Pension pitfalls

Court verdict raises alert for directors over liabilities risk

By Julius Melnitzer

In the course of the company's restructuring proceedings, Nortel Network Corp.'s board decided that it would continue to make contributions to the company's pension plans.

"Typically, a company facing insolvency doesn't do that," says David Vincent of Ogilvy Renault LLP's Toronto office. "But throughout, the directors were operating with a case called Slater Steel in the back of their minds."

As well they might. The 2008 decision of the Ontario Court of Appeal had raised considerably the alert level for directors wary of personal liability with respect to the decisions they took regarding pension plans.

"It's probably an understatement to say that Slater Steel has had a chilling effect in terms of boards' decisions about how the company should handle pension plans — particularly if there's a hint of financial trouble in the air," Mr. Vincent says.

Generally speaking, courts grant directors and officers a discharge from liability on the conclusion of restructuring proceedings under the Companies' Creditors Arrangement Act. In Slater's case, the directors obtained the usual discharge despite the fact the proceedings were unsuccessful and Slater went into receivership under the Bankruptcy and Insolvency Act.

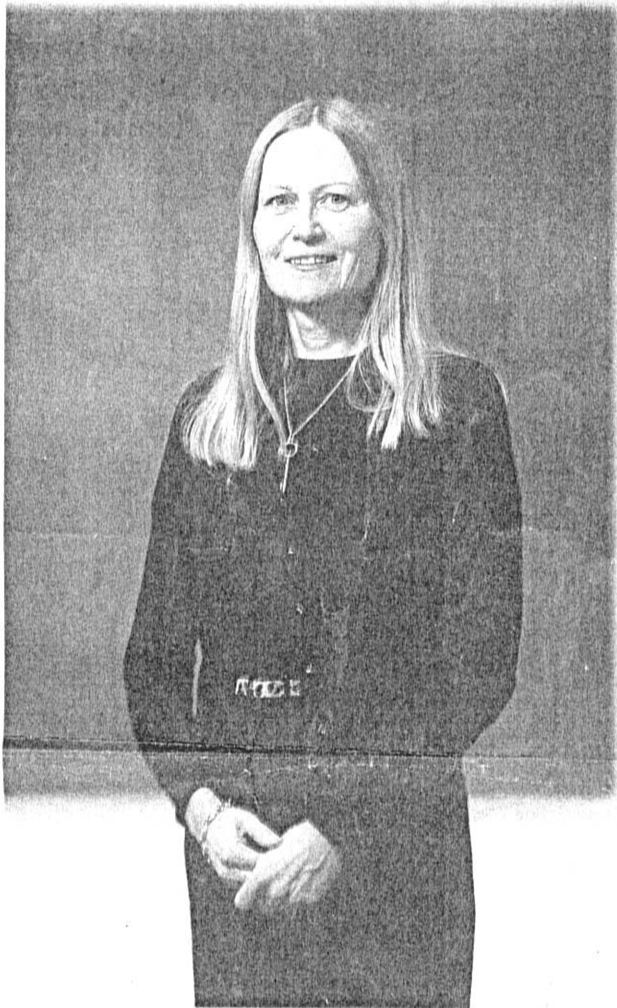
Morneau Sobeco Ltd. Partnership, which succeeded Slater as administrator of the company's plan, alleged the directors and officers who had served on Slater's audit committee had breached their fiduciary duties by acquiescing in actuarial valuation reports said to contravene the Pension Benefits Act. Morneau alleged the breaches resulted in a $20-million deficit for which the audit committee members were responsible.

The defendants relied on the discharges they had obtained under CCAA as a bar to Morneau's proceedings. But as the Court of Appeal saw it, the discharges protected only the directors and officers "from claims arising from their service as directors and officers." Here, the suit against the audit committee members did not relate to that function, but to the defendants' functions as administrators of the Slater plan.

"The court basically said that directors and officers were not immune from all civil liability simply because they obtained a CCAA discharge," Mr. Vincent says.

In other words, the decision opened the door to the possibility that any director involved in a pension-related decision could become liable as acting in an administrator's capacity.

"The question to which we don't have an answer is whether every director can become an administrator, or whether there was something particular the Slater audit committee did that made them administrators," says Kathryn Bush of Blake, Cassels & Graydon LLP's Toronto office.



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Kathryn Bush, of Blake, Cassels & Graydon LLP, says the Slater Steel decision "sends a message that directors should be more careful about what they do about pensions."

Ms. Bush believes courts will construe Slater Steel narrowly.

"There's no question that Slater sends a message that directors should be more careful about what they do about pensions, particularly in cases where they make aggressive funding decisions when a company is in financial difficulty," Ms. Bush says. "But that doesn't mean that directors dealing with pension issues will always be cast as administrators, and Slater may just be a case of bad facts making bad law."

Until the courts qualify Slater Steel, however, directors and officers will be looking for ways to protect themselves against pension liability.

"My insolvency partners are of the view that the result in Slater can easily be avoided by changing the wording of the CCAA discharge to refer specifically to pension liability," Mr. Vincent says. "But it's not at all clear that would do the job."

And quite apart from civil liability, directors and officers can also be subject to charges under the Pension Benefits Act. A recent decision of the Ontario Court of Justice — *R. v. Christophe et al* — provides a glimpse of just what might await those who are convicted of such contraventions.

Bernard Christophe and several others sat on the board of trustees of the $1.1-billion Canadian Commercial Workers Industry Pension Plan trust fund. During their tenure, the investment committee, on which three of the accused also sat, contravened the Pension Benefits Act by investing more than the allowed 10% of the plan's assets in a single company. The board ratified the investments.

The accused pleaded guilty and received an $18,000 fine.

"In my view, that's a pretty light consequence," Mr. Vincent says. "On the other hand, the defendants couldn't have been pleased with their categorization as Pension Benefits Act offenders."

In imposing the fine, the court noted the accused were senior and accomplished business people, none of whom had a previous criminal or regulatory record. The pension fund did not suffer any losses as a result of the contraventions and the accused received no personal benefit from the decisions they made, nor did they receive any financial compensation for acting as trustees or as members of the investment committee.

As it turns out, Christophe is a case that deals with a contravention of quantitative restrictions. But for the most part, pension reform is removing quantitative restrictions in favour of a "prudent person" test for the propriety of investments.

Ms. Bush says the shift in emphasis from quantitative to qualitative shouldn't put directors at greater risk if proper procedures are followed.

"Boards should ensure that they draft a proper mandate and statement of investment policies and procedures and review them annually to see if they are still appropriate and whether any of the investments are offside," she says.

"If that's done, the directors should be fully protected by the underlying documents."

Some companies may face future pension litigation

Shifting financial risk to employees raises legal risk

Jim Middlemiss
Behind the Bar

Defined-contribution pension plans are a ticking litigation time bomb just waiting to blow up on employers, pension lawyers say.

Randy Bauslaugh, a pensions lawyer at McCarthy Tétrault LLP in Toronto, said that is because "they carry so much legal risk" compared to defined-benefit plans, which carry financial risk.

Defined-benefit plans (DB) are favoured by workers because they don't have to do much other than enrol and continue working for an employer.

Employees know how much they'll get in retirement based on a predetermined formula; however, the risk falls on employers to make sure the plan is properly funded.

In a defined-contribution plan (DC), employees are responsible for picking investments and overseeing how their plan is doing. The amount earned in retirement is based on the performance of the plan.

Lawyers say in the late 1980s and 1990s many employers moved away from offering DB plans because of financial risk and converted to DC plans.

Only 33% of Canada's workforce is covered by some type of registered pension plan, according to the federal office of the chief actuary.

Between 1998 and 2008, registered pension plan coverage in the public sector decreased to 84% from 87% and in the private-sector coverage declined to 25% from 28%.

Mr. Bauslaugh, whose law firm acts for employers, said financially a DB plan is a "much more risky animal" than a DC plan. However, he said, by shifting the financial risk to employees for their retirement future, the "legal risk increases dramatically. You are creating many more ways for plan members to be dissatisfied with the retirement income" and that can result in future lawsuits.

Mark Zigler, a lawyer at Koskie Minsky LLP in Toronto, acts for employees and unions. "There is a misconception that by putting in place a defined-contribution plan you get out from layers of legal issues," he said. "They really do carry a lot of legal risk."

Lawyers say everything from the way the plan is structured to the disclosure of risk, the adequacy of the investments offered, the fees charged and the information communicated to employees about how the plan works and its likely performance can provide the basis to a

As well, conversions from DB plans to DC plans can also result in litigation. Since many DB plans were only recently converted, it may take years for the litigation to emerge.

Doug LeFaive, a pensions lawyer at Sack Goldblatt Mitchell LLP in Toronto, which acts for unions and employees, said: "I think a lot of employers converted on the assumption that [DC plans] would be a solution to all the pension problems. That was a mistake. A lot of employers were sold a bill of goods."

Mr. LeFaive said the U.S. offers a glimpse of the future. "There is a huge amount of litigation going on involving defined-contribution plans. When litigation develops in the U.S., it migrates north."

The lawsuits involve everything from suing employers over comments made about the impact on retirement when plans were converted to performance issues, lack of investment options and exorbitant fees charged by financial institutions overseeing plans.

In Canada, there are at least three cases involving pension conversions.

- One involves Halliburton Group Canada Inc., which converted to a DC plan and froze employees' salaries and service at the date of conversion for determining the final amount owed under the DB plan. The Alberta pension regulator ruled the company couldn't do that because it interfered with vested rights and the Alberta Appeal Court declined to overturn the case.

A lot of employers were sold a bill of goods

- In a Quebec case involving AbitibiBowater Inc., employees were told that a DB plan would never be improved and would likely be closed. Employees were given the option of moving to a DC plan. However, the DB plan continued and was later improved. Twenty-five employees who converted sued for misrepresentation and were awarded $4.4-million.
- In a British Columbia case involving Tolko Industries Ltd., the B.C. Superior Court ruled that employees can sue actuarial firm Towers, Perrin for advice it provided involving a conversion to a DC plan.

Elizabeth Brown, a pensions lawyer at Hicks Morley Hamilton Stewart Storie LLP in Toronto, said help is on the way. The federal government recently amended the Pension Benefits Standards Act to provide employers with a "safe harbour."

The government will issue new regulations that employers can follow when converting to a DC plan. Employers who follow them will be able to avoid litigation, she said.

She expects the legislation will be adopted by provinces. She said the new guidelines will provide best practices and eliminate uncertainty about litigation.

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