

Mergers And Acquisitions In Canada

Section 6: Pension and Benefits Considerations



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Pension And Benefits Considerations

Introduction

Pension and benefits issues should be addressed early in any corporate transaction. This section provides a general overview of the significant issues which arise when a business with a registered pension plan is to be acquired, sold or merged with another business. It also briefly touches on other types of employee benefit arrangements which often trigger significant cost issues in corporate transactions.

Registered Pension Plans - General Statutory Framework

Canadian registered pension plans are subject to an assortment of federal and provincial pension legislation. There is no uniform pension legislation across the country.

Federal pension legislation applies to a plan whose members are employed in a sector that is within the legislative authority of the federal government (e.g. banking, shipping, broadcasting). If the federal pension legislation does not apply, then the pension legislation of the province in which the plan members are employed applies. A pension plan with members employed in various jurisdictions is subject to the pension laws of all the applicable jurisdictions.

Every pension plan must be registered with the pension regulator of the jurisdiction in which the majority of plan members are employed. The pension regulator enforces the pension laws of other jurisdictions that apply to the plan. In limited circumstances, dual registration may be required.

The lack of uniform pension legislation across Canada can be problematic for employers because pension legislation across the country is not always consistent. Some of the requirements and themes which are common amongst the various jurisdictions in the context of corporate transactions are addressed in this Chapter.

All Canadian pension plans must be registered with the Canada Revenue Agency (“CRA”) and comply with specific provisions of the Canadian *Income Tax Act*⁶¹ (the “Act”) in order to receive favourable tax treatment. Eligible employer contributions to a registered pension plan are tax-deductible. Such contributions (and the earnings thereon) are not included in employee income until pension payments are made to the employees.

Types of Pension Plans

Generally, there are two types of pension plans:

1. a defined benefit plan (“DB plan”); and
2. a defined contribution plan (also known as a money purchase plan) (“DC plan”).

A DB or DC plan can be either “contributory” (i.e. member contributions are required) or “non-contributory” (i.e. member contributions are either prohibited or voluntary). Some employers have “hybrid” DB/DC plans.

In a DB plan, the pension payable to a member is determined according to a pre-determined formula. There are many types of formulae that could be used, such as final average earnings, career average earnings and flat benefit, among others. For example, in a final average earnings plan, the employee might be entitled to

61 (1985, c.1 (5th Supp.))

an annual pension equal to one per cent of the average of his or her earnings in the last five years of his or her employment, multiplied by his or her total years of pensionable service, subject to the Act's maximum annual pension benefit limit. The employer's required contributions to the DB plan will vary depending on the actuarial methods and assumptions used to determine the required funding level, in order to provide the promised benefit and the actual investment returns on contributions made. Given the nature of DB plans, either surplus assets or deficits can be generated.

In a DC plan, the contribution amount is fixed and is subject to contribution limits under the Act. For example, the employer contribution amount might be five per cent of the member's earnings, subject to the contribution limit in the Act. Upon death, termination of employment or retirement, the plan member (or spouse/beneficiary of the member, as applicable) is entitled to the accumulated contributions plus investment earnings thereon in the member's DC plan account.

Typically, the employees are provided with an array of investment funds by the employer from which they select their investment choices for their DC plan funds. If the member is alive upon termination of employment or attainment of the relevant retirement age, the accumulated funds can be used to purchase an annuity for the member or transferred to other locked-in retirement vehicles. The value of an individual's retirement income under a DC plan is solely dependent upon the level of investment income that is accumulated on the fixed contributions, whereas a DB plan provides a promised level of retirement income. As a result, a DC plan is considered to be riskier for an employee than a DB plan.

In Canada, there are no "safe harbour" rules for the investment of assets in DC plans. In 2003, an association of Canadian regulators called the Joint Forum of Financial Market Regulators (which has representatives from Canadian pension, securities and insurance regulators) issued "Guidelines for Capital Accumulation Plans" These guidelines suggest best practices by employers and service providers, so that capital accumulation plan ("CAP") members will have the information and assistance they require to make appropriate investment decisions. A DC plan is considered to be a CAP.

DC plans should not be confused with group registered retirement savings plans ("RRSP"s). A group RRSP is a collection of individual RRSPs. An RRSP is a tax-deferred vehicle issued under the Act, which allows individuals to deduct from taxable income, the amounts contributed to their plan, up to certain contribution limits. The earnings on those amounts are not subject to tax while they are held within the RRSP. In general, all amounts received from an RRSP are included in the individual's income.

RRSPs are governed under the Act but are not subject to pension legislation. The CAP guidelines, referred to above, apply to RRSPs as well. Although a group RRSP may be structured like a DC plan (e.g. fixed contributions based on a percentage of earnings), they are two entirely different retirement arrangements. For example, funds held within a group RRSP are not required to be "locked-in" (i.e. they can only be used to provide periodic payments upon retirement). Thus, unlike DC plan funds which must be locked-in under pension laws, group RRSP funds can be commuted and withdrawn in cash by employees prior to retirement. From the point of view of a corporate transaction, if the target company has a group RRSP rather than a registered pension plan, the issues to be addressed are much less daunting.

Impact of Pension Legislation on Corporate Transactions

Generally, under pension legislation, if a member of the seller's registered pension plan, whose employment has been terminated (or "transferred" in the case of Quebec) due to the sale of a business, commences employment with the purchaser and participates in the purchaser's registered pension plan, the following applies:

1. the individual continues to be entitled to all benefits accrued in the seller's plan up to the date of the sale; and
2. for purposes of any eligibility conditions, vesting and locking-in of benefits in either plan, all years of employment and membership in the seller's plan and the purchaser's plan shall be taken into account (i.e. there is a deemed continuation of employment and plan membership for limited purposes, despite the fact that under common law there is a termination of employment with the seller). This deemed continuation of employment and plan membership is relevant in cases where, for example, a member of the seller's plan could be eligible for enhanced early retirement benefits if he or she meets the age and service combination of 85. The member's years of service with the purchaser would count towards that age and service threshold and the member could in fact become entitled to such enhanced early retirement benefits in the seller's plan by virtue of his or her employment with the purchaser.

Requirement (a) does not apply if the member's accrued assets and liabilities are transferred to the purchaser's plan. Requirement (b) applies whether or not assets and liabilities are transferred.

Due to the deemed continuous employment and plan membership requirement in the sale of a business context, in general, affected members of the seller's plan are not entitled to exercise transfer options in respect of accrued benefits, which would otherwise be allowed if an employee terminated employment or plan membership in ordinary circumstances. One exception is British Columbia, which does allow members to exercise transfer options, despite the deemed continuous employment and plan membership rule.

In several provinces (including British Columbia, Ontario and Nova Scotia), if a successor registered pension plan is not provided by the purchaser to the transferred employees, the pension regulator may order the seller to wind up its pension plan, either partially or fully, depending on whether some or all of the seller's plan members have been hired by the purchaser. The amount of notice that the regulator must provide varies by province.

Even if a successor pension plan is provided, but is subsequently terminated by the purchaser in full or in part after closing, the seller is still vulnerable to a regulator's order to wind up its plan (again, either in full or in part, depending on how many of the transferred employees have had their membership in the purchaser's plan terminated). The seller could seek a covenant from the purchaser that it will keep the successor pension plan in place for a specified period of time after closing (e.g. two years). As a purchaser, it is not desirable to be bound by such a covenant as several circumstances (e.g. insolvency or corporate re-structuring) could impair the purchaser's ability to comply with it.

In Alberta, a wind-up of the seller's plan is required if the assets and liabilities of the transferred employees are not assumed by the purchaser's pension plan, while in Saskatchewan, a wind-up might be ordered by the regulator in these same circumstances.

In a partial or full plan wind-up, the law requires that affected employees be granted immediate vesting and transfer options in respect of their accrued benefits. In addition, in Ontario and Nova Scotia, if the plan includes enhanced benefits (e.g. early retirement benefits) and certain age and service requirements are met, special “grow-in benefits” must be paid to members affected by a partial or full wind-up. Immediate vesting and “grow-in benefits” translate into higher-funding costs for the plan sponsor. (The grow-in benefits are only applicable to DB plans and are not relevant to DC plans.) Thus, in Ontario and Nova Scotia, the cost implications to a plan sponsor of a DB plan wind-up could be much more significant than those of a DC plan, depending on the enhanced benefits, if any, provided under the DB plan.

A plan wind-up may also be undesirable to a seller because it triggers the legal requirement to distribute the surplus allocable to the terminated employees. In Alberta and British Columbia, the legislation clearly states that on a partial wind-up, an affected member is not automatically entitled to share in surplus. In Quebec, partial wind-ups do not exist. Federally regulated DB plans are generally not subject to this surplus distribution requirement upon a partial wind-up.

For both DB and DC plans, a wind-up report will have to be filed with the regulator for approval before any accrued benefits can be distributed from the plan. A wind-up report for a DC plan will be much simpler and less costly to prepare than a DB plan wind-up report, which will require actuarial input.

For all of the foregoing reasons, a seller may wish to avoid a requirement to wind up its registered pension plan due to the sale of its business. Provisions can be negotiated in the sale agreement to reduce the risk of an immediate wind-up.

Impact of Labour and Employment Law on Pension and Benefits Issues

Collective Agreement

Under labour relations legislation in Canada, successor employers (i.e. purchasers) are bound to the collective agreement which applies to the acquired business. The wording of the applicable collective agreement regarding the retirement benefits must be closely examined as it may specify the type of retirement plan that is required (e.g. group RRSP, DC plan or DB plan), the level of pension benefits that must be provided (if a DB plan), or the contribution rates required of the employer (if a DC plan) and/or other specific plan benefits (e.g. indexing, bridge benefits, early retirement benefits). The purchaser will be bound by these requirements when providing a new or existing plan for the transferred employees. To change any terms and conditions of employment would constitute a breach of the collective agreement.

If the collective agreement states that the employees are entitled to participate in a specifically named pension plan (e.g. “The Pension Plan for the Employees of Company ABC”), the purchaser must assume sponsorship and administration of that particular plan from the seller. However, this may not be feasible if the seller is retaining some of the employees and is transferring only a portion of its employees to the purchaser. In that case, the purchaser will have to establish a new plan or amend its existing plan so that it is identical to “The Pension Plan for the Employees of Company ABC” (i.e. in terms of type of plan, benefit levels, enhanced benefits, options etc.). Since the purchaser cannot technically comply with the collective agreement in this situation, negotiations with the union will also be necessary. The purchaser will also have to determine whether it wishes to transfer any accrued assets and liabilities of the transferred employees from the seller’s plan to its own plan.

Purchasers may also be liable under successor employer labour legislation for pension and retiree health and welfare benefits that accrued prior to the date of purchase. This is a risk, even if the pension and retiree benefits are not described in the current collective agreement, and even if the individuals who are entitled to such benefits never become employed by the purchaser.

It is imperative that all collective agreements are reviewed early in the due diligence process and that legal advice is obtained to determine the necessity of involving the union as part of the proposed sale process.

No Collective Agreement

If a collective agreement does not exist, it is a matter of negotiation between the parties as to the type of retirement plan or plans the purchaser will provide post-closing to the transferred employees, and how pre-closing accrued pension assets and liabilities are to be addressed. If the sale agreement is silent, the purchaser is free to do whatever it likes. In the case of a sale of assets, the transferred employees' accrued pension assets and liabilities will remain with the seller. In the event of a sale of shares, the pension plan obligations that are in place in the target company will remain there after the sale of the shares of the target company.

In a typical asset purchase deal, the seller will try to obtain a covenant from the purchaser to offer employment to the seller's employees on terms and conditions that are substantially similar in the aggregate to those enjoyed by these employees immediately prior to the closing date of the asset sale. Inferior offers increase the likelihood that the affected employees will not accept the purchaser's offers. Any resulting severance liabilities will be to the seller's account, unless the asset purchase agreement provides otherwise.

In some cases, the seller may require the purchaser to provide pension benefits which are substantially similar to those provided by the seller to the transferred employees. If the purchaser agrees to meet this requirement, it must be careful as to how this promise is worded in the sale agreement and in its communications to the transferred employees. For example, if the seller's plan provides members with rights to surplus in the plan and the purchaser promises to provide substantially similar pension benefits, the seller and/or transferred employees could argue that the transferred employees are entitled to the same surplus rights in the purchaser's plan (even if the purchaser's plan does not provide for it).

It should be noted that in Quebec, because most corporate transactions will result in the transfer of employment agreements, the purchaser will almost invariably be obligated to provide pension benefits which are substantially similar to those provided by the seller to the transferred employees, subject to constructive dismissal rules.

Due Diligence

A purchaser should request copies of as many pension plan disclosure documents as possible, including:

1. current and historical plan texts, funding agreements (i.e. trust agreements, insurance contracts), employee communications, and all amendments thereto;
2. actuarial valuation reports and cost certificates;
3. collective agreements;
4. recent financial statements;
5. investment policies;

6. funding agent and investment manager reports;
7. correspondence from regulators dealing with material issues; and
8. legal opinions obtained regarding plan terms, such as the right to take contribution holidays and to charge expenses to the plan assets.

The due diligence process should determine how the pension plan is structured and administered, and how the assets are invested. It should also identify contribution and administration costs and liability implications (e.g. unfunded liabilities, outstanding claims by plan members, issues raised by regulators and any promise to employees to increase the pension benefits offered).

Ideally, if a purchaser is proposing a post-closing for the purpose of withdrawing surplus from the seller's/target's pension plan, or using such surplus for contribution holidays or to offset a deficit in another pension plan of the purchaser, then the purchaser should review all current and historical plan and funding documents of the seller's pension plan to determine if any of these proposed actions are legally permitted. Practically speaking, given the time constraints of, and the limited documentation that is available during the due diligence process, it is very difficult for a purchaser to obtain a legal opinion on these proposed actions. If that is the case, the purchaser should not simply assume, when putting together its bid for the business, that any of these proposed actions can be carried out (especially since in the case of employer surplus withdrawals and pension plan mergers, regulatory approval would be required post-closing and may not necessarily be obtained). Furthermore, as noted above, the terms of the collective agreement that are applicable to the target employees would impact the post-closing pension plan arrangements.

With respect to funding issues in a DB plan that are identified in the due diligence process, the purchaser should consult with its own actuary for additional information and assistance. For due diligence relating to DC plans, some of the concerns, among others, would be the manner in which plan members have been advised of their investment choices, whether sufficient investment choices were provided, the manner in which the target company monitored the performance of the investment options offered and selected by plan members, and whether the investment options were permitted under applicable laws.

Representations and Warranties

In addition to the due diligence process, the representations and warranties regarding the pension plan of the seller are important in protecting the purchaser, if the plan or any of its assets and liabilities are to be assumed. For example, a purchaser will typically seek, at minimum, representations and warranties that: the target company's pension plan has been registered, administered and invested in compliance with all applicable laws; all contributions are up to date; there are no funding deficiencies (for a DB plan, either on a going concern or a solvency basis); and the target company does not participate in a multi-employer pension plan.

From a purchaser's point of view, the type of representations and warranties that a seller might give will also depend on whether it has a DC or DB plan. The representations and warranties should survive closing as pension issues, if any, will likely not be identified for months (if not years) after closing. Subject to any limitation periods (legislated or otherwise), in the event of unwelcome surprises, the purchaser should attempt to retain recourse against the seller for any inaccurate representations and warranties given by it, for as long as possible after the closing.

Purchase or Sale of a Business

The pension implications that arise in the context of a purchase or sale of a business will depend on whether shares or assets of the target company are being acquired.

Asset Purchase

When a seller corporation with a pension plan sells assets of its business, there are various options available in dealing with the pre- and post-closing pension arrangements. Each option has different risks and implications for both the purchaser and the seller.

The options are as follows:

1. the purchaser does not provide a successor pension plan (“No Successor Plan Option”);
2. the purchaser provides a successor pension plan (either a new or an existing plan) to the transferred employees, but does not assume and transfer to the successor pension plan any accrued assets or liabilities from the seller’s pension plan in respect of the transferred employees (“Successor Plan Option - No Transfer”);
3. the purchaser provides a successor pension plan (either new or existing) and transfers the accrued assets and liabilities relating to the transferred employees from the seller’s pension plan to the successor plan (“Successor Plan Option - With Transfer”); and
4. the purchaser assumes full sponsorship and administration of the seller’s pension plan (“Plan Assignment Option”).

There are several issues that impact which options are available and preferable to the seller and the purchaser, including the following:

1. Is there a collective agreement, and if so, what does it require?
2. What kind of pension plan (DB or DC) does the seller have? What type of plan does the purchaser have?
3. Is the seller planning to retain any of the employees who currently participate in its registered pension plan?
4. What is the composition of the seller’s plan? Are most of the liabilities attributable to retirees and deferred vested members, or to active employees who will be transferred to the purchaser?
5. Is the seller’s plan in deficit or surplus?
6. If the seller’s plan is in deficit, can the purchaser require the seller to fully fund the plan before closing if the purchaser is considering assuming the plan? If not, can the purchaser obtain a discount on the purchase price?
7. Is the cost of funding the seller’s pension plan on an ongoing basis appropriate for the purchaser if the plan is assumed?
8. If there is surplus in the plan, can the surplus be applied to take contribution holidays if the plan is assumed? (As mentioned, it is difficult for a purchaser to answer this question within the due diligence period.)
9. What are the current retirement and benefit arrangements of the purchaser? If the purchaser already has a pension plan, will the assumption of the seller’s plan create duplication and additional administrative burdens and costs for the purchaser?

10. Is there any language in either the seller's or the purchaser's pension plan and funding documents that would prohibit the transfer of assets from the seller's plan to the purchaser's plan and the co-mingling of such assets? Is there a risk that such a transfer would not be approved by the regulator, as discussed below?

Analysis of Options

No Successor Plan Option

This option is not available if a registered pension plan is required pursuant to a collective agreement. Even if no collective agreement exists, this option may pose severance cost risks for the seller if the purchaser's offers of employment do not provide substantially the same terms and conditions of employment in the aggregate as those provided by the seller immediately before closing. This is especially true in Quebec, where most corporate transactions will result in the transfer of employment agreements.

As pointed out above, the seller is at risk of being ordered by the pension regulator to partially or fully wind up its pension plan if no successor pension plan is provided by the purchaser (e.g. if the purchaser chooses to provide a group RRSP instead).

Successor Plan Option - No Transfer

In this case, on retirement, a transferred employee would receive his or her pension payments from two sources: the purchaser's plan and the seller's plan (or an insurance company if an annuity was purchased by the purchaser or seller). The seller continues to have control of the pre-closing assets and liabilities relating to the transferred employees, and the responsibility for administering and investing those assets.

For purposes of benefit accrual in a DB plan, the purchaser's plan can either recognize service from the closing date only ("post-closing service approach"), or recognize the employee's combined service with both the seller and the purchaser, but require an offset for the benefit payable from the seller's plan (the "wrap-around approach"). The deemed continuous employment and plan membership requirements under pension legislation does not apply to benefit accrual. The impact on the employee's overall pension benefit under these two approaches will vary depending on the type of DB plans provided by the purchaser and seller. However, in a final average earnings plan, the transferred employee would definitely be disadvantaged under the post-closing service approach as the pre-closing service benefits would be calculated using the earnings of the employees as of the closing date, without taking into account salary increases provided by the purchaser.

Under the "wrap-around" approach, higher initial funding obligations would be created for the purchaser (actuarial input should be obtained). The purchaser may want to take this added funding cost into account when negotiating the overall purchase price of the deal, if the wrap-around approach is being considered by the parties. Also, it is important to distinguish between what is payable in accordance with the seller's plan and what is paid, in case the seller becomes bankrupt. The purchaser would not want to be obliged to make up for any shortfall or non-payment from the seller's plan.

The seller also has to be careful in considering whether the purchaser should be required to assume the transferred employees' assets and liabilities from the seller's plan (which is the Successor Plan Option - With Transfer, as discussed below). As noted earlier, in Alberta, if there is no transfer of assets and liabilities

to the purchaser's plan, the seller's plan must be wound up. In Saskatchewan, there is a risk that a wind-up might be ordered by the Saskatchewan pension regulator.

Successor Plan Option - With Transfer

Under this option, the benefit to a transferred employee is that upon retirement the employee would receive one cheque from the purchaser's plan (or an insurance company). Also, it allows the purchaser to have control over the pre-closing and post-closing pension assets of the transferred employees, rather than leaving the control of the pre-closing assets with the seller.

For a DB plan, there are generally two ways to determine the value of assets to be transferred from the seller's plan to the purchaser's plan. Under the first approach, the parties could agree that assets in an amount equal to the liabilities relating to the accrued benefits of the transferred employees be transferred. The second approach is to transfer the proportion of assets in the seller's plan that is equal to the same proportion by which the transferred employees' liabilities compare to the overall liabilities of the seller's plan. In this second scenario, a proportionate amount of any surplus or of any deficit would also be transferred to the purchaser's plan. In Quebec, this second approach is required by pension legislation.

Adjustments to the purchase price could be negotiated to account for any deficits or surplus. In this regard, it should be kept in mind that just because surplus might be transferred over to the purchaser's plan, the purchaser may not necessarily have the legal right to use it for contribution holidays or to withdraw it. Thus, there is a risk that the surplus transferred (which may have translated into a higher overall purchase price for the purchaser) may not end up having any practical value to the purchaser. In many jurisdictions, surplus withdrawals by employers are permitted only if authorized under the plan documents and/or a certain number of plan members consent to the proposed surplus withdrawal. In all cases, regulatory approval of the proposed surplus withdrawal is also required. In short, the withdrawal of surplus from a registered pension plan by an employer can be difficult (and in some cases, impossible) to effect. It is usually a costly and lengthy process.

Another important issue in the determination of the transfer amount is the basis on which the liabilities are calculated. The parties should, in the sale agreement, agree on whether the transfer amount will be determined using liabilities calculated on a going concern basis, on a solvency basis or the higher of the two. The going concern financial position of a pension plan is determined based on the assumption that the plan will continue indefinitely into the future (e.g. it assumes increases in earnings). The solvency financial position is determined by comparing the market value of assets to the liabilities, for benefits earned prior to the valuation date, calculated as though the pension plan had been terminated on the valuation date (e.g. earnings are frozen and all plan members are fully vested). The liabilities and funded status of the seller's plan could be drastically different, depending on whether the calculations were made on a going concern or a solvency basis.

For DB plans, an actuarial report would have to be prepared outlining the assumptions used to calculate the amount of assets and liabilities being transferred. The transfer amount can be contentious if, for example, the purchaser's actuary does not agree with the assumptions and the calculations used by the seller's actuary. It is typical to see lengthy provisions in the purchase and sale agreement to address what would happen if there is a disagreement amongst the actuaries, who the arbitrator will be, and also what would occur if the agreed-upon transfer amount is not approved by the regulator.

Transfers of assets and liabilities between two DC plans are much simpler to deal with. Essentially, the transferred employees' account balances as of the closing date, adjusted for net earnings thereon (and any expenses charged to such accounts) from the closing date to the actual transfer date, would be transferred to the purchaser's DC plan. The surplus or deficits (provided that contributions under the seller's plan are up to date as of the closing) are usually not at issue with transfers involving DC plans (although an exception could arise if the DC plan had been converted from a DB plan with surplus). Forfeited contribution amounts, if any, should be addressed. It is uncommon to see agreements between purchasers and sellers involving a transfer of assets and liabilities from a DB plan to a DC plan or vice versa.

In an asset transfer situation (DB or DC), the sale agreement should indicate how the transferred assets are to be administered and invested while waiting for regulatory approval, and who will bear the administration expenses during the waiting period. The agreement may also dictate whether the assets ultimately transferred will be in cash and/or in-kind.

A transfer of assets and liabilities from a seller's pension plan to a purchaser's pension plan requires written approval from the pension regulator. Each jurisdiction has its own policies in respect of proposed asset transfers. For example, in Alberta, if there is a surplus in the seller's DB plan and the surplus is not transferred as part of the asset transfer, the transferred members retain any rights they may have had to the surplus in the seller's plan, even though they are no longer employed by the seller and their assets and liabilities have been transferred out of the seller's plan.

Plan Assignment Option

If sponsorship of the seller's plan is assigned to the purchaser, the assets and liabilities of the entire plan (i.e. relating to active members, retirees, terminated members with deferred vested benefits, beneficiaries) are assumed by the purchaser. Thus, the purchaser could end up administering the benefits of individuals with whom they have no prior relationship. The purchaser should include language in the agreement of purchase and sale to the effect that the purchaser will not be responsible for liabilities in respect of the administration or operation of the plan prior to closing. From the perspective of the regulator and the plan members, the purchaser would likely be seen as the entity responsible for both pre- and post-closing obligations and liabilities regarding the assigned plan, regardless of any such purchaser-favourable language in the agreement of purchase and sale.

The assignment of sponsorship and administration of the seller's plan does not require regulatory approval, although the appropriate amendments to the plan (and related documents, such as excerpts of the sale agreement, the pension assignment, or the assumption agreement, if any) will have to be filed with the pension regulator and CRA for registration.

This assignment option is not feasible if the seller is retaining some of the employees who are members of that plan (unless those retained employees are removed from the plan prior to closing). In addition, if the seller's plan participates in a pooled investment arrangement with other plans of the seller or its affiliates (e.g. master trust arrangement), such participation should be terminated prior to the effective date of the assignment of the plan from the seller to the purchaser.

Share Purchase

When shares of a target company are sold to the purchaser, the target's employment contracts and all its pension and benefit plans remain unaffected.

In general, no amendments, regulatory filings or other actions are required in a share sale with respect to the pension plan, as the target company remains the sponsor and administrator of the plan. Similarly, if the target company participates in a multi-employer pension plan ("MEPP"), its contribution obligations to the MEPP would also continue. There are some exceptions to this general rule.

The following are examples of pension issues that may be relevant in a share purchase.

Related Companies Participate in Target Company's Pension Plan

If companies related to the target company are not part of the share acquisition, it is necessary to terminate their participation in the target company's pension plan as of the closing date. Otherwise, post-closing, companies unrelated to the buyer will participate in the target company's pension plan. Not only is this undesirable, but it will also cause the plan to fall under unique pension legislative requirements applicable to MEPPs. Among other things, MEPPs have significantly different administration rules under the pension legislation than those which apply to single-employer pension plans.

The pre-closing treatment of the accrued assets and liabilities of the employees of the related company will also have to be addressed. For example, the parties will have to decide if such assets and liabilities should remain in the target company's pension plan or be transferred into a successor plan of the related company.

Assets of the Target Company's Pension Plan Participate in a Master Trust

Where the target company is related to other Canadian companies with pension plans, it is common for assets of the target company's pension plan to be co-mingled with assets of other pension plans sponsored by the seller or other related companies for investment purposes. These are referred to as master trust arrangements.

In this situation, the assets of the target company's pension plan will have to be extracted from the master trust arrangement before closing. This may lead to negotiations between the seller and the purchaser as to the valuation of that portion of the master trust assets attributable to the target company's pension plan, and the means by which such assets are to be distributed from the master trust (e.g. in cash or in kind or both).

Target Company is a Participating Employer in the Pension Plan of a Related Company

The target company in an acquisition may be a "participating employer" in a pension plan that is controlled by a company that is not part of the acquisition. The target company must take steps to terminate its participation in the seller's pension plan, or the plan of the related company, as of the closing date. The issues that arise in this scenario are similar to those applicable to an asset sale scenario. For example, what kind of retirement plan will the target company provide to its employees post-closing?

Purchaser Requires Termination of Pension Plan

A purchaser could negotiate this provision into the sale agreement if the purchaser prefers to add the target company's employees into its own existing pension and benefit plans post-closing (e.g. for economies of scale). This approach will, of course, be subject to the provisions of any applicable collective agreements.

Mergers

When two companies amalgamate, all assets and liabilities of the two amalgamated companies will continue in the amalgamated company ("Amalco"). However, the pension plans of the two merging entities do not automatically merge just because the two companies themselves have merged. Each of the plans will continue to exist separate and apart from the other unless Amalco takes steps to merge the plans. As a result, Amalco may end up with more than one pension plan and all employees of the two amalgamated entities (both current and new) may end up being entitled to participate in one or more of Amalco's plans because they may meet the definition of "employee" or "member" in more than one Amalco pension plan. For this reason, it is important for Amalco to take steps to amend its pension and other benefit plans prior to, or on, the amalgamation date to clarify which Amalco employees should participate in which plans (i.e. depending on their location, job description, division, etc.). Amendments should also be made to all of Amalco's plans no later than the date of the amalgamation.

If Amalco wishes to merge the pension plans of the two merging entities, regulatory approval will be required. As noted above, such approval may be difficult to obtain. Before merging pension plans, the pre-merger plan and funding documents (both historical and current) must be reviewed in order to determine if a merger is legally permitted. Accordingly, a legal opinion should be sought before any steps are taken to merge two pension plans.

Other Benefits/Costs Issues of Note

In addition to a registered pension plan, the target company likely provides a variety of other benefit arrangements for its employees. Although it is not possible to address all such benefit arrangements here, retiree benefits and supplemental executive retirement plans ("SERPs"), also called "top-up plans," are briefly addressed below.

Retiree Benefits

In the due diligence process, it is important for a purchaser to determine whether the target company provides retiree benefits to its current retirees and if such benefits have been promised to current employees upon their retirement, pursuant to either a collective agreement, employment contract or employee communications. With respect to existing retirees, unless the right to change or terminate the retiree benefits was reserved by the target company and such right was properly communicated to the retirees while they were employed (i.e. prior to retirement), the target company may not change or terminate these benefits, as they are usually "vested" in the retirees.

In a share transaction or merger, retiree benefit liabilities will remain with the target company. Similarly, if the current employees have been promised retiree benefits by virtue of a collective agreement, employment contract or employee communications, the obligation to provide such benefits would be attached to the target company. The target company's ability to change or terminate the benefits for future retirees in

respect of unionized current employees will depend on negotiations with the union, and in respect of the non-unionized current employees, whether or not the target company reserved the right to change or terminate their promise, if any, and if such a right was properly communicated to such non-unionized employees.

In an asset deal, the purchaser may be required to provide retiree benefits to the transferred employees due to a collective agreement, or the seller may be required to provide substantially similar salary and benefits in the aggregate to the transferred employees by the purchaser.

SERPs or “Top-Up Plans”

As noted above, the Act imposes a limit on the maximum benefits that can be provided under a DB plan. Some employers promise to provide employees with the amount of pension the individual would have otherwise received under a DB plan, but for the limit in the Act (it is less common to see top-up plans for DC plans). The pension benefit amount exceeding the limit in the Act (the “top up benefit”) is usually provided pursuant to a SERP (or simply via an employment contract, which is referred to as an SERP for discussion purposes). Top up benefits are not legislated under pension legislation at this time and can be either funded or unfunded. If it is funded, certain rules in the Act apply.

SERP liabilities can be costly and may not be easily discernible from the due diligence process, since they are not subject to legislative requirements to prepare actuarial valuation reports. Questions that a purchaser should ask include whether it is funded, how it is funded, if there is a deficit, the number of participants and the costs of fulfilling the SERP promises. Again, if the seller provides a SERP, the purchaser in an asset deal may be required by the seller to provide the same kind of arrangement post-closing.

MEPPs: Multi-Employer Pension Plans

Many Canadian employers participate in MEPPs pursuant to collective agreement obligations, or simply because they are attracted to these arrangements where they do not have any obligations to administer the plan. MEPPs are administered by boards or individual trustees. They are less common in non-unionized workforces.

In the last few years, there have been several surprising and significant lawsuits and regulatory prosecutions launched in respect of MEPPs. The surprising element has been the alleged liability of the participating employers who had the impression that their liability in respect of the MEPP in which they participated, was limited to the amount of contribution they promised to make to the MEPP, as set out in the collective agreement. That may not be the case. With the exception of Quebec, pension legislation across Canada allows benefits under a MEPP to be reduced in the event of a termination of the MEPP in circumstances where there is a deficit. The plan documents, however, must allow this.

In litigation referred to as the “Participating Co-Ops” litigation (Financial Services Tribunal of Ontario, File Number P0275-2006), the Ontario pension regulator took the position that the participating employers were liable for the deficit in a terminated MEPP due to specific wording in the MEPP documents. In other litigation referred to as “CCWIPP” (Ontario Superior Court of Justice, File Number CV-06-CV324987-0000), plaintiffs in a \$2-billion representative action took the position that certain participating employers were liable for the consequences of alleged poor investment decision-making. That litigation recently settled.

Purchasers of a business should be aware that although the target company may genuinely believe that it has no liability in respect of the MEPP in which the target company participates, that belief may not be upheld by the courts. Accordingly, purchasers should seek representations and warranties that there are no MEPPs or, alternatively, if there is a MEPP issue, that the MEPP has been administered in accordance with applicable laws and permits the reduction of benefits in the circumstances of a deficit.

Conclusion

Canadian pension law allows claims to be pursued by regulators, unions and employers, notwithstanding releases. Often, there is no limitation period. The financial and reputational risks associated with pensions can be enormous. Fraser Milner Casgrain LLP has deep and extensive experience in dealing with those risks. We can identify and attempt to avoid or limit them.



About FMC

Fraser Milner Casgrain LLP (FMC) is one of Canada's leading business and litigation law firms with more than 500 lawyers in six full-service offices located in the country's key business centres. We focus on providing outstanding service and value to our clients and we strive to excel as a workplace of choice for our people. Regardless of where you choose to do business in Canada, our strong team of professionals has extensive knowledge and expertise on regional, national and cross-border matters. FMC's well-earned reputation for consistently delivering the highest quality legal services and counsel to our clients is complemented by an ongoing commitment to diversity and inclusion to broaden our insight and perspective on clients' needs.

Our Approach

At FMC, we understand the complexities posed by changing market conditions. We know that to serve your needs effectively, we must understand your business and objectives in a broad context in order to anticipate developments, identify opportunities and respond to challenges.

FMC prides itself on being able to deliver effective solutions which advance the strategic interests of its clients. We do this by combining and leveraging our diverse professional capabilities and strong business acumen, with a clear understanding of our clients' needs and priorities.

We believe, first and foremost, that our success is tied directly to the success of our clients. As such, our approach is client-focused and results-driven. We offer pragmatic advice and our effort is a collaborative exercise, led by the appropriate partner and assisted by the appropriate professionals.

Experience Worth Pursuing

Our Mergers and Acquisitions Group acts on takeover bids (hostile and friendly), amalgamations, arrangements, and other business combinations involving public or private companies, as well as share and asset purchases and joint ventures. Our firm provides innovative and sophisticated advice on all matters arising in connection with M&A transactions, including tax, competition, *Investment Canada Act* compliance, financing, environmental, government relations, employment, pension and intellectual property law. We provide strategic advice, prepare all documents, and appear before securities commissions and courts whenever challenges need to be made or defended.

Success in hostile and friendly takeover bids is often more a matter of innovative approach than application of conventional legal procedures. Our experience allows us to move quickly and efficiently to assure the best outcome for our clients. We know the players; we know the regulators; and we know how to structure a successful transaction. With offices across the country, industry expertise in Canada's principal business sectors, lawyers who have worked for the regulators and experts in relevant practice groups like tax, competition, foreign investment and litigation, we know how to get the deal done.

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