

PENSION PLANS AND THE LAW OF TRUSTS

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The purpose of this article is to begin to establish a much-needed analytical framework for pension law. This complex area of law has grown in recent years, yet few lawyers and fewer judges have had training in the area. The author uses equity and trust law principles in her approach, following the lead of recent Canadian court decisions. When a pension is funded by a trust, trust law is to be applied to funding issues. However, in general, the administration of a pension plan is governed by contract law. Pension trusts are not purpose trusts, for which there are no direct beneficiaries, but are more akin to "classic" or "true" trusts. Employers see pensions trusts as contractual promises and feel that money put aside to ensure the fulfilment of a trust belongs to the employer. Employees feel that money deposited into pension plans are deferred wages and that, therefore, the money belongs to them.

The author examines the rights enjoyed by beneficiaries of a pension trust. The rights of the beneficiaries to trace trust property and restrictions on an employer's right to surplus assets are currently in dispute. The author also discusses ways of amending, varying or ending pension trusts. In the end, the author concludes, it is up to lawyers, academics and judges to develop a complete framework. However, trust law and equity principles should be used, while other systems of law which intersect with pensions, such as contract and employment law, should be taken into account when conflicts arise.

Le but de cet article est de commencer à établir une structure analytique pour le droit des pensions, dont on a grand besoin. Récemment, ce domaine complexe du droit s'est développé, mais peu d'avocats et encore moins de juges ont reçu une formation dans ce domaine. L'auteur utilise les principes d'équité et de fiducie dans son approche, en suivant les décisions récentes des tribunaux canadiens. Quand une pension est financée par une fiducie, on applique le droit des fiducies aux questions de financement. Pourtant, en général, l'administration d'un fonds de pension est régie. Les fiducies de fonds de pension ne sont pas des fiducies à des fins d'utilité privées ou sociale, pour lesquelles il n'y a pas de bénéficiaires immédiats, mais elles ressemblent plus à des fiducies "classiques" ou "véritables." Les employeurs pensent que les fiducies de fonds de pension sont des engagements contractuels et que l'argent réservé pour payer une pension leur appartient. Les employés pensent que l'argent versé dans des fonds de pension constitue un salaire différé et que, pour cette raison, l'argent leur appartient.

L'auteur examine les droits des bénéficiaires d'une fiducie de fonds de pension. Le droit d'un bénéficiaire d'exercer ces droits directement sur les biens placés en fiducie et les restrictions apportées aux droits de l'employeur sur le surplus des actifs sont actuellement controversés. L'auteur discute aussi des méthodes pour bien modifier, changer ou mettre fin à une fiducie de fonds de

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pension. A la fin, l'auteur conclut que, c'est aux avocats, aux universitaires et aux juges de développer une structure complète. Il faut, toutefois, utiliser les principes d'équité et de fiducie, et d'autres systèmes de droit qui interviennent dans les fonds de pension, comme le droit des contrat et le droit du travail, doivent être considérés quand des conflits se présentent.

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Introduction

In preparing a paper on pensions, there is an almost overwhelming temptation to summarise recent caselaw on the following four topics: ownership of surplus pension funds on plan termination; the right to take contribution holidays; fiduciary responsibility in the administration of pension plans and funds; and the pension plan considerations that arise upon reorganisation and restructuring of businesses. To give in to the temptation would be a wasted opportunity. I want to go beyond a summary of recent judicial pronouncements and, instead, to begin the search for a framework of analysis. Nowhere is the need for such a framework more pronounced than in the pension field, for it is largely undeveloped. Answers to questions raised through the litigation process have generally been provided on a case-by-case basis. Courts have been noticeably reluctant to do more than resolve specific disputes and then only in narrow

terms. The consequence is that it is difficult, if not impossible, to provide legal advice with any degree of certainty in much of the pension field.

Because pensions is a very new field for lawyers¹ and because it has not traditionally been taught in law schools,² few lawyers and even fewer judges have had training in the field. There is virtually no legal academic writing in the area and there is no easy way to acquire a sound grounding in the field. But, there is a mountain of legal work being done in the area. A number of factors contribute to the volume of work. First, there is the sheer volume of assets under the control of pension funds. Second, much attention is focused on pensions by all segments of Canadian society because of Canada's aging population. Third, as the massive restructuring of business and government sectors continues and unemployment remains high, pensions have become a major point at the bargaining tables.

Not surprisingly, the widespread social concern with pensions is mirrored in an ever increasing volume of litigation in the pension field. Even a quick scan of the law reports reveals that pensions, for which there was no separate set of catchlines in the law reports as recently as three years ago, now occupies a significant amount of the reported space. Work demands on the solicitor's side is increasing as well. This work relates to issues involved with the creation, proper administration and wind-up of pension plans.

Pension issues may appear to arise infrequently or in relation to isolated issues. We might think of things like pension benefits in same sex relationships or the question of ownership of surplus pension funds on plan wind-ups and query how much work of an ongoing nature really exists. Two recent cases will illustrate that, far from being isolated, questions about pension plan administration are constant and ongoing.

The first is the high profile case of *R. v. Blair et al.*³ which caused the question of pension plan administration, which was once relegated to human resources departments, to be of concern at the highest levels in corporations. Enfield Corporation Ltd. was the registered administrator of all of the pension plans of its subsidiaries. It delegated responsibility for administration of the plans and investment of the trust funds to a pension committee. Penhale, the pension fund investment manager at Enfield, used pension monies improperly in an attempt to prevent a takeover of Enfield. The three members of the pension committee were charged with a breach of the Act in failing to properly supervise

¹ Until the 1980's, pension work — including the drafting and interpretation of documents — was almost exclusively performed by actuaries. It was not until pension reform legislation was passed in the late '80's that plan sponsors, in general, recognised the need for lawyers in order to ensure the proper discharge of responsibility in the administration and investment of pension plans.

² The Faculty of Law at the University of Western Ontario is the only law school of which the author is aware that offers a course devoted to pension law. The topic is touched upon in various courses in various law schools.

³ (1993), 106 D.L.R. (4th) 1 (Ont. Ct. (Prov. Div.)), rev'd (1994), 129 D.L.R. (4th) 367 (Ont. Gen. Div.) [hereinafter *Enfield*].

Penhale. A breach of the legislation is a quasi-criminal offence under s.110 of the *Pension Benefits Act*.

At first instance, all three members of the pension committee were found guilty of failing to supervise Penhale in a prudent and reasonable fashion. The convictions were overturned on appeal⁴ on a technical basis: only the registered administrator could be charged under subsection 22(7). Nonetheless, the prosecution and initial convictions raised the level of corporate awareness about the need for appropriate supervision and attention to the proper functioning of the pension plan and fund.

The second case, *Ontario Public Service Employees Union v. Ontario (Attorney General)*,⁵ illustrates how the question of administration of pensions is of concern at the highest levels of unions and governments. One of the Ontario provincial government's strategies for deficit reduction is to significantly reduce the size of the civil service. It is very likely that such a reduction will trigger significant pension consequences.⁶ The government passed a regulation⁷ in which it purported to exempt itself from the "grow in" provisions of the *Pension Benefits Act*.⁸ OPSEU, the union representing civil servants, challenged the government's right to pass the regulation without its consent. OPSEU won. The court declared that the portion of the regulation purporting to exempt the government from the provisions of the pension legislation was void and of no effect as it had been enacted without union consent. The fact that the court was willing to place strictures upon the exercise of power of the legislative arm of the government is startling; that it occurred in the context of a pension matter serves to illustrate the significance of the pension field today.

There is a huge need for sustained, thoughtful attention to this highly complex area of law. As the questions become increasingly more pressing and more sophisticated, answers must be fashioned within a framework of intelligible and flexible principles. The principles and framework must be developed by a bar which includes those with trust expertise and experience, as well as those with expertise in the fields of corporate, labour and tax law. Equity and trust law contain the principles and approach which can lead to a sensible and successful development of this new area. This was, in fact, the approach adopted by the Supreme Court of Canada in the sale major pension case it has decided to date: *Schmidt v. Air Products of*

⁴ *Ibid.*

⁵ (1995), 26 O.R. (3d) 740. (Div. Ct.).

⁶ S. 69 of the *Pension Benefits Act*, R.S.O. 1990, c.P.8 empowers the Superintendent of Pensions to order a partial plan wind up in certain circumstances. The consequence of a partial wind-up order is to trigger enhanced rights under the legislation in the form of "grow in" benefits under s. 74 and, possibly, additional rights under the terms of the pension plans themselves.

⁷ O. Reg. 343/95.

⁸ R.S.O. 1990, c. P.8.

*Canada Ltd.*⁹ The majority decision was delivered by Cory J. He had this to say about the role of trust law in the pension field:¹⁰

Air Products has suggested that the Catalytic pension fund was not subject to an express trust but instead to a trust for a purpose. Relying on *dicta* of the British Columbia Court of Appeal in *Hockin v. Bank of British Columbia* (1990), 71 D.L.R. (4th) 11, the company argues that a trust set up as part of a pension plan constitutes a trust whose sole purpose is to provide defined benefits to members. Once those benefits have been provided the purpose is fulfilled, the trust expires and the terms of the pension plan alone determine entitlement to any remaining fund surplus. I cannot accept this proposition.

Trusts for a purpose are a rare species. They constitute an exception to the general rule that trusts for a purpose are void. (See D. W. M. Waters, *Law of Trusts in Canada* (2nd ed. 1984), at 127-28.) The pension trust is much more akin to the classic trust than to the trust for a purpose. I agree with the following comments of the Pension Commission of Ontario in *Arrowhead Metals Ltd. v. Royal Trust Co.* (March 26, 1992), unreported, at 13-15, cited by Adams J. in *Bathgate v. National Hockey League Pension Society* (1992), 11 O.R. (3d) 449, at 510:

Purpose trusts are trusts for which there is no beneficiary; that is, they are trusts where no person has an equitable entitlement to the trust funds. Funds are deposited in trust in order to see that a particular purpose is filled; people may benefit, but only indirectly. . . .

People are clearly direct beneficiaries of pension trusts. Pension trusts are established not to effect some purpose, such [as] building a recreation centre, but to provide money on a regular basis to retired employees. It misconceives both the nature of a purpose trust and of a pension trust to suggest that pensions are for purposes, not persons. It is important to recognize that the characterization of pension trusts as purpose trusts results in the pension text, a contract, taking precedence over the trust agreement. That is, in making common law principles of contract paramount to the equitable principles of trust law. It is [trite] law that where common law and equity conflict, equity is to prevail. In light of that rule, it seems inappropriate to do indirectly that which could not be done directly.

To repeat, the first step is to determine whether or not the pension fund is in fact a pension trust. This will most often be revealed by the wording of the pension plan itself, but may also be implied from the plan and from the way in which the pension fund is set up. A pension trust is a "classic" or "true" trust and not a mere trust for a purpose. If there is no trust created under the pension plan, the wording of the pension plan alone will govern the allocation of any surplus remaining on termination. However, if the fund is subject to a trust, different considerations may govern.

Schmidt makes it clear that where the choice of funding vehicle for a pension is a trust, trust law is the dominant set of legal principles to be applied. Given the trend towards defined contribution plans, which are even more

⁹ [1994] 2 S.C.R. 611 [hereinafter *Schmidt*].

¹⁰ At 640-41.

obviously trusts than are defined benefit plans,¹¹ the need for the application of trust and equitable principles is only going to increase.

In this paper, I will attempt to set out the boundaries of the emerging field of pension law. I will begin by providing an abbreviated overview of the history of the area. Thereafter, I will explore answers to the following three questions:

- . What is the nature of a pension trust?
- . What are the rights of pension trust beneficiaries?
- . How can a pension trust be altered, varied or revoked?

One topic, noticeable for its absence from the list of items to be covered, is that of the fiduciary liability of plan sponsors, administrators and all those involved in the administration of a pension plan and fund. This topic has been the subject matter of a great many conferences in the past three or four years. Rather than attempting to summarise the information generated in those conferences, readers are directed to the published papers.¹²

In exploring answers to these three questions, the relevant trust principle will be stated. Key pension cases will then be considered to illustrate whether application of the principle in the pension field is consistent with trust law and, where it is not, to provide some explanation for the variance from trust principles. My intent is to provide insight into some of the key aspects of pension law and to begin to develop the framework of which I spoke earlier.

1. *Setting the Stage*

a. *Some History*

Pension plans, as we know them, came into being after World War II. Prior to that time, many corporations — large and small — gave out retirement allowances. These could not be termed pensions; they were basically gratuitous

¹¹ In a defined contribution pension plan, the amount to be contributed by and on behalf of a member is specified. The contributions are credited to each plan member and accumulated with interest. At retirement, the pension consists of the funds in the account (i.e. the contributions plus investment income). The funds are used to purchase an annuity and it is the annuity which is paid on a monthly basis to the retired member as a pension. Defined benefit pension plans are so termed because the benefit to be paid to each member of the pension plan on retirement is a set, or defined, amount. The amount is calculated based on a formula, found in the plan document, related to the member's length of service, or length of service plus earnings.

¹² For the reader's convenience, I list the most recent papers I have delivered on this subject. E.E. Gillese, "Pension Funds: Who is a Fiduciary?" (The Canadian Institute, Toronto, 1994); Gillese, "Fiduciary Responsibility — A Regulator's Viewpoint" (CCH Seminar, Toronto, 1995); Gillese, "A Regulator's Viewpoint of Pension Plan Governance" (Lexium, Toronto, 1995).

rewards for loyal service. Employees had no legally enforceable rights to the benefits and employers were free to revoke promised rewards at any time, even when the rewards were "in pay". No legal principles were involved in the payment of retirement allowances at this time as they were purely voluntary, employers made them without an intention to create legal relations and employees had no known cause of action which could be invoked to force their payment. This was the first phase in the development of pension law.

Phase 2 began after the second World War. In 1942, for the first time, income tax rules set out that in order for employer contributions to a pension plan to be deductible from taxable income, they had to be supported by an actuarial statement attesting to a funding requirement. To warrant deductibility of contributions, pensions once in pay could not be revoked. This led to the recognition of an enforceable employee right to certain limited retirement benefits. Basic contract law could be invoked to claim payment of promised retirement benefits.

As well as the (limited) legal recognition of employee claims to retirement benefits, the immediate post war period saw a rapid expansion of trade unions and a dramatic rise in the expansion of pension plan coverage.

From that time to the early 1960's, the majority of pension plans in Canada were funded by way of insurance contracts. The legal principles which were applicable to pension matters were those of contract law, as both the plan text and the funding vehicle were contractual in nature. The plan text was a form of unilateral contract: the employee accepted it on its terms and the employer typically expressly had the right to unilaterally amend the plan. In any event, the employer had broad powers of amendment by virtue of contract law principles. The insurance contract was typically between employer and insurance company; thus the employee had no role or right in the matter of funding. It is trite law that the doctrine of privity of contract precludes third parties from suing on the contract even where the contract is for the benefit of that third party.

Phase two can be seen to be the real beginning of pension law as it was then, for the first time, that the concept of an enforceable employee right to a pension was recognised. The right to sue was a major shift in the balance of power between employer and employees as employees previously had no enforceable legal rights with respect to pensions.

Pension plans entered a third phase with the passage of the *Pension Benefits Act 1963* in Ontario. The Act represented recognition of the public interest in protection of pension promises through regulatory intervention. The legislation, through provisions such as the "45 and 10 rule", established that employees accrued rights to their pensions during employment and not just at retirement. The legislation made it clear that pension plan promises had to have security of funding. The legislation articulated a major shift in the respective roles of employee rights and plan sponsor obligations. The balance of power between employer and employees was significantly altered by the introduction of pension legislation in Phase 3.

At the same time (i.e. the early part of the 1960's), it became common to fund pension plans by means of trusts. Employer contributions were made to segregated trust funds. In contributory pension plans, employee contributions were withheld from pay and remitted to the segregated trust fund. The reasons for the movement away from insurance contracts to trusts were many. The legislation was one impetus. Major insolvencies led to the fear that pension plans might be unfunded and employees felt more confident that the pension promise would be met because the funds were held in segregated trust accounts. Employers were happier because investment returns accrued to the benefit of the trust fund and not to insurance companies. The investment returns could be used to enhance benefits or offset required contributions.

Phase 4 in the development of pension law occurred with the introduction of pension reform legislation which was passed by the majority of Canadian provinces beginning with Ontario's *Pension Benefits Act, 1987*.¹³ The legislation was expressly directed at employee rights under pension plans. It improved the position of employees in the areas of: eligibility and vesting; employer contributions and interest calculations on contributions; portability; disclosure of information; and, spousal rights.¹⁴

Some would argue that the main effect of the reform legislation was to introduce greater (needless) regulation and complexity in an already complex field. I would suggest that it did more than that. The reform legislation considerably expanded the rights of plan members. It altered, again, the power balance between employers and employees in the matter of pensions. The clearest example of this was the strengthening of vesting rights; the recognition that a plan member accrues an irrevocable right to a pension benefit. After the reform legislation, employees generally have a vested right to a pension after two years membership in the plan. This amounts to an assured pension right very early on after becoming employed and means that almost all employees — not just older ones — have an interest and stake in the pension plan and fund. This shift in balance was exaggerated by the moratorium which was placed on the withdrawal of pension surplus.

One additional point needs to be made in relation to the current pension legislation. The legislation provides little or no guidance on the broad issues and questions which beleaguer us such as entitlement to surplus, the right to take contribution holidays and the right to claim reimbursement for expenses from the fund.¹⁵ Its focus is on detail, such as the calculation of employee benefits. It does not and, as currently expressed, cannot provide a framework for resolving significant questions in the pension field.

¹³ S.O. 1987, c. 35 as am. by R.S.O. 1990, c.P.8.

¹⁴ A review of the changes introduced by the 1987 legislation can be found in a paper written by the author entitled "Employee Rights Under Bill 170" *The New Ontario Pension Benefits Act, L.S.U.C. Continuing Education, Toronto: 1987*.

¹⁵ At one time, indexation would have been added to the list. The legislation does not deal with the issue but, with inflation levels down, it is no longer the pressing issue it once was.

Moreover, the legislation perpetuates a further complicating feature of the pension field. Section 8 of the Ontario pension legislation provides that an employer may be the administrator for a pension plan. In the vast majority of cases, the employer is indeed the administrator. It should be self-evident that this will frequently put the employer in a conflict of interest position. Take, for example, the setting of assumptions on which contribution rates will be based. An administrator of a pension plan is a fiduciary. As such, the administrator owes a duty of loyalty to the plan beneficiaries; the result should be that the administrator will favour conservative assumptions. On the other hand, the administrator is also the employer. The employer will want less conservative assumptions so that it does not attract an overly high contribution rate. This type of conflict of interest permeates the administration of the plan and fund.¹⁶

We have only recently entered Phase 5. That is the phase in which the legal system contributes to the formulation of the private pension system. The contribution of the legal system will be to give shape to this area of law, develop known and intelligible principles and engender some degree of certainty. In this way, people can plot their courses of action with respect to pensions with some degree of certainty of outcome. It is the time in which answers will be developed in more general terms so that fewer cases must go to court for resolution. Without such guidance from the legal system, we can only wonder about the future of the private pension system in Canada.

b. Plan Documentation

An understanding of the basic documents used to create a pension plan and fund is helpful in understanding the points made in later sections of the paper.

Pension plans normally consist of two documents. The first document is the pension plan text. The pension plan text contains the information which an employee needs in order to understand what membership in the pension plan involves. It will include information on things such as eligibility, vesting and the formula for calculation of benefits. Some of the specific terms that a well drafted pension plan will include are:

- a) the method of appointment of and/or identity of the administrator;
- b) conditions for membership in the plan;
- c) benefits and rights that accrue upon termination of employment, termination of membership, retirement or death;
- d) requirements for entitlement to pension benefits and ancillary benefits;
- e) the method of calculating contributions and interest payable thereon;
- f) the method of determining benefits payable;

¹⁶ Quebec eliminated this problem by mandating joint governance. Other countries have opted to make it mandatory that the functions be separated so as to preclude the conflict.

- g) the mechanism for establishing and maintaining the pension fund; and
- h) a power of amendment.

It is wise to include additional information such as the history of predecessor plans, an explanation of the use and treatment of surplus during the continuation of the plan and on wind-up and information on disclosure. Provincial legislation guides the creation of plan documents by prescribing certain minimum provisions which must be included.¹⁷

While the pension plan document usually states what mechanism will be used to fund the pension plan, funding itself is typically dealt with through a separate document and legal relationship. As we have seen, historically, funding was done through insurance contracts but is now typically done through a trust.

The trust agreement contains the terms that standard trust agreements would include such as :

- a) establishment of the trust and procedures by which contributions will be made;
- b) disposition of funds;
- c) investment of funds;
- d) right to payment of expenses and compensation;
- e) a raft of powers which enable the trustee to invest and manage the trust fund;
- f) provision for accounting for the trust fund;
- g) resignation and removal of the trustee and appointment of a successor trustee;
- h) amendment of the trust;
- i) termination of the trust;
- j) other standard terms such as governing law, giving of notices, and prohibition of assignment of trust.

Once trusts were used as the funding vehicle for pensions, it became unclear which set of principles was to dominate in cases of dispute: contract law or trust law. The problem was (and is) acute because, unfortunately, the results dictated by contract law are often in direct opposition to those dictated by trust law. There is no ready means of determining which system of law should dominate, in part, because the equities of the situation could be invoked to support either.

The issue of surplus entitlement is illustrative. When a pension plan winds up, all pension promises must be provided for. Any excess of assets over liabilities is surplus. As we all know, surplus assets are frequently the subject of litigation with both the employees and the employers claiming entitlement.

¹⁷ See, for example, s.10 of the *Pension Benefits Act*, R.S.O. 1990, c.P.8.

From the employees' viewpoint, the money placed in trust to fund the pension promise is deferred wages. Thus, they argue that if the money had not been transferred to the trust, in order to provide them with pensions, it would have been given to them in the form of higher wages. Following trust principles, money placed in trust for the employees belongs to them as do the fruits of such money (i.e. the investment returns). Therefore, or so the argument runs, all surplus funds belong to employees.

From the employers' perspective, however, the fact that money is placed in trust is secondary to the promises that have been made. From the employers' viewpoint, what has been promised to employees is not the money in the trust but, rather, fixed benefits established by predetermined formulas. Once the promised benefits have been paid or provided for, the employees have received all that they are entitled to and therefore surplus funds belong to the employer. It can be seen that the focus of the employers argument is the pension plan document which created the benefits and which we know is a contract. Thus, the employers' viewpoint is frequently based on the paramountcy of contract principles.

It is this tension between competing equities which makes it impossible to simply say that where trust and contract conflict, trust law and principles are to prevail. A simplistic, prescriptive approach of that sort cannot and will not provide the tools with which to fashion flexible and meaningful relief. It would create, in my view, a situation like that which existed in Canada in the cohabitation cases in the 1970's. You will recall that the courts struggled with how to adapt the resulting trust doctrine to provide for property distribution when personal relationships broke down. A rigid application of the resulting trust doctrine¹⁸ led to great injustice. The courts then turned to constructive trusts to fashion relief. Through the doctrine of constructive trust, the Canadian courts adopted a mechanism with sufficient flexibility that it could take into account modern day realities. There was much confusion, frustration and hardship that resulted from the initial rigidity of the law. If we can learn from our mistakes, it is to see that where there are competing equities with no obvious "winner", the law needs to adopt a principled and flexible stance.

Returning to the matter of documentation, we have seen that there are typically two documents which are in conflict: the plan text and the trust agreement. This problem is compounded by the fact that the current pension documentation normally follows a chain of earlier documents and the current documents may be in conflict with those earlier documents. That is, the provisions of current plan texts may be inconsistent with prior versions of the plan text. Current trust documents often are in conflict with prior trust documents. One example that abounds in the pension field is the inclusion of surplus reversion language in current pension plan texts and trusts in the face of earlier documentation which states that all money deposited in trust is to be used solely and irrevocably to the benefit of the employees.

¹⁸ *Murdoch v. Murdoch*, [1975] 1 S.C.R. 423.

c. *The Role of Social Policy*

A final element which confounds and confuses is the role of social policy. How much, if at all, should the courts be influenced by the fact that provision of pension plans in Canada is optional? Should the courts be concerned with the possible effects of their decisions on the willingness of employers to offer or maintain pension plans? Some other countries make it mandatory that employers provide pension plans,¹⁹ but there is nothing to suggest that this might occur federally or in any of the provinces.

Common sense tells us that it is highly desirable that employers offer pension plans. Hard evidence supports this view. The World Bank Policy and Research Report entitled "Adverting the Old Age Crisis: Policies to Protect the Old and Promote Growth"²⁰ states that three pillars of support are needed in order to provide adequate retirement income for a country with an aging population such as we have in Canada. These three pillars are: government programs, individual savings, and private pension plans.

We know that court decisions must have, as their focus, a legal solution to the problem presented by the parties. That is, the dispute and its resolution must be primarily *inter partes*. But can we afford to ignore the effects of such decisions on the will of employers to offer pension plans? Before answering that question, consider the case of *Re St. Marys Paper Inc.*²¹

St. Marys paper mill ran into financial difficulties. A trustee in bankruptcy was appointed. The trustee decided to carry on the business. One of the terms of employment requested by the employees was that the trustee pay current service costs owing under the pension plan. The trustee agreed, but disclaimed any responsibility for any other obligations under the plans, including the unfunded liability which it advised the employees was a claim in the bankruptcy. Every former employee hired by the trustee received a letter confirming this arrangement.

At first instance, the trustee was found to be a successor employer and therefore liable not just for current service costs — which it was prepared to pay — but for the unfunded pension fund liability — which it had specifically disclaimed.

On appeal, the judgment was upheld. The dissenting judgment of Abella J.A. is instructive and illustrates the dilemma posed in taking into account social policy considerations. I quote it at length to demonstrate both points:²²

¹⁹ Australia being an example of a recent addition to the list of countries which requires employers to offer pension plan coverage to its employees.

²⁰ International Bank for Reconstruction and Development (Oxford University Press, 1994).

²¹ [1996] S.C.J. No. 3 (QL) appeal dismissed because case was moot; (1994), 116 D.L.R. (4th) 448 (Ont. C.A.) aff'g (1993), 107 D.L.R. (4th) 715 (Gen. Div.) [hereinafter *St. Mary's* cited to (1994), 116 D.L.R. (4th) 448].

²² (1994), *ibid.* at 467-69.

In my view, no liability is imposed by the PBA on any employer unless that employer has agreed to provide a pension plan. A successor employer can undoubtedly explicitly agree to continue to be bound by a previous owner's plan. Once it so agrees, it is required to make all payments stipulated under the plan and to comply with all relevant legislative requirements. But I do not agree that the payment of current service costs and related actions by the trustee in the unusual circumstances such as existed in this case triggers all other PBA employer duties.

The trustee is not a successor employer (*Rizzo and Rizzo Shoes Ltd. (Re)* (1991), 11 C.B.R. (3d) 246, 92 C.L.L.C. 14,013, 6 O.R. (3d) 441 (Gen. Div.)). It has not been so found by the Ontario Labour Relations Board, which has exclusive jurisdiction to make such a declaration in a unionized workplace (*Great Atlantic and Pacific Co. of Canada, Ltd. v. Vance*, a judgment of the Ontario Court (General Division), Divisional Court, released January 24, 1994) [now reported 111 D.L.R. (4th) 328, 94 C.L.L.C. 14,010, 16 O.R. (3d) 816]; it has not purchased the assets of the former employer; and most decidedly it did not agree to become contractually bound by the terms of the pension plans. On the contrary, its legal position as a trustee temporarily arranging to keep the business viable until a new employer could be found, and as one agreeing to restrict its obligations to current service cost contributions, was made clear to all employees when the trustee agreed to continue the business of the bankrupt company.

Section 55(2) of the PBA states that contributions should be made by an employer "in the prescribed manner and in accordance with the prescribed agreement for funding". But only "an employer required to make contributions under a pension plan" is caught by this duty. The trustee is not required to make contributions. It is not, therefore, an employer under the PBA liable for the special payments or any unfunded liability. Similarly, its payments of the current service costs would not entitle it to apply for any surplus in the plans. Its behaviour has not attracted either any benefits or burdens under the plans.

Any other interpretation unduly interferes with the fiduciary nature of the trustee's role. Except in clearly defined circumstances, the duties it assumes in discharging responsibilities to creditors, including employees, do not make it personally liable for liabilities of the bankrupt that arose prior to the bankruptcy. This is clear from s. 31(4) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, which provides that all debts incurred and credit received in carrying on the business of a bankrupt are deemed to be incurred and received by the estate. Making the trustee responsible for the plan's unfunded liability makes the trustee liable for previously incurred liabilities.

The trustee is a creature of statute whose mandate is to liquidate the assets of the bankrupt so that they can be distributed to those who are entitled to them. It holds any property of the bankrupt in trust for those entitled to a share of it.

In fulfilling this mandate, the trustee may carry on the business for a limited time. It is obviously not at liberty to do so without regard to operative employment laws that seek to protect workers from exploitation, but that is far from the situation here.

Contracts of employment with employees, including collective agreements, terminate with a bankruptcy. The trustee decided to try to save the business and, in so doing, the jobs of almost 500 workers. It had no obligation whatever to continue the pension plans and could easily have wound them up. Instead, the employees asked that current services cost contributions be paid so that a new purchaser would have the option of continuing the plans and assuming employer obligations under them. The trustee acceded to the request in the interests exclusively of the employees.

This concession unravelled a chain of unanticipated events that resulted ultimately and ironically in a claim by those same employees for a result neither they nor the trustee had intended or expected.

Their assertion, if accepted, acts as a determinative barrier to the assumption by a trustee of any pension plan continuity where a bankrupt business is operated and sold as a "going concern". This invites the automatic termination of pension plans upon bankruptcy by trustees unwilling to risk extraordinary long-term liabilities for the short-term accommodation of employees.

The PBA is legislation designed to protect employees' pension plans from arbitrary erosion and should be interpreted accordingly. I would prefer to interpret the PBA in a way which both respects the unique role of the trustee in circumstances such as these, and encourages conduct which inures to the benefit of employees covered by pension plans. A more technical reading of the PBA, rendering the trustee an inadvertent employer under the Act by its current service cost payments, discourages both.

I agree with Farley J.'s comments when he states in his reasons [107 D.L.R. (4th) 715 at 720, 1 C.C.P.B. 27, 15 O.R. (3d) 359]:

...it would seem to be in everyone's best interests to allow a trustee in bankruptcy the flexibility of seeing if an undertaking could be sold on a going concern basis while maintaining current payments but not exposing the trustee to liability for past unfunded liabilities.

I do not, however, share his view that the PBA precludes this option. In my opinion, the trustee is not an "employer required to make contributions under a pension plan" as contemplated by s.55(2), and accordingly is not liable for any of the unfunded liabilities.

The effect of the decision in *St. Marys* was to require the trustee to make the special payments to reduce the unfunded liabilities. It was a decision which is defensible when considered on an *inter partes* basis. But, what will the next trustee who takes over a factory do? Will it offer to make pension contributions for the employees? I would think not. Are we happy with a decision which discourages trustees from continuing pension plans? There is no easy answer to the question of the role of policy considerations in legal decisions. The real question is: can we afford to ignore it when developing the framework to govern pension matters?

For those who wish more insights into the background issues involved in the pension field, I would direct them to the following cases:

*Schmidt v. Air Products Canada Ltd.*²³

*Re Attorney General of Canada and Confederation Life Insurance Company*²⁴

*Bathgate v. National Hockey League Pension Society*²⁵

*Re Reeve et al. and Montreal Trust Co. of Canada et al.*²⁶

²³ *Supra* footnote 9.

²⁴ (1995), 24 O.R. (3d) 717 (Gen. Div.).

²⁵ (1992), 98 D.L.R. (4th) 326 (Ont. Gen. Div.).

²⁶ (1986), 25 D.L.R. (4th) 312 (Ont. C.A.) [hereinafter *Reeve*].

2. What is the nature of a pension trust?

What is the nature of a pension trust? This is perhaps the most fundamental legal question that exists in the area of pension law. In general, two systems of law are involved: contract law and trust law. Neither can be said to be obviously dominant in the workings of the pension plan. Administration of the plan is clearly governed primarily by the plan text, a contract. Funding of the plan, where done through a trust, is clearly governed by the trust agreement. The equities of the situation, as discussed briefly above, are competing and each side has compelling arguments in its favour.

Some would argue that the question of the fundamental nature of the pension trust has been laid to rest by the Supreme Court of Canada in the *Schmidt* decision. I disagree. *Schmidt* is a case about surplus ownership on plan termination. Which system of law is dominant may very well differ depending upon whether the question is being asked in relation to a terminated pension plan or one that is continuing. Recall again the *St. Marys* case. The disturbing aspect of the decision in *St. Marys* is that it created a legal environment in which it was preferable for trustees to refuse to make current service costs, the making of which had the effect of continuing to have employee benefits accrue under pension plans. An open discussion of the policy ramifications of legal decisions may very well shift the balance from one system of law to another.

The role that policy considerations are to play in the making of legal decisions is unclear. As a consequence, some may reject the reason given above for arguing that the nature of a pension trust is unclear. The second reason cannot be rejected. *Schmidt* itself is logically inconsistent in result and reasoning. I have written an article which demonstrates the inconsistency and I would direct those readers who wish a full exploration of the topic to that article.²⁷ In its simplest form, the inconsistency is this. Trust principles are said to be paramount in *Schmidt*. Their application led to surplus entitlement being found to lie with employees in the case of one of two merged plans. Nonetheless, the employer was held to have legally taken contribution holidays.²⁸ Cory J., writing for the majority, had this to say about contribution holidays.²⁹

When the plan is silent on the issue [of contribution holidays], the right to take a contribution holiday is not objectionable so long as actuaries continue to accept the application of existing surplus to current service costs as standard practice. These principles apply whether or not the pension fund is subject to a trust. Because no money is withdrawn from the fund by the employer, the taking of a contribution holiday represents neither an encroachment upon the trust nor a reduction of accrued benefits.

²⁷ E.E. Gillese, "Contribution Holidays" (1995) 15 E. & T.J. 136.

²⁸ A pension plan sponsor is said to take a "contribution holiday" in any year in which the sponsor's current service cost is funded partially or entirely from surplus existing in the pension fund.

²⁹ *Supra* footnote 9 at 656.

It is logically inconsistent to say that trust law is dominant, that surplus funds belong to employees but that an employer may take the benefit of the surplus funds during the operation of the pension plan even where there is no express provision entitling them to do so. To allow contribution holidays in such circumstances is to sanction a breach of the basic trust principle that trust funds must be administered for the sole benefit of the beneficiaries.

The inconsistency created by *Schmidt* has resulted in later decisions which are at odds with the reasoning quoted above.³⁰ The inconsistency reveals, in my view, an approach which favours the paramountcy of contract law — and therefore, generally, the employer — during the operation of a pension plan.

It cannot be said that the inconsistency in reasoning in *Schmidt* is a flaw. It may represent the inchoate beginnings of the flexible application of trust principles which I call for at the beginning of this paper.

In any event, the inconsistency demonstrates that the question of the nature of a pension trust has not been settled. Therefore, it behooves us to consider the competing arguments which underlie the question.

a. *The employers' argument*

The agreement by an employer with employees to provide a pension plan is in the nature of a promise and is, therefore, primarily contractual in nature. The way in which the promise is made good is a question to be decided by the employer as, ultimately, it is the employer who must ensure that the promise is honoured. Money that is put aside to ensure that the promises will be fulfilled belongs to the employer. If there are doubts about rights and powers with respect to the money, ambiguity is to be resolved in favour of the employer. This argument views the pension plan text as the dominant legal document. The trust instrument is secondary; it is merely a tool used to ensure that the promises made in the plan text are kept. The paramountcy of contract law is based on the intention of the parties.

Employers offer an alternative argument based on resulting trust. Money is placed in trust to see that certain benefits are paid. Surplus funds are to be dealt with according to classic resulting trust principles: where an express trust fails, in part, because it has not been fully declared, the undeclared portion reverts to the settlor.

The employers' arguments are bolstered by the historical fact that contract was the governing system when pensions became a legal matter as, at that time, insurance contracts were the predominant funding mechanism.

³⁰ See *Hockin v. Bank of British Columbia* (1995), 123 D.L.R. (4th) 538 (B.C.C.A.) [hereinafter *Hockin*], leave to appeal to S.C.C. refused S.C.C. Bull. September 29, 1995 at 1399; *Chateauneuf v. TSCO of Canada Ltd.* (1995), 124 D.L.R. (4th) 308 (Que. C.A.), leave to appeal to S.C.C. refused 124 D.L.R. (4th) vi.

b. *The employees' argument*

The employees' argument is rooted in the "deferred wages" view of pensions. That is, when employers bargain with employees, they determine how much they are willing to pay employees in total. Employers may pay the whole amount in wages or they may pay a certain wage and provide certain benefits in addition to the wages. The money which employers pay to employees consists of the direct compensation and the indirect compensation, wages and, in this case, the money deposited into the pension fund. The two together are the compensation to which the employee is entitled. The money put aside to fund the pension promise would have gone to the employees in the form of higher wages had it not been placed in trust to fund the promised pensions. The choice of a trust as a funding vehicle illustrates the fact that the money is no longer the employer's; it has been segregated and placed in trust for the benefit of plan members. On this view, the money belongs to the employees and, except for express rights to the money which form part of the terms of the pension arrangement, the employer is to have no benefit of the money. Any ambiguities are to be resolved in favour of the employees as the money belongs to them, in the eyes of equity.

The employees arguments are bolstered by the implicit assumptions in the legislation that pensions are a form of deferred wages.

c. *Non-charitable purpose trust analysis rejected*

One matter going to the nature of a pension trust appears clear as a result of *Schmidt*. Pension trusts are express trusts for persons; they are not to be dealt with according to the principles that govern non-charitable purpose trust.³¹

The pension trust is much more akin to the classic trust than to the trust for a purpose... A pension trust is a "classic" or "true" trust and not a mere trust for a purpose.³²

In rejecting purpose trust analysis, the Supreme Court of Canada followed the trust line of analysis which Ontario courts, by and large, had adopted beginning with *Re Reeve et al. and Montreal Trust Co. of Canada et al.*³³ In *Reeve*, Zuber J. A. stated:

At the centre of this dispute lies the simple fact that the funds in dispute are trust funds. The settlors of the fund were the employer (Canada Dry Limited) and the employees. The pension plan and the trust agreement provide that the contributions were irrevocable and that the beneficiaries of the trust were the members of the pension plan (*i.e.*, the employees, spouses, etc.).

The consequences that flow from these premises are clearly stated in *Waters, Law of Trusts in Canada*, 2nd ed. (1984), at 291:

³¹ As an aside to trusts lawyers, *Hockin* and the line of cases which followed demonstrates that judicial resistance to the idea of non-charitable purpose trusts appears to be gone.

³² *Supra* footnote 9 at 640-4.

³³ *Supra* footnote 26 at 317.

A settlor cannot revoke his trust unless he has expressly reserved the power to do so. This is a cardinal rule, and it involves two important concepts. The first is that the trust is a mode of disposition, and once the instrument of creation of the trust has taken effect or a verbal declaration had been made of immediate disposition on trust, the settlor has alienated the property as much as if he had given it to the beneficiaries by an out-and-out gift. This almost self-evident proposition has to be reiterated because it is sometimes said that the trust is a mode of "restricted transfer". So indeed it is, but the restriction does not mean that by employing the trust the settlor inherently retains a right or power to intervene once the trust has taken effect, whether to set the trust aside, change the beneficiaries, name other beneficiaries, take back part of the trust property, or do anything else to amend or change the trust. By restriction is meant that he has transferred the property but subject to restrictions upon who is to enjoy and to what degree. The mode of future enjoyment is regulated in the act of transferring, but the transfer remains a true transfer.

The appellant does not take issue with these general principles but asserts that it has reserved a power of amendment which is wide enough to entitle him to recover surplus funds. In my opinion, this proposition is simply untenable. The language of the trust agreement and the pension plan do not support such an argument.

Although the flavour of the reasoning adopted by the Supreme Court of Canada is that of *Reevie*, it should be noted that the court relied upon the decision of the Pension Commission of Ontario in *Arrowhead Metals Ltd. v. Royal Trust Co.*³⁴ as cited by Adams J. in *Bathgate v. National Hockey League Pension Society*.³⁵

d. *Resulting trust analysis rejected*

Resulting trust analysis has effectively been eliminated in the context of surplus ownership disputes by *Schmidt*:

A resulting trust may arise if the objects of the trust have been fully satisfied and money still remains in the trust fund. In such situations, the remaining trust funds will ordinarily revert by operation of law to the settlor of the fund. However, a resulting trust will not arise if, at the time of settlement, the settlor demonstrates an intention to part with his or her money outright. This is to say the settlor indicates that he or she will not retain any interest in any remaining funds.

...

The exigencies of tax law are such that preferential tax treatment will only be afforded to registered pension plans. Registration, originally contingent upon clear evidence that the employer's contribution would be irrevocable, now requires a plan to provide that, following termination of the plan, any remaining surplus in excess of the statutory maximum level of employee benefits must revert to the employer. Therefore, the provisions of most registered pension plans will normally themselves exclude the possibility of a resulting trust's arising. That is not to say that the resulting trust will never have a place in the context of pension funds. Yet the practical reality is that the factual circumstances which could trigger the operation of a resulting trust will rarely occur in pension surplus cases.³⁶

³⁴ (March 26, 1992), (Pension Commission of Ontario) [unreported].

³⁵ *Supra* footnote 25.

³⁶ *Supra* footnote 9 at 647-49.

e. *Creation issues*

For a trust to come into existence, it must have three essential characteristics, often called the three certainties. The person alleging that a trust was created must adduce evidence demonstrating that the settlor intended to create a trust; the subject matter of the trust must be ascertained or ascertainable; and, the objects of the trust must be certain. The certainty which has been the focus of litigation and promises to be the subject matter of continued litigation is the certainty of intention to create a trust. To satisfy the certainty of intention requirement, the court must find an intention that the trustee is placed under an imperative obligation to hold property for the benefit of another. Certainty of intention is a question of construction. The language must convey more than a moral obligation or mere wish as to what is to be done with the property. The language used needs to show the intention to create a trust can be found or inferred with certainty.

The pension cases in this area are a curious blend of those that accord with a traditional trust approach and those that do not. There is a line of cases in which, despite an employer's use of an insurance contract as a funding vehicle, the requisite certainty of intention to create a trust has been found to exist.³⁷ The courts in these cases have found that language in the plan documentation demonstrated that the employer intended to hold the policy in trust for the plan members, thus a trust arose and trust principles applied in the determination of rights.

On the other hand, there are cases in which a trust has been used as the funding vehicle but normal trust principles have not been applied on the basis that the trust came to an end³⁸ or that despite the use of a trust vehicle, no intention to create a trust existed.³⁹

3. *What are the rights of pension trust beneficiaries?*

Three key rights of trust beneficiaries are:

- a) the right to trace the trust property
- b) the right to collapse the trust through use of the rule in *Saunders v. Vautier*⁴⁰
- c) the right to compel due administration of the trust.

Each of these basic rights will be examined in the context of recent pension cases.

³⁷ See, for example, *Re Lahave Equipment Ltd. and Superintendent of Pensions (Nova Scotia) et al.* (1994), 121 D.L.R. (4th) 67 and *Bull Moose Tube Ltd. v. Ontario (Superintendent of Pensions)* (1994), 3 C.C.P.B. 187 (Ont. Gen. Div.).

³⁸ See *Joy Technologies*, *infra* footnote 42.

³⁹ *Re CrownX Inc. and Edwards et al.* (1994), 20 O.R. (3d) 710 (Ont. C.A.).

⁴⁰ (1814), 49 E.R. 282, *aff'd* (1841), 41 E.R. 482.

a. *The right to trace trust property*

Beneficiaries have the right:

To trace and recover the trust property or its traceable product if such be wrongfully in the hands of anyone who is not a purchaser for value in good faith without notice of the breach of trust.⁴¹

Many of the surplus cases — particularly those involving merged plans — implicitly follow the principle enshrined in the above quotation. *Joy Technologies Canada Inc. v. Montreal Trust Company of Canada et al.*,⁴² however, a recent case decided by a court of first instance in Ontario calls into question whether this principle will be adopted *holus bolus* into the pension trust field.

*Joy Technologies*⁴³ stands for the proposition that a brand new, hitherto unknown mechanism for termination, may exist. If this case is correctly decided, this mechanism for terminating a trust will have the effect of seriously limiting the right of pension trust beneficiaries to trace trust property.

The applicant in *Joy Technologies* was an employer who had created a pension plan for its employees. When the final pension plan was wound up, surplus assets were found to exist. The applicant sought the return of the surplus funds but the employees opposed the application on the basis that the surplus funds belonged to them.

It is accepted law that in order to determine who owns surplus pension funds, the court must trace the assets and plan language from the inception of the plan.⁴⁴ In *Joy Technologies*, there were a number of plans which had been brought together in one final plan. Language in the original plan gave exclusive benefit in the trust funds to the employees and expressly prohibited the company from amending the plan in such a way as to divert any part of the assets for its benefit. Assets from the predecessor plans were transferred to the successor plans and could be traced to the final plan. On tracing principles, the trust continued and so it might be assumed the prohibition on amendments that would divert funds to the company would continue. The court found, however, that was not the case. It found that, at the time of the transfer of assets from the predecessor plans to the successor plans, no surplus funds had been transferred. It held that the transfer of assets fulfilled the employer's obligation to hold the funds for the exclusive benefit of the beneficiaries. Having fulfilled its obligations, the company was in a position to create, in effect, a new trust. Therefore, when the terms of the final plan were drafted, it was tantamount to the creation of a new trust. As a "new" trust was created, the company had the right to insert language providing for the reversion of surplus funds to it on plan wind-up.⁴⁵

⁴¹ D.J. Hayton, *The Law of Trusts* (London: Sweet & Maxwell, 1989).

⁴² (1995), 7 E.T.R. (2d) 243 (Ont. Gen. Div.) [hereinafter *Joy Technologies*].

⁴³ *Ibid.*

⁴⁴ *Schmidt*, *supra* footnote 9.

⁴⁵ *Joy Technologies*, *supra* footnote 42 at 258-59.

On the basis of these and other provisions of the trust agreements and the related plans, the obligation of each of the companies upon termination of the trust agreements for their respective prior plans was to pay out the assets in the funds "for the exclusive benefit of the members" of those plans. There is no further restriction as to the use of the funds. In particular, there is no requirement that, if the funds are paid over to another trust, the successor must have the same provision with respect to the distribution of funds upon termination of the successor trust or that it must not have any provision that any surplus may be paid to the sponsoring company. What is required, and all that is required, is that the funds are to be used for the exclusive benefit of the members.

...

The fact that the benefits under the Terminated Plan were an improvement over the predecessor plan benefits and at the outset of the Terminated Plan and for some period afterward it had an unfunded liability necessarily indicates that all of the funds so transferred were applied, upon transfer, for the benefit of employees and other beneficiaries of the plan and not for the benefit of the applicant. Because the funds were applied in this manner, the requirements of the predecessor trusts were complied with and were discharged through that compliance and have no further application to those funds.

It is important to note that the assets held in the predecessor plans were not paid out to the plan members. They were transferred to the successor plan. On what basis can it be said that the trust ended, so that the final plan and trust could begin afresh with new provisions which were contrary to the provisions of the earlier plans? There was no distribution to beneficiaries. There was no invocation of the rule in *Saunders v. Vautier*. There was no variation of the trust. There had to be some new mechanism by which the trust could end, otherwise basic rules of tracing would require that the funds in the initial trust be followed into the later trusts and those funds would be imprinted with the language of entitlement from the earlier plans.

Joy Technologies is authority for the proposition that if trust funds are transferred to a new trust for the benefit of the beneficiaries, a new trust is created and there is no further restriction on the use of the funds. In other words, any restriction on an employer's right to surplus assets is satisfied when the funds are transferred to another trust for the benefit of the beneficiaries and the restrictions are no longer operative. Where there is satisfaction of the obligations under an earlier trust the restrictive language of that earlier trust does not apply to a successor plan. In order to change entitlement to future funds, one need only transfer assets to a "new" trust so long as the transferred assets are held to the benefit of the beneficiaries.

The reasoning and result in *Joy Technologies* appears to fly in the face of tracing law, trust principles and, indeed, much of the reasoning that underlies other surplus pension cases. It remains to be seen whether it is good law.

- b. *The right to collapse the trust through use of the rule in Saunders v. Vautier*⁴⁶

It is accepted law that, in addition to termination through distribution, a trust may be ended through use of the rule in *Saunders v. Vautier*⁴⁷ or through the exercise of a power of revocation. *Saunders v. Vautier* stands for the following legal proposition: a beneficiary who is *sui juris* and absolutely entitled can require the trustee to make an immediate distribution of the trust property and thereby terminate the trust prematurely. Absolute entitlement means the beneficiary's interest is vested and represents the full (actual and possible) beneficial interest.

The *Saunders v. Vautier* principle has been extended to trusts for more than one beneficiary, whether entitled successively or concurrently, so long as together the beneficiaries account for the full beneficial interest. Even when the principle is used in this extended sense, it is referred to as the rule in *Saunders v. Vautier*.

There are two parts to the *Saunders v. Vautier* rule, both of which must be met in order for it to apply. First, the beneficiary (or beneficiaries) must be *sui juris*, that is, adult and of full mental capacity. Second, the beneficiary (or beneficiaries) must be absolutely entitled to the trust property. To be absolutely entitled, all the beneficiaries must be ascertained and together their interests must account for all the interests in the trust property, both actual and possible.

The rule in *Saunders v. Vautier* is frequently utilised in the pension context. For example, pension plans for one or two persons frequently have unclear surplus entitlement provisions. Plan beneficiaries gather together and, through the use of the rule in *Saunders v. Vautier*, call for an end to the trust and deal with the trust property. This obviates the need for a court declaration of entitlement and has been held by the Pension Commission of Ontario to satisfy legislative requirements such as those in subs. 79(3) of the *Pension Benefits Act* which requires that pension plan documentation provide for payment of surplus to the employer on plan wind-up if the employer wishes to obtain the surplus funds.

The application of the rule in the pension area appears to be consistent with its application in the field of trusts generally. However, its interrelationship with variation of trusts applications, as will be seen below, is questionable.

One interpretation of a recent decision of the Pension Commission of Ontario is that the effect of paragraph 8(1)(b) of R.R.O. 1990, Regulation 909, as amended, has been to seriously derogate from the rights of pension trust beneficiaries. In the unreported case of *Ferro Industrial Products Limited*, the Pension Commission of Ontario ruled that the consent of annuitants was not needed in an agreement which resolved entitlement to surplus funds pursuant

⁴⁶ The rule in *Saunders v. Vautier*, *supra* footnote 40, has been abolished by legislation in Alberta and Manitoba and replaced with a judicial discretion to terminate or vary trusts which would otherwise attract the rule.

⁴⁷ *Supra* footnote 40.

to paragraph 8(1)(b). In effect, the decision held that the legislation had the effect of abrogating that portion of the rule in *Saunders v. Vautier* which requires that together the beneficiaries must account for the full beneficial interest. The alternative view is that annuitants cease to be beneficiaries upon being annuitised and therefore neither the legislation nor the Commission's ruling amounts to a derogation from beneficial entitlement.

c. *The right to compel due administration of the trust*

The right of a beneficiary to compel due administration of a trust by the trustee is manifested in a number of different ways. There are a great many cases of this sort in the pension context. Three aspects of the right to compel due administration are discussed here.

(i) *Disclosure of reasons*

As a matter of trust law, where a trustee is given a discretion, the trustee is not required to give reasons for the exercise of that discretion. This principle appears to be operative in the field of pension trusts without modification. *Wilson and another v. Law Debenture Trust Corp. plc*⁴⁸ is a recent example of this. A company sold a division and transferred the affected employees to the purchaser. As part of the terms of sale, the purchaser established a pension plan. The vendor company's pension plan was funded through a trust. The trust deed provided that the trustees were to transfer such of the trust assets as the trustees determined to be appropriate. The trustees transferred an amount equal only to the past service reserve of the transferred employees leaving the whole of the surplus in the vendor's plan. The employees sought disclosure of the documents which might indicate the trustees' reasons for making such a decision. The court refused, saying that the principles applicable to trusts generally were to be applied to pension trusts and, in the absence of any evidence of impropriety, the trustees were under no obligation to disclose documents containing evidence of its reasons for the manner in which it exercised its discretion.

(ii) *Payment of legitimate expenses*

Part of the beneficiaries' right to compel due administration is to restrain the trustees from improper use of the trust funds as, for example, in payment of expenses which are not legitimate. This area has had a flurry of litigation and promises to hold more.

Here are some examples. Can an employer change the nature of the pension plan from defined benefit to defined contribution and look for reimbursement

⁴⁸ [1995] 2 All E.R. 337 (Ch. D.).

of the expense associated with such a change? In *Hockin*,⁴⁹ the court found that the administrative expenses charged by the bank against the fund were actually costs incurred by the bank more for its own benefit than for the benefit of the employees. Therefore, the court stated that those administrative costs were collateral to the purposes of the pension fund and ordered the bank to reimburse the fund. The court stated at 558-59:

The next issue is the administration expenses charged by the bank against the fund.

The bank made express representations to the employees that it would, and the terms of the original plan expressly required that it should, pay all the administrative costs of the pension plan. The employees were encouraged to contribute to the plan based, in part, upon such representations. The bank, however, never informed the employees of its amendment to the plan to provide for the plan to bear the administrative costs.

The bank also charged the costs of the entire effort to effect the 1986 amendments to the pension fund. The bank not only charged the costs of its internal staff but also the costs of the actuaries involved in the plan conversion and the cost of producing the video and other publicity material designed to persuade the employees to participate in the new plan. These costs were, in our view, incurred by the bank rather more for its own benefit than for the benefit of the employees and were collateral to the purposes of the pension fund.

With respect to the issue of costs, the court denied the bank its costs on appeal and at trial because it was within the trial judge's discretion to make such an order. The court stated:⁵⁰

The bank cross-appealed on the issue of costs saying it should have been awarded 50% of the costs of the trial before Paris J. It says counsel asserted and failed to prove misconduct on the part of the bank. In the exercise of his discretion the trial judge awarded the employees 50% of their costs and awarded no costs to the bank.

As things have unfolded since the decision of the Supreme Court of Canada in *Schmidt*, we do not think we should interfere with the decision of the trial judge on costs. It was a matter of discretion and we are not satisfied that he fell into any error in principle in ordering as he did.

Can an employer legitimately charge the costs of applying for a surplus ownership determination to the trust fund? Many cases have proceeded on such a basis. *Hockin*, quoted above, barred the bank from such recovery as did the court in *Sherwood Communications Group Ltd. v. Canada Trust Co.*⁵¹ Costs on a solicitor-and-client scale were not paid out of the surplus in the pension fund as requested by the parties because Carruthers J. was of the opinion that the application should not have been made in the first place. Carruthers J. stated:⁵²

Under all of the circumstances, I dismiss this application. I am asked by counsel for all parties to grant costs of this application on a solicitor-and-client scale to be paid out

⁴⁹ *Supra* footnote 30.

⁵⁰ *Ibid.* at 560.

⁵¹ (1992), 94 D.L.R. (4th) 86 (Ont. Gen. Div.).

⁵² *Ibid.* at 92.

of the surplus. I am not prepared to do so. I have concluded that this application should not have been made, and I have dismissed it. I do not understand then why the employer who brought the application should be paid out of the surplus and on a solicitor-and-client basis. At this point, no one knows if in fact there is a surplus, and, should there be one, it is not known who is entitled to it, or in what amount.

The parties Wasserman and Gagnon shall have their costs on a solicitor-and-client basis to be paid by the applicant.

Can an employer charge the costs of a consultant to come in and see if the plan is being properly administered?

Can an employer charge the costs of a legal opinion on surplus ownership to the fund? What about the costs of preparing amendments which are for the benefit of the employer?

The general principle is undoubted: a trustee is entitled to indemnity for all costs and expenses properly incurred by the trustee in the due administration of the trust.⁵³ A trustee is entitled as of right to full indemnity out of the trust estate against all his/her costs, charges and expenses properly incurred, e.g., the excess of solicitor and client costs over party and party costs, so long as the trustee fulfils the well-recognized duty of a trustee, namely, to deal with the estate as a man of ordinary prudence would deal with his own property.⁵⁴ The question that remains to be played out in the pension field is: what expenses are legitimate?

(iii) *Even handed treatment*

Trustees must act impartially when dealing with beneficiaries. As a consequence, they must act even-handedly; they may not give preferential treatment to any one beneficiary or group of beneficiaries unless authorised to do so by the trust instrument. This rule, as formulated, is not easily reconciled with regular activities in the pension field. A few examples will demonstrate this. Where employers are permitted to take contribution holidays without express provision in the trust instrument, have they been favoured over employees?^{54a}

Employers are permitted to use pension funds to provide early retirement inducements as for example in the case of "early retirement windows". The money so used is being given preferentially to some, not all, employees. That is, pension trust funds are used to provide a benefit to one group of beneficiaries. Use of pension funds in this manner has been widespread. Confirmation that it is permissible was recently given in *Anova Inc. Employee Retirement Pension Plan (Administrator of) v. Manufacturers Life Insurance Co.*⁵⁵ The rationale given by German J. was:

⁵³ *Thompson v. Lamport*, [1945] S.C.R. 343; *Trustee Act*, R.S.O. 1990, c. T.23, s.33.

⁵⁴ *Re Howland*, [1935] O.W.N. 340 (C.A.).

^{54a} This presupposes the employer is a beneficiary. If the employer is not viewed as a beneficiary, how could a contribution holiday be taken at all, if not expressly authorized?.

⁵⁵ (1995), 121 D.L.R. (4th) 162 (Ont. Gen. Div.) [hereinafter *Anova*].

The evidence was that this was done for the benefit of the company which would benefit all the employees. There were funds available which at that date would not impair the ability of the company to meet its obligations to all members.⁵⁶

However, is it not a breach of the even-handed rule? If so, on what basis is it permissible?

Anova is instructive for another reason. In the same judgment, German J. found that granting enhanced benefits to two plan members was a breach of the rule even though at the time the enhancements were made there was an actuarial surplus which would allow the benefits to be given without prejudicing the remaining employees.

According to the Pension Commission of Ontario, the legislation sanctions a breach of the even handed rule when negotiating a surplus sharing arrangement with members and former members.⁵⁷

There is an intersection of the even-handed rule and the conflict of interest cases which needs exploration. The problem arises because the administrator is so often the employer. Without a clear delineation of roles, the administrator can be seen to be preferring the employer over the employees which is not only a potential conflict of interest but also a breach of the even-handed rule.⁵⁸

4. *How can a pension trust be changed?*

Pension trusts are trusts and they are, therefore, susceptible to alteration, variation and revocation. Each of these three methods of changing the pension trust, once it is operational, is explored now.

a. *Alteration*

Normally, any alteration to the trust arrangement is to be done in accordance with the terms of the amending clause within the instrument itself. The simplest and most ideal method for amending a trust is through the use of an express amending power contained in the trust instrument. Amending powers are now common features of pension trust instruments; at the time of creating a trust, a broad power of amendment should be included which clearly states the steps that are to be taken in order to amend the trust. Note that, as discussed more fully below, the Supreme Court of Canada in *Schmidt* rejected the idea that a broadly worded power of amendment clause includes the power to revoke. Only an express power of revocation is sufficient authorization to allow revocation in part or full.

Examples of invalid amendments — that is, supposed amendments which breach the conditions contained in the amending clause itself — abound in the pension field. In the '80's, many employers "amended" pension plan

⁵⁶ *Ibid.* at 180.

⁵⁷ See *Ferro Industrial Products Limited*, an unreported decision of the Commission released December 19, 1995.

⁵⁸ See also the section below on alteration of trusts.

documentation to provide that surplus assets were to belong to the company. The documentation frequently contained language which precluded amendments that derogated from the irrevocable rights of plan members to the funds. The courts have held such "amendments" to be invalid. Indeed, *Schmidt* itself contains an example of such an invalid amendment.

We all know that compliance relates not only to the substance of the amendment but to the process followed in creating the amendment. If the power of amendment states that an amendment can be made only after notice is given to certain parties, pains must be taken to ensure that the notice is duly given and that records showing how the notice requirement have been met are kept. One aspect of alteration/amendment that is different in dealing with pension trusts is the very real possibility that documents outside of the trust instrument and pension plan may affect the process to be followed. Alteration may require a corporate resolution. There almost certainly are regulatory requirements to be met such as filing the amendment with the Pension Commission. You must determine as well whether there are companion documents that must be examined, such as master trusts or collective agreements. Remember the *OPSEU* case discussed in Part 1 of this paper.⁵⁹ It illustrates the perils of attempting to alter the terms relating to pension trusts without following all procedural requirements.

A recent case decided by the Pension Commission of Ontario⁶⁰ demonstrates that the usual way of conceiving of alteration of trusts needs modification in the pension context. Imperial Oil wished to amend its pension plan to change the requirements that plan members had to meet in order to become entitled to enhanced early retirement benefits. The amendment imposed the additional requirement that plan members would have to be aged 50 or older at the time of termination for efficiency reasons in order to qualify. The employees argued that the amendment was void. One argument made was that Imperial Oil was in a conflict of interest in passing the amendment. Its role as employer made the amendment financially attractive but its fiduciary responsibility as administrator of the plan barred it from passing an amendment which was clearly to the detriment of plan beneficiaries who had reached the previous requirements of a 10 year service qualification. The significance of the decision lies in the fact that the Commission rejected the notion that Imperial Oil was acting as administrator when it passed the amendment.

We do not accept that Imperial Oil was acting in its capacity as administrator when it passed the Amendments and therefore we do not accept that section 22 applied to its actions. The words "employer" and "administrator" are used throughout the Act. However, they are not used interchangeably. Rather, they are used to describe the two different functions that an employer may serve in respect of a pension plan.

...

We are of the view that an employer plays a role in respect of the pension plan that is distinct from its role as administrator. Its role as employer permits it to make a decision

⁵⁹ *Supra* footnote 5.

⁶⁰ *Imperial Oil Limited Retirement Plan* (1988), Index no. XDEC-30, released August 3, 1995 and published in Bulletin 6/3 (Fall 1995).

to create a pension plan, to amend it and to wind it up. Once the plan and fund are in place, it becomes an administrator for the purposes of management of the fund and administration of the plan. If we were to hold that an employer was an administrator for all purposes once a plan was established, of what use would a power of amendment be? An employer could never use the power to amend the plan in a way that was to its benefit, as opposed to the benefit of employees. Section 14 presupposes this power is with an employer as it created parameters round the exercise of a power of amendment.⁶¹

Thus, in addition to ensuring that an alteration is substantively within the terms of the amending power and that proper procedures have been followed in creating the amendment, in the pension context it must also be determined who has the right and power to make the amendment. If it is an amendment which is properly in the domain of the administrator then it may be that an additional set of questions must be asked to determine whether the amendment can be made and those questions relate to the role of the administrator as a fiduciary.

In sum, the question of alteration raises the spectre of conflict of interest. If the administrator, a fiduciary, is responsible for seeing that alterations to the plan are consistent with the discharge of a duty of loyalty, how does it amend the plan to provide for early retirement windows? For any other change which is described under the even-handed rule above? Is it free to make alterations which are in breach of that rule? *Imperial Oil* offers some guidance on these issues.

b. *Variation*

Variations of pension trusts may be accomplished in one of three ways. First, under the common law, courts may approve settlements to disputes which involve the variation of a trust where there is evidence of a real and serious dispute. It is often the case in pension matters that real and serious disputes exist so it is open to proceed under this head at common law.

Second, applications under rule 14.05(3) of the *Rules of Civil Procedure* may be appropriate.

Third, applications may be made under the variation of trusts legislation. Here, there is a difference in the approach of the court from that found in respect of trusts outside the pension area. Under the express terms of variation of trusts legislation, the courts cannot approve arrangements on behalf of adult capacitated beneficiaries. While it is not expressly set out in the legislation, it has been generally assumed that adult capacitated beneficiaries must consent to the proposed arrangements.⁶² If any adult, capacitated beneficiary refuses to consent, the courts have been reluctant to approve a proposed arrangement. In this way, the variation of trusts legislation has been viewed as complementary to the operation of the rule in *Saunders v. Vautier*. However, the recent case of

⁶¹ *Ibid.* at 9-10.

⁶² See the Ontario Law Reform Commission Report, at 390. See also *Re Suffert's Settlement*, [1960] 3 All E.R. 561.

*Versatile Pacific Shipyards v. Royal Trust Corporation of Canada*⁶³ has cast doubt on the validity of this assumption as the court sanctioned a variation of trust in the face of outright opposition by beneficiaries. The pension plan in *Versatile* provided that surplus on plan termination would go to the plan members but the power to terminate lay with the company. The plan also provided that the company could apply surplus to cover current contribution costs. The company applied for a variation of trust at a time when it was in serious financial difficulty. An agreement was reached with approximately 90% of the current members pursuant in which it was proposed that one half of the surplus would be paid to the members and the other half to the company. The court found a clear benefit to the members because there was a real danger surplus would not be available if the order was not granted. The court acknowledged that, in most cases, the interest of contingent and unascertained beneficiaries must weigh heavily in its consideration. However, where there was a real risk that the surplus would be used in ways of no benefit to the current members, the interests of contingent and unidentifiable beneficiaries was not to be weighted too heavily.

c. *Revocation*

Schmidt makes it clear that the traditional rules relating to revocation of trust apply to pension trusts. Cory J. states:⁶⁴

As a result I find that, at least in the context of pension trusts, the reservation by the settlor of an unlimited power of amendment does not include a power to revoke the trust. A revocation power must be explicitly reserved in order to be valid.

Thus, once a pension trust is created, the settlor cannot retrieve any part of the trust assets unless the settlor retains a power of revocation when creating the trust.

Whatever uncertainty may have existed in Canada as to whether the courts would accept as valid, trusts that had been created with a power of revocation, has been eradicated. The court reinforced the concepts surrounding the fundamental nature of a trust thereby rejecting the notion that there is some inherent or residual power in a settlor to intervene once the trust has taken effect.

Case law in the pension area prior to *Schmidt* suggested that unrestricted powers of amendment or modification could be interpreted to include the power to revoke.⁶⁵ The Supreme Court made it clear, however, that a broad power of amendment could not include a power of revocation — nothing short of an express power of revocation would enable a settlor to revoke trust property.

⁶³ (1991), 84 D.L.R. (4th) 761 (B.C. S.C.).

⁶⁴ *Supra* footnote 9 at 647.

⁶⁵ See *Maurer et. al v. McMaster University* (1991), 4 O.R. (3d) 139 (Gen. Div.); *Hockin v. Bank of British Columbia*, [1990] 71 D.L.R. (4th) 11 (B.C.C.A.); *Re Campbell-Renton* (1960), 25 D.L.R. (2d) 512 (Ont. H.C.).

Conclusion

The Supreme Court of Canada, in *Schmidt*, called for legislation which would provide a scheme for the equitable distribution of surplus in terminated plans. I doubt that the political will needed to pass such legislation exists. In any event, it would be a partial solution at best to the real problem. The real problem is that pension law is an emerging field and there is no framework for development. Pension law is the intersection of competing interests of employees and employers. It is the intersection of competing systems of law: contract law and trust law. It is a matter of huge public concern and the response of the legal system will be a major factor in determining whether private pensions thrive and flourish or die. There is no easily identifiable solution.

It is up to the legal profession, the legal academics and the judiciary to forge the way ahead and to develop a framework in which problems can be resolved without recourse to the courts. Development of a coherent set of flexible principles and their meaningful application is a challenge that will span the next decade, at least.

As the framework for pensions begins to take shape, it is trust law and equitable principles which should be our guides. I am not advocating a rigid adherence to trust principles. Rather, trusts should be our starting point. Having established a point of departure, there must be a thoughtful application of trust principles which takes into account the other systems of law which intersect with trusts to form pensions. If, for example, there are pension problems which ought to be resolved according to contract or employment law principles, then there ought to be a clear understanding of why and when contract or employment law prevails over trust law. And, finally, there will be no avoidance of the policy considerations which must be taken into account.

"Pension Plans and the Law of Trusts" — an exciting field of law whose shape is only just emerging. The challenge to provide leadership and direction will be left to the legal system. It will be up to the academic writing, practising bar and judiciary to provide such direction. Can it meet the challenge without addressing the underlying question: are pensions deferred wages? I do not think so.