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PENSION PLAN MERGERS

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The legal ability of a plan sponsor to merge two separate defined benefit plans containing "exclusive benefit" trust language has been called into question as a result of a series of recent cases in Ontario and British Columbia. After the *Air Products* case in 1994, the prevailing legal view in the common law provinces has been that plan language concerning surplus entitlement on the termination of a plan (surplus ownership rights of plan members) was irrelevant to the merger of pension plans, since surplus entitlement did not crystallize until plan termination. Accordingly, one could merge plans regardless of the surplus ownership rights under trust principles.

In *Air Products*, the Supreme Court of Canada held that members do not have a claim to surplus in an ongoing plan since actual surplus does not arise until a plan is terminated, and that contribution holidays do not amount to an encroachment upon a trust nor a reduction of accrued benefits for plan members. The Ontario Court of Appeal in *Heilig vs. Dominion Securities Pitfield* applied similar reasoning when it concluded that there was nothing inherently objectionable about the merger of a plan in surplus with one that was in a deficit, even if the assets of the surplus plan were subject to a trust for the benefit of plan members.

Since the 1994 *Air Products* decision, it has been the practice of provincial regulators to approve plan mergers even where the surplus from one of the merging plans has been used to fund the deficit of the ongoing liabilities in the other merging plan.

However, two recent cases - *Rogers Communications* and *Transamerica Life vs. ING* - have created great uncertainty in the law by suggesting that when the assets of two plans are merged, any trust fund limitations continue to apply to the respective portions of the funds following a merger. In *Buschau*, the B.C. Court of Appeal held that the merger of two plans was valid but that members retained the same rights and promised benefits that existed prior to the merger. In addition, the Court ordered that the merging funds be accounted for separately to preserve any surplus ownership rights. This finding has led to many questions as to whether a plan sponsor can utilize surplus in one plan to offset a deficit in another plan or whether a plan sponsor can utilize surplus for contribution holidays for the entire merged plan as opposed to merely the surplus generated for one particular pre-merger plan.

Perhaps the more disturbing aspect of this case was the decision of the Court to permit members of a closed plan to terminate their portion of the plan based on an ancient trust law principle (rule in *Saunders vs. Vautier*) and thereby compel a distribution of surplus. In subsequent proceedings, the B.C. Superior Court ordered the plan to be terminated based on the *Trust and Settlement Variation Act* as opposed to the common law rule in *Saunders vs. Vautier*). This decision is currently under appeal.

The decision of the Ontario Court of Appeal in *Transamerica vs. ING* also raises some potential hurdles for plan mergers. The Court held that the "exclusive benefit" language contained in the trust in addition to the specific undertaking by the plan sponsor to keep the assets and liabilities of the two merging plans separate and apart, effectively prevented the plan sponsor from utilizing the assets in one portion of the trust (Halifax trust) to satisfy the liabilities relating to the separate other portion of the trust (NN Life trust). The effect of the decision was to prohibit the use of surplus from one merging plan to fund the benefits of members from another merging plan.

Somewhat disheartening was the court's curt rejection of the recent decision of Ontario's Financial Services Tribunal in *Baxter vs. Ontario* (Superintendent of Financial Services) In *Baxter*, the Tribunal held that there was nothing inherently objectionable about a merger of a pension plan that is in a surplus position with one that is not, even if the assets of the former plan are subject to a trust for the benefit of the members.

There are a number of significant ramifications as a result of the uncertainty caused by these recent court decisions:

- Plan mergers are increasingly being subjected to greater scrutiny and legal challenges by plan members and therefore legal advise and counsel is required to navigate through the complex legal and regulatory issues;

- Sponsors of merged plans or sponsors who are contemplating a plan merger should carefully review the historical plan trust documents which may impact on their ability to utilize surplus through contribution holidays or possibly plan improvements;

- The decisions highlight a growing trend of negative decisions against the plan sponsor to utilize surplus based on narrow focus and strict adherence to restrictive trust principles with little regard to practical considerations such as tax implications or the feasibility of continuing to sponsor defined benefit plans;

- Plan sponsors with merged plans should seek legal counsel with respect to making certain representations and warranties regarding the funding status of merged plans in a business transaction.

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