



## Draft Legislation: February 2010

Earlier this year, the Honourable Jim Flaherty announced the creation of employee life and health trusts (“ELHTs”) through proposed amendments to the *Income Tax Act* (Canada) (“the *ITA*”). The press release stated that the amendments “will ensure that a fair and neutral tax regime applies to employee life and health trusts.”

Initial responses from the pension and benefits community were notably consistent in commenting that the amendments did not meet their stated purpose of ensuring a fair and neutral tax treatment of ELHTs.

Specifically, the following aspects of the proposal attracted significant commentary:

- Deductibility of Contributions
  - ELHTs would impose limits on deductions for the year to “the amount [that] may reasonably be regarded as having been contributed to fund designated employee benefits payable in the year.” This feature creates significant problems as employer contributions are typically fixed, negotiated amounts, and are not linked directly to when the benefits are paid out.
  - The deductibility problems would also create challenges to the proper funding of long-term disability and other benefits which have payout periods in excess of one year.
  - There is an asymmetry between insured and self-insured plans; while insured plans can deduct the full amount of premiums, self-insured plans are limited to deductions for the amount of contributions that relate to benefits payable for that year.
- Tax Implications
  - Unlike registered pension plans, ELHTs would be taxed on the investment income, which would result in assets being lost to taxation, rather than being used to provide benefits.
- Transitional Provisions
  - The proposals did not include transitional provisions to allow existing health and welfare trusts to benefit from the conversion to ELHTs.

## Bill C-47 First Reading in the House of Commons: September 2010

On September 30, 2010, the Federal government tabled Bill C-47, a second Act to implement certain provisions of the budget tabled in Parliament on March 4, 2010 and other measures (*Sustaining Canada’s Economic Recovery Act*) in the House of Commons. Bill C-47 is substantially similar to the February 2010 draft legislation, with the exception of the introduction of new rules for multi-employer employee life and health trusts (“ELHTs”). Overall, the main concerns of the pension and benefits industry noted above have not been resolved.

Bill C-47 does not alter the deductibility of employer contributions, although new provisions allow qualified multi-employer ELHTs to make a full deduction for the year in which the contributions are made. For a multi-employer ELHT to qualify, the contributions must be negotiated and fixed under a collective bargaining agreement; not more than 95% of employees can be employed by a single employer; and there must be at least 15 participating employers or at least 10% of employees must be employed by more than one participating employer.

For ELHTs that do not meet the multi-employer requirements, Bill C-47 makes no changes to limiting deductions to contributions for funding benefits payable in that year. Additionally, the asymmetry that disadvantages self-insured plans has not been addressed.

Finally, Bill C-47 does not change the taxation of ELHT investment income, and does not include transitional provisions to allow existing health and welfare trusts to convert to ELHTs.

## **Legislative Update: Safe Harbour in DC Plan**

In the United States, “safe harbour” rules may be found in the *Employee Retirement Income Security Act* (“ERISA”). The purpose of these rules is to protect defined contribution (DC) plan administrators from any fiduciary liability that may arise as a result of investment decisions made by plan members, provided that the administrator has acted in good faith and met other requirements.

On September 30, 2010, the Canadian government introduced the concept of a safe harbour into Canadian pension law by tabling Bill C-47 amending the federal *Pension Benefits Standards Act* (“PBSA”). Bill C-47 includes pension reform amendments for defined contribution plans, which were introduced in October 2009. These amendments will serve to provide administrators of defined contribution plans with a “safe harbour” from liability that may arise from member-directed investments.

In order to allow plan members to tailor their investment choices based on their retirement needs, defined contribution plan administrators must offer investment choices reflecting varying degrees of investment risk. In the event of litigation alleging breach of fiduciary duties, plan administrators who have complied with this obligation and other requirements of the regulations will be deemed to have met the statutory “prudent person” standard of care.

The specific nature of the requirements has yet to be defined but is expected to be set out in Regulations to be released at a future date.

## ***Burke v. Hudson’s Bay Co.*, 2010 SCC 34 (released October 7, 2010)**

In 1987, the Hudson’s Bay Co. (“HBC”) sold its Northern Stores to the North West Company (“NWC”). Twelve hundred employees transferred to NWC and were enrolled in a new pension plan. HBC transferred funds from its defined benefit pension plan to NWC’s plan sufficient to cover the benefits for the transferred employees. However, HBC did not transfer any of the projected \$94 million of actuarial surplus, leading to the transferred employees’ claim that HBC breached its fiduciary duty.

The Supreme Court of Canada noted the issue of transfer of surplus in an ongoing plan – as opposed to a terminated or wound-up plan – is a novel issue in pension law. The Court

reviewed the historical plan documents, finding that the employees' equitable interest on termination was limited to their defined benefits. Therefore, the Court concluded that the plan did not entitle the employees to an equitable interest in the surplus on termination, and that HBC was under no obligation to transfer a portion of the surplus.

The Court cautioned that this decision was based on the specific plan documents before the court, as is often the case when interpretation of trust agreements and plan texts is at issue:

This decision does not purport to deal with other situations involving actuarial surplus and plan transfer. Each situation must be evaluated on a case-by-case basis. Specifically, the resolution of the issue of surplus transfer when the pension plan documents indicate that employees are entitled to surplus on plan termination is best left to another case where that issue arises. (at para. 96)

## **Conflict of Pension Law: *Halliburton* & the Future of Accrued Benefits**

On September 9, 2010, the law pertaining to accrued benefits changed. The decision of the Alberta Court of Appeal in *Halliburton Group Canada Ltd. v. Alberta*, released on that date, contradicts the body of law that previously guided the analysis of what constitutes an accrued benefit, and has left pension plan sponsors questioning how much control they have over their own pension schemes.

### **History**

While the factual history of this matter is complex, the primary issue arises out of a DB/DC conversion that took place over several years. Between 1998-2001, several amendments were filed in relation to the Halliburton Group Canada Inc. ("HGCI") pension plan that resulted in both the salary and service of defined benefit (DB) plan members being frozen for those who transferred their membership to the defined contribution (DC) portion of the plan. The amendments were eventually registered simultaneously in 2005. At no time did the Alberta Superintendent of Pensions (the "Superintendent") inform the plan sponsor that the amendments would not be registered thereby allowing the sponsor to administer the pension plan in accordance with the filed amendments as is permitted in the *Employment Pension Plans Act* (the "EPPA").

Shortly after the amendments were registered, an amendment clarifying related tax-limit issues was filed in draft for comment by the Superintendent, in addition to the triennial actuarial valuation and cost certificate. These documents were rejected because they reflected the hard freeze of salaries and service that had already taken place between 1998-2001, and which had been administered accordingly since their respective dates of filing. Similarly, the Superintendent required that the actuarial valuation of the plan had to include projected earnings for post-conversion service in determining the plan's liabilities and contributions. The Superintendent took the position that, upon further review, a hard freeze was not permissible as members had accrued the right to have their post-conversion earnings taken into consideration when determining their ultimate DB entitlement. In essence, the Superintendent asserted that rather than determining the accrued DB benefit as of the date of determination (i.e., date of amendment), the right to calculate the DB entitlement based on final employment earnings (i.e., as of date of retirement) accrued to DB members on the day they joined the plan; a right that could not be modified by amendment.

## Decision and Implications

This matter has not been fully examined on its merits. Rather, the Alberta Court of Appeal was faced with a scenario that required it to render a decision largely based on its assessment of the Queen's Bench decision. Although the facts were presented, the decision to uphold the summary judgment decision of the Queen's Bench was focused on the standard of review employed as opposed to the law pertaining to what constitutes an accrued benefit. However, due to the reasons presented in the decision, what remains to be seen is how this decision will impact the ability of a pension plan sponsor to amend its plan, particularly in light of the fact that the law in Alberta is now effectively at odds with that which exists in British Columbia.

In rendering its decision, the Alberta Court of Appeal did not consider the relevant law as was espoused by the BC Court of Appeal. In both the 1995 decision in *Hockin v. Bank of British Columbia* and the 2001 decision in *C.A.S.A.W. v. Alcan Smelters and Chemicals Ltd.*, the BC Court of Appeal found that projected earnings were not an accrued right. So how does a plan sponsor with members in BC and Alberta reconcile this significant difference in law? Unfortunately, because Halliburton is not seeking leave to appeal to the Supreme Court of Canada, plan sponsors are left to navigate the ambiguities that have resulted between the two jurisdictions, and elsewhere in Canada, until such time as this question is once more before the courts.

For most plan sponsors, particularly those in Alberta, this decision is troubling on its face. However, in consideration of its broader application it may not be that awkward. While plan conversions are not nearly as common as they once were, the decision has neither prevented them going forward nor prohibited hard freezes from being undertaken. What the decision does say is that if a plan sponsor chooses to introduce a hard freeze, the current and historical plan language must be able to withstand the scrutiny that will be applied. The examination that will be required in advance of an application for registration must be thorough as the decision has arguably expanded the discretionary powers of the Superintendent.

The EPPA allows the Superintendent to revoke the registration of a pension plan in certain circumstances. It does not, however, expressly allow for the same actions in relation to a registered amendment. Despite the reasoning of the Court of Appeal that section 8 of the EPPA applies broadly to allow the Superintendent to undertake such action, section 8 is directed more at circumstances of unsafe administration. This was not the case for HGCI; it was administering its pension plan in accordance with its registered terms – a situation that is difficult to define as “unsafe”. However, the Alberta Court of Appeal has permitted the Superintendent to apply the powers granted in section 8 to require a plan sponsor to rescind one of its own amendments. It is debatable whether this was the intention of the legislature when it granted the discretionary authority contemplated in section 8 to the Superintendent.

The judicial process surrounding the HGCI pension plan has demonstrated the complexity of pension law in Canada. In this era of pension reform and calls for harmonization, when the courts cannot find consensus on the state of the law, agreement between governments with respect to how pension plans ought to be administered becomes imperative and the single source of consistency that ought to be the subject of advocacy from within the industry.

## What's New?

### *Dawson v. Tolko Industries Ltd.*

In this case, Tolko had converted its defined pension benefit plan to a defined contribution plan. The plaintiffs, comprised of employees and former employees of Tolko, brought suit against both Tolko and the consulting firm responsible for communications during the conversion. They alleged that their benefits under the defined contribution plan were significantly less than what they would have been under the defined benefit plan, and that the communications they received were inadequate in providing the information necessary for members to make an informed decision. The BC Supreme Court has heard arguments pertaining to the merits of this case and has reserved judgment. The Court is expected to release its decision in the coming months and Spectrum HR Law will provide commentary on the decision at that time.

## Spectrum News

Chris Brown was named President of the Association of Canadian Pension Management at its Annual Conference on September 16, 2010 in Whistler.

Chris Brown will be speaking at the Association of Canadian Pension Management, Ontario Regional Council's impACT 2010 session November 23, 2010

Michael Wolpert will be the speaker at Vital Benefit's Benefits Seminar Series, "CAP Guidelines – Don't Take Your Eyes off the Road!" on November 25, 2010 in Calgary at the Calgary Chamber of Commerce.

Chris Brown will be a speaker at the Canadian Bar Association's Northern Alberta Pension Section's December meeting in Edmonton, on prospects of US-style DC plan litigation coming to Canada.

For further information regarding the above or to discuss any other aspect of pensions and benefits law, please contact a member of the Spectrum HR Law Pensions, Employment Benefits and Executive Compensation Practice Group:

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