribution (DC) plan.

But, in the case of *St. Marys Cement v. United Steelworkers,* a labour arbitrator held in March 2010 that the company could do just that. The arbitrator recognized that the pension plan had been duly incorporated into the collective agreement between the parties. However, the terms of the plan that had been so incorporated included a very broad, unilateral amendment in favour of the employer. Accordingly, the arbitrator construed the collective agreement to include the unilateral employer power of amendment and held that such power of amendment was broad enough to permit the DB plan to be morphed into a DC plan at the employer's will.

The union's counsel argued that the incorporation of the plan into the collective agreement effectively secured the DB promise. The arbitrator evidently had some sympathy for this position, but he concluded that the bare words used in the plan and the agreement did not permit him to draw that inference. Accordingly, the employer was free to turn the DB plan into a DC plan over the union's protests.

St. Marys Cement was decided by a labour arbitrator, not a court, so its precedential value is likely somewhat limited. Moreover, the arbitrator in this case was persuaded by the words used—or, more precisely, not used—by the parties in the clause incorporating the plan into the agreement. For these reasons, the case should not be read as a signal for employers across the country to convert their unionized pension plans from DB to DC whenever they so choose. However, it does suggest that the hands of DB plan sponsors for unionized employees may not be quite so tied as previously believed.

— **GARY NACHSHEN,** PARTNER AND DIRECTOR, NATIONAL PENSION AND BENEFITS PRACTICE GROUP, STIKEMAN ELLIOTT LLP

BENEFITS: WRONKO V. WESTERN INVENTORY SERVICE LTD. (2008)

Previous decisions have been interpreted such that employers can make unilateral changes to employment contracts upon reasonable notice. But the Ontario Court of Appeal found that an employer cannot unilaterally amend the terms of an employee's contract of employment. In *Wronko v. Western Inventory Service Ltd.,* the Court found that if an employee refuses to accept an employer's offer to amend the terms of his or her employment contract and the employer allows the employee to continue working, the terms of the original employment contract remain in force. By allowing the employee to continue working, the employer acquiesces to the employee's refusal to amend the employment contract.

Darrell Wronko's original employment contract with Western Inventory Service contained a termination provision that provided for the payment of two years' salary upon termination. In 2002, Western demanded that Wronko sign a new employment contract that would reduce his entitlement upon termination. Wronko refused to sign the contract and was insistent that his original contract remain in force. In response, Western informed Wronko that it was giving him two years' notice of the amendment to the termination provision. Wronko continued to work but did not agree to the amended termination provision. In 2004, Western sent Wronko an employment contract that contained the amended termination provision. Western informed Wronko that if he did not accept the new terms and conditions of employment, Western would no longer have a job for him. Wronko refused to accept the new employment terms and pursued a wrongful dismissal claim.

The case will have significant implications for employers that are considering the implementation of fundamental changes to employee benefits and compensation arrangements. To change the terms of an employment contract when an employee refuses to accept the variation, an employer must terminate the employee with proper notice and then offer the employee re-employment on the varied terms.

— KATHY BUSH AND JEREMY FORGIE,
PARTNERS, BLAKE, CASSELS & GRAYDON LLP

PENSION: RE INDALEX

The priority of pension deficiencies over other creditor claims are again in the legal spotlight, as a result of many recent insolvencies. One of the important cases now wending its way through the Ontario courts is *Re Indalex,* which was heard at first instance in the summer of 2009. Indalex's assets were sold within the context of a *Companies' Creditors Arrangement Act* proceeding, and the sale was approved by the court. Former employees and the union asserted deemed trust claims over the sale proceeds in respect of underfunded liabilities in the Indalex pension plans. The court was required to determine whether the sale proceeds were subject to the statutory deemed trust provisions of the *Pension Benefits Act* and should be used to fund a current plan windup deficiency and an anticipated one.

The court held that the amounts arising from the windup of one of the plans, and the future windup of the other plan, were not due or accruing due as of the date of the sale of Indalex's assets, so a deemed trust did not arise. It also noted that funding deficiencies were permitted to be paid over a number of years, and the amount of the payment did not become due until it was actually required to be paid. Furthermore, there was no amount that was due as of the date of the sale, as one of the plans had not yet been wound up. The case is currently before the Ontario Court of Appeal.

— **NATASHA VANDENHOVEN,** PARTNER, DAVIES WARD PHILLIPS & VINEBERG LLP

BENEFITS: DAYCO (CANADA) LTD. V. CAW-CANADA (1993)

The 1993 Supreme Court of Canada decision in Dayco provided the first in a series of answers to this question: When can an employer unilaterally change retiree benefits?

Dayco closed its Hamilton, Ont., plant in January 1985. Before the plant closure, Dayco and the union had negotiated an agreement under which group benefits for active employees would cease six months after the closure. This agreement did not address benefits for retirees. Dayco then advised retirees that their benefits would also cease after the six-month window. The union grieved this decision on the basis that the language in the former collective agreements protected the benefits of employees who retired when those agreements were in effect.

Dayco argued that it had no obligation to continue benefits for retirees, since the applicable collective agreements had expired. The Supreme Court disagreed and found that once employees retire, their side of the labour-for-benefits contract is complete, and the benefits promised for their labour must be provided.

The decision has provided the groundwork for several cases since. For example, in *Dinney v. Great-West Life* (2005), the Manitoba Court of Appeal, following Dayco, found retirees had a vested right to have their pension benefits indexed in accordance

with the formula in effect at the time they retired. The reasoning in Dayco has also provided a useful tool for predicting when benefits will vest—whether under an employment contract, collective agreement, pension plan text (or plan booklet) or legislation. It has also been useful for employers to understand how best to preserve future rights to amend such benefits; namely, by clearly and unequivocally reserving the right to change such benefits and avoiding conduct that might send a message that benefits are irrevocable.

— **MARK FIRMAN,** ASSOCIATE, McCARTHY TÉTRAULT LLP

PENSION: NOLAN V. KERRY (CANADA) INC. (2009)

Nolan v. Kerry (Canada) Inc., one of the few pension law cases decided by the Supreme Court of Canada, involved a defined benefit (DB) pension plan that was amended to introduce a defined contribution (DC) component. A dispute arose between the company and certain former employees regarding, among other things, the ability of the company to use surplus DB funds to take a contribution holiday in respect of its obligations under the DC portion of the plan, as well as over the validity of the company's use of fund assets to pay various plan expenses. In a majority decision, the Court determined several key pension issues, including payment of plan expenses and contribution holidays.

With respect to plan expenses, the Court found that there is no statutory or common law authority that obliges an employer to pay expenses of a pension plan. The plan documents generally govern whether expenses may be paid from the pension fund, but silence on the issue does not oblige an employer to pay the expenses. As well, a provision in pension plan documentation prohibiting funds from being used other than for the exclusive benefit of the employees does not impose an obligation on the company to pay expenses. Amendments to a pension trust fund to specify that expenses may be paid from the fund do not infringe the exclusive benefit language.

The Court reiterated that unless contribution holidays are specifically prohibited by the terms of a plan, an employer is entitled to take a contribution holiday. The creation of two different pension components (i.e., a DB and a DC component) does not necessarily result in two distinct pension plans and trusts. In addition, where surplus in the DB portion is used to fund DC contributions under the same trust, there is no violation of the exclusive benefit provision. Provided that it is not otherwise prohibited by the plan and trust documents, the use of trust funds to benefit either the DB or DC component is permissible.

— **JANA STEELE,** PARTNER, PENSIONS GROUP, GOODMANS LLP