

NAVIGATING PENSION AND BENEFIT ISSUES ON TERMINATION OF EMPLOYMENT



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NAVIGATING PENSION AND BENEFIT ISSUES ON TERMINATION OF EMPLOYMENT

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*8TH ANNUAL PENSION AND BENEFITS HOT SPOTS:
ESSENTIAL UPDATES ON KEY LEGAL ISSUES*

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Bill 236: impact on benefits when structuring a termination package

On December 9, 2009 the Government of Ontario released Bill 236, which amends the Ontario *Pension Benefits Act* ("PBA"). As at April 20, 2010, Bill 236 had received second reading and was recommended for third reading, as amended, by the Standing Committee on Finance and Economic Affairs. The following Bill 236 changes are relevant to termination of employment packages for employees who are Ontario members of registered pension plans.

immediate vesting:

In determining whether severance packages for short-service employees satisfy common-law obligations, there will no longer be any need to consider whether the terminating employee would have vested if the employee had remained employed for the longest possible common-law notice period. Under the proposed amendments in Bill 236, everyone is immediately vested when they become members of the registered pension plan. This will bring Ontario in line with the immediate vesting requirements of Quebec, and proposed changes to pension legislation in other jurisdictions.

certain employee terminations will be more expensive:

At present the PBA requires certain early retirement enhancements to be provided to terminating defined benefit ("DB") pension plan members. This type of benefit enhancement, known as "grow in", can be valuable, depending on the design of the plan. "Grow in" benefits currently apply only in circumstances of plant closure and other partial-plan-wind-up scenarios. That will change. Under Bill 236, DB plan sponsors will be required to provide "grow in" benefits to all employees whose employment is terminated by their employer without cause, regardless of whether their pension plan is partially wound-up. The current "55 points" (age plus service) requirement will continue to apply.

Most plan sponsors are aware that pension costs may increase when dealing with plant closures. It may be a surprise for some to learn that individual terminations, not just mass layoffs, may now trigger large pension payouts due to the Bill 236 extension of "grow in". Actuaries have estimated that employers

whose pension plans offer unreduced early retirement pensions with a bridge benefit could see the commuted value of a pension more than double as a result of this Bill 236 change.

Note that multi-employer pension plans and jointly sponsored pension plans are entitled to elect not to provide grow-in benefits to their members.

impact of new grow-in rules on voluntary exit packages:

Bill 236 says the following as to when the entitlement to “grow in” applies:

“This section applies [the entitlement to “grow in”] if a person ceases to be a member of a pension plan on the effective date of one of the following activating events:

...2. The employer’s termination of the member’s employment, if the effective date of the termination is on or after July 1, 2012. ...” (section 57(1), amending section 74 of the PBA)

[emphasis added]

This entitlement to “grow in” is triggered only if the employer terminates the member’s employment. A voluntary early retirement program would likely not trigger the entitlement. When employers structure voluntary severance packages, if the packages do *not* include a “grow in” enhancement in the voluntary program, should the employer disclose this to the employee? The answer may be yes, i.e. an employee who voluntarily chooses an early retirement buy-out should be informed of the fact that he would be entitled to the “grow in” benefit, if the termination were involuntary (with 55 points). The caselaw regarding disclosure of employee benefit information, described at page 8 of this paper, puts the onus on employers to clearly disclose the employee benefit repercussions of the options employees are offered on termination.

If the employer *does* include the “grow in” benefit when structuring voluntary retirement packages, consideration should be given as to whether the text of the pension plan should be amended to permit this since it may not be required by the PBA or the plan terms.

introduction of “wilful misconduct”, etc. into the PBA:

Employees who are terminated for wilful misconduct, disobedience, etc., will not be entitled to the “grow in” benefit. Bill 236 says:

“Termination of employment is not an activating event if the termination is a result of wilful misconduct, disobedience or wilful neglect of duty by the member that is not trivial and has not been condoned by the employer or if the termination occurs in such other circumstances as may be prescribed.” (section 57(1.1), amending section 74 of the PBA) [emphasis added]

The underlined words are identical to the wording of regulations under Ontario employment standards legislation that disentitle terminated employees to the statutory termination pay and notice of termination of employment, and severance pay.¹ It is important not to equate this with “just cause”. The common-law concept of “just cause for dismissal” is different from the employment standards statutory concept of “wilful misconduct”. For long-service employees, for example, it may be more difficult for an employer to establish “just cause” than it is to establish “wilful misconduct”. On the other hand, some commentators say it is less difficult to prove “just cause” than “wilful misconduct” because the common law “just cause” test doesn’t require a conscious intent. The body of caselaw at common law regarding what does and does not constitute “just cause” for dismissal may not be helpful to the Superintendent, nor employers, in determining whether the Bill 236 right to “grow in” applies. The Superintendent may be comforted by the fact that referees under the Ontario employment standards legislation have been interpreting and applying the “wilful misconduct” statutory test for decades; unfortunately, however, there is not a large body of reported caselaw². Also, the outcome of those employment standards adjudications may have been influenced by the fact that relatively small dollars were involved. It is likely that at some point the Superintendent will be drawn into disputes under the PBA on this point. Time will tell; and so will the regulations under this provision. The regulations were not released as at April 20th.

¹ Paragraphs 2(1)(3) and 9(1)(6) of O. Reg. 288/01 under the Employment Standards Act, S.O. 2000, c.41.

² The Ontario Labour Relations Board now reviews decisions by officers under Ontario employment standards legislation regarding disputes as to whether a dismissed employee is not entitled to severance and termination benefits under that legislation due to wilful misconduct.

Settlements of wrongful dismissal civil claims that purport to resolve disputed entitlement to the new “grow in” benefit will not be binding on spouses of pension plan members who aren’t party to the settlement. Similarly, the Superintendent’s power to make an order regarding entitlement to a “grow in” benefit will not necessarily be limited by a settlement; it is not possible to contract out of rights under the PBA.

“grow in” should be considered in 2010 and 2011 terminations

This change to the “grow in” rules takes effect July 1, 2012. That doesn’t mean that the issue can be put aside until 2012. The “grow in” component of all termination packages should be considered when planning terminations in late 2010, and in 2011. If you are advising on terminations where a common-law notice period expires after June 30, 2012, be aware that the terminating employee may take the position that they are entitled to this pension improvement in determining wrongful dismissal damages, even though they terminate employment prior to July 1, 2012. Their claim would assert that they are entitled to the full value of the entire pension benefit had the employee remained in employment during the entire common-law notice period, including the right to grow-in which would be triggered after June 30, 2012.

Value of benefits to be included in a severance package

An employee whose employment is terminated without cause is entitled to damages for the benefits he would have received if he had continued in active employment for the duration of the common-law notice period. There have been no changes to this long-standing requirement. An employer is required to pay a terminated employee an amount that would put the terminating employee in the same position the employee would have been in if he had continued in active employment (subject to the terminated employee’s common-law duty to attempt to mitigate his damages by finding new employment).

Employers have attempted to soften this requirement by taking the position that the terms of an employment contract override this obligation. The Ontario Court of Appeal, in its 2006 *Taggart* decision,³ found that very clear contractual wording is required in order to limit a terminated employee’s entitlement to wrongful dismissal damages in respect of the value of pension benefits that would have accrued

³ *Taggart v. The Canada Life Assurance Co.*, [2006] O.J. No. 310 (C.A.)

through the entire notice period. In order to effectively limit an employee's claim, a pension plan (and all other written components of the employment contract) must explicitly state that a dismissed employee is disentitled to damages as compensation for the loss of pension benefits that would have accrued during the common-law notice period. The language in the pension plans of the employer in the *Taggart* case didn't do that. The pension plans stated that the plan did not provide an "enlargement" of a member's rights, and that plan benefits could not be used to "increase damages" in respect of a member's termination of employment. The Ontario Court of Appeal found that Taggart was entitled to damages in lieu of a 24-month pension plan accrual period and that the language in the pension plan documents, though it may have precluded an increase in Taggart's rights, wasn't clear enough to disentitle him to his rights.

The British Columbia Court of Appeal in 2009 reached the same conclusion regarding a stock option plan, in the *Saalfeld*⁴ case. The dismissed employee was entitled to five months' common-law notice. The employer said that the former employee was not entitled to the benefit of vesting under the stock option plan that would have occurred during the five-month notice period. Rather, the employer insisted that the wording of the stock option plan was clear: it said that no stock options could be exercised after either (a) the day specified by the employer as being the last day the employee is to work, or (b) where pay in lieu of notice is given, the day on which such notice is given in writing. The B.C. Court of Appeal rejected the employer's position and the wording of the plan. The Court found that since the individual was entitled to five months' notice of termination of employment, the employer did not *lawfully* terminate her employment when it did so on short notice. The Court held that the employer had breached "the reasonable notice duty", and therefore was obliged to pay damages in respect of that breach. The damages, said the Court, are the "benefits she would have accrued if the employment contract had been performed according to its terms until the end of the reasonable notice period." This decision is a blow to any employer with hopes of enforcing the terms of a written contract that provides for anything other than full benefit coverage, or payment in lieu thereof, for the entire common-law notice period.

⁴ *Saalfeld v. Absolute Software (2009)*, 71 C.C.E.L. (3d) 29.

Employers: remember your duty to disclose

Courts have repeatedly said that employers are legally obliged to fully disclose all relevant information regarding employee benefits to their employees.⁵ It is not sufficient for an employer to advise a terminating employee to get independent advice. Nor is it sufficient for employers to rely solely on the fact that plan terms are set out in (dense) plan texts⁶. For example, employers must inform terminating employees of the fact that they will lose retiree health and welfare benefits if they elect portability with respect to their registered pension plan. Employers must also answer reasonable questions as to the value of pension options offered in connection with severance alternatives offered by the employer. The PBA fiduciary standard imposed on the administrator of a pension plan includes the obligation to act in the best interests of plan members when explaining their pension benefits to them.

Consider the following New Brunswick Court of Appeal comments in 2001:

“Admittedly, there is no general and overriding obligation on a party, including an employer, to make ‘full disclosure’. ... At the same time, the standard of care is not reduced to a duty of common honesty. ... Surely, an employer is under an obligation to make sufficient disclosure to enable an employee to make an informed decision in cases where the employer asks an employee to make an election with respect to separation pay options that impact significantly on pension benefits. ... Noranda was under a duty to disclose to Mr. Allison material information relating to the pension consequences of electing either the lump sum or instalment separation pay option. That duty was breached by Noranda’s failure to disclose information required by Mr. Allison in order to make an informed election. Moreover that failure constitutes a misrepresentation by Noranda, that mislead Mr. Allison into believing that the election decision did not impact on pension benefits...”⁷

⁵ *Spinks v. Canada* (1996), 134 D.L.R. (4th) 223 (F.C.A.); *Deraps v. Labourers’ Pension Fund of Central and Eastern Canada* (1999), 179 D.L.R. (4th) 168 (Ont. C.A.); *Allison v. Noranda Inc.* (2001), 28 C.C.P.B. 1 (N.B.C.A.); *Graham v. St. Anne-Nackawic Pulp Co.*, [2004] N.B.J. No. 148 (Q.B.); *Smith v. Canadian National Railway Co.*, [2002] N.S.J. No. 2672 (S.C.); *Gauthier v. Canada (Attorney General)*, [2000] N.B.J. No. 143 (C.A.).

⁶ See *Society of Energy Professionals v. Ontario Power Generation (Health Benefits Grievance)*, May 18, 2005, described in the *Pension and Benefit Law Reporter* published by Lancaster, November/December, 2005.

⁷ *Allison v. Noranda Inc.*, *supra*, pp. 9 and 10.

Salary continuance sink-holes

Employers run into troubles when structuring salary continuance/severance packages. The following are not new issues, but they persist and are therefore worth mentioning:

***failing to confirm LTD, AD&D and life insurance coverage
(or lack thereof) during a salary continuance period***

An individual does not have to go to work in order to be characterized as receiving income from employment under the *Income Tax Act* (Canada).⁸ This long-standing principle has enabled employers to send employees home, continue to pay them their salary and continue their benefits during a lengthy notice period. An individual's status as an employee continues, and the employer is not guilty of wrongful dismissal as long as the individual receives all of the salary and benefit entitlements he would have received if he had continued to report to work and provide services. (Note that employment standards legislation across the country deems terminated employees to be employed for benefit accrual purposes, for the period of the statutory notice period. This binds third-party insurance providers as well. The challenge is in respect of the common-law notice period that extends beyond the statutory minimum.)

In order for this salary continuance strategy to succeed, no ROE (Record of Employment) should be issued until the end of the salary continuance period, and the usual payroll withholdings (CPP, EI) should continue to apply to the salary payments. It is a challenge for employers that third-party group insurance policies often provide that LTD (long-term disability), AD&D (accidental death and dismemberment) and life insurance coverage is subject to an "actively at work" requirement. Employers should either (a) disclose the salary continuance arrangement to their insurance providers and confirm that coverage continues, or (b) inform the individual on salary continuance that those particular benefits do not continue. If employers at least *inform* the terminating employee that they will not be entitled to coverage of those benefits, the employee will become subject to a duty to attempt to mitigate that loss of benefit coverage.

⁸ *Serafini v. MNR*, 89 DTC 453.

If employers do nothing, and incorrectly assume that the third-party insurer will continue coverage, the employers effectively become the insurer.⁹

***continuing registered pension plan accruals
after employment has terminated***

Terminating employees sometimes request that payments equal to their prior salary amounts be treated as a retiring allowance. This approach is typically designed to either to take advantage of the tax-deferred rollover opportunities, or simply to permit terminating employees to enjoy the lower rates of withholding tax that apply to retiring allowances. In some situations, a lump sum payment is made when the terminating employee finds alternate employment. Employers must be clear in their payroll treatment of all such payments, whether periodic or lump-sum, as to whether they are payments in respect of employment (T4), versus retiring allowance payments (T4A). If they are T4A payments, accruals cannot continue under a registered pension plan in respect of the period applicable to the payment. Pensionable service under a pension plan can continue only if the member of the plan is an employee. It is not necessary for all employment benefits to be continued in order for the employment status to continue for pension plan accrual purposes, nor is it necessary for T4 earnings to be paid on a periodic basis as they were before the employee was given notice of his termination. Lump sum payments in respect of termination of employment will not necessarily be retiring allowance; they could be characterized as income from employment, depending on how the arrangement is confirmed in writing between employer and employee, whether and when an ROE is issued, and whether employment benefits continue.

Payments in lieu of pension accruals: gross-up?

This issue is not “hot”, but it simmers in many termination packages. Where a dismissed employee is a member of a defined contribution pension plan, or Group RRSP or DPSP, the appropriate measure of damages in respect of the employer’s contributions during a common-law notice period is not necessarily simply the amount that the employer would have contributed to the plan. A compelling argument could be

⁹ *Egan v. Alcatel Canada Inc.*, [2006] O.J. No. 310 (C.A.); leave to appeal denied by the Supreme Court of Canada on August 3, 2006.

made that this basic amount should be grossed-up to take account of the fact that such payments are not contributed to a tax-deferred plan as they would have been if the employee continued employment. This issue was addressed in a 2001 Ontario Court of Appeal decision.¹⁰

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¹⁰ *Peet v. Babcock & Wilcox Industries Inc.*, [2001] O.J. No. 1129 (C.A.)