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article for the Canadian Corporate Counsel

Bad news for pension plan sponsors

The Monsanto pension surplus decision was released by the Supreme Court of Canada recently. It generated some dramatic headlines: “Court hands key pension victory to workers”; “Monsanto Decision Will Mean \$millions to Thousands of Laid-Off Workers”; “Members must get part of pension surplus”; “Plan sponsors find Monsanto decision hard to swallow.”

What does "Monsanto" say?

The Court said that when a registered pension plan is partially wound-up, if there are surplus assets as at the date of the partial wind-up, the amount of surplus allocable to the terminating members must be paid out of the plan.

Monsanto terminated the employment of 146 employees in 1997 and 1998, and partially wound-up the portion of its defined benefit pension plan applicable to the terminated employees. There was surplus in the plan. Monsanto took the position, similar to that taken by many other plan sponsors, that it did not have to distribute the portion of the surplus that was allocable to the part of its plan that was being partially wound up. It said that surplus doesn't crystallize, and can't be known, until a pension plan is *completely* wound up. If and when there was surplus left in the plan when it fully terminated, at that point Monsanto would consider the surplus rights (if any) of the terminated members.

That position used to satisfy the Ontario pension regulator. Many partial wind-ups of other plan sponsors had been approved by the regulator, even though surplus was not distributed at the time of the partial wind-up. Unfortunately, however, the regulator changed its position, and in the late 1990's began to refuse to approve of partial wind-up applications that didn't provide for surplus distribution. The fight with Monsanto began. Many pension plan partial wind-up reports were in limbo pending the outcome of the Monsanto litigation.

At the first tribunal level, Monsanto won. The case was appealed, however, up to the Supreme Court of Canada. The Court considered a section of Ontario pension legislation that says that when a pension plan is partially terminated, the terminating members must have the same rights and benefits that they would have if the plan were fully terminated. A separate section of the legislation clearly requires that on a full termination of a pension plan, all assets be distributed from the plan. That includes surplus assets. The question was whether this requirement to distribute all assets on a *full* termination meant that surplus allocable to the partially wound-up part of a pension plan, had to be distributed at the time of a *partial* wind up. The Court's answer was yes.

Does this mean that all terminating employees get the surplus?

Not necessarily. Those media headlines were wrong about an automatic lottery win for terminated workers. The Court said only that surplus had to be distributed on a partial wind-up. It didn't consider the question of who should get it. It expressly left that to be determined on a case by case basis.

So who gets the surplus?

It depends on what the current and historical plan documents say. If there's "bad language" that casts doubt on the employer's entitlement to surplus, then the plan sponsor is going to have to either (a) give the surplus to the terminating members, or (b) try to do a surplus-sharing deal with the terminating members, to split it between the members and the plan sponsor. The percentage split will be whatever can be negotiated; there are no legislative or regulatory guidelines as to what a fair surplus sharing deal is.

If there's "good language", however, that clearly says that the plan sponsor is entitled to the surplus, things get interesting. Some commentators say that the Court's decision in "Monsanto" requires the plan sponsor to distribute the surplus to itself. But the plan sponsor must comply with the Ontario regulatory requirement to get the necessary two-thirds' consent from the terminating members, in order to withdraw surplus. Why would the members consent to a 100% surplus payout to the plan sponsor? Wouldn't there be a stalemate? Other commentators say that the plan sponsor can waive its so-called right to surplus, and leave the surplus in the pension plan. Nothing in the "Monsanto" decision or pension legislation addresses this scenario.

Under any scenario where the employer is able to withdraw surplus, it's likely now that there will have to be a court proceeding to get approval for a surplus withdrawal. Much will depend on what the historical plan documents say: is the plan governed by a trust, or purely contract? Who owns the surplus? How can a surplus deal be implemented if the necessary percentage of members don't consent to the deal? How can the plan sponsor be sure that any deal it strikes with the terminating members will not be subject to attack by the remaining active members of the plan? In the absence of any guidance from the Court, or regulators, how does a plan sponsor calculate the correct amount of surplus allocable to the terminating members? What if there's no surplus in the plan today, but the plan sponsor is being forced to distribute surplus with respect to a partial wind-up that occurred many years ago? No pension lawyer or consultant will be able to give a guarantee to a plan sponsor that a surplus sharing deal is bullet-proof, without court approval.

What exactly is a "partial wind-up"?

There's no statutory requirement to voluntarily carry out a partial wind-up at any time. However, the pension regulator has jurisdiction to *order* a partial wind-up in certain circumstances. The most common ones are: (a) whenever a significant number of members terminate employment due to some kind of corporate sale or restructuring (there's no clear definition of "significant number", but it could be as small as 10% of the

members of the plan); or (b) there's a closure of a location at which some of the members of the pension plan work. If the regulator doesn't order a partial wind-up, there's no obligation to carry out one.

In many cases plan sponsors voluntarily carry out partial wind-ups, where they are sure that the regulator would otherwise order one. A common clever approach has been to voluntarily provide the enhancements that would apply on a partial wind-up (e.g. full vesting), but not actually carry out a partial wind-up. The goal of this approach is to avoid the partial wind-up rules which trigger the obligation to distribute surplus. If there's no partial wind-up, there's no obligation to distribute surplus assets allocable on a partial wind-up.

When there is a partial wind-up, the plan sponsor files a partial wind-up report with the pension regulator, proposing to distribute pension benefits to the terminated members. Full vesting, portability, and limited improved early retirement benefits are the enhancements that must be provided under the Ontario partial wind-up rules. Benefits can't be paid until the partial wind-up report is approved by the regulator, or special regulatory consent is given. It usually takes several months for the regulator to approve of a partial wind-up report. There can be disputes with the regulator regarding the partial wind-up report, such as the application of the required wind-up enhancements, or exactly which members should fall within the partial wind-up.

How far back does this "Monsanto" decision apply?

In Ontario, it could apply back to 1969, which is when the Ontario partial wind-up legislation came into effect. That means that hundreds of partial wind-ups could be re-opened. Individuals who were terminated from employment, and pension plans, many years ago, could now demand to receive a piece of the surplus that existed many years ago but may exist no longer.

Does this apply only to Ontario pension plans?

No. Legislation similar to the Ontario partial wind-up provisions exists in pension statutes across the country. Surplus distribution on a partial wind-up could be required with respect to federally-registered pension plans, as well as plans that are subject to the pension laws of Saskatchewan, Manitoba, New Brunswick and Newfoundland. It also applies to old partial wind-ups under Quebec law (even though there are no longer partial wind-ups under current Quebec pension legislation).

My company's pension plan is a defined contribution plan, so there's no surplus. We're not affected by "Monsanto", right?

You could be affected by "Monsanto", if the pension plan was at one point a defined benefit plan. It was common in the for defined benefit plans to be converted to defined contribution plans. It's possible that your company's pension plan went through a partial wind-up at a time when there was surplus. In that case, there could be an obligation to

distribute surplus, even if the surplus has long since been used up for contribution holidays.

How should a plan sponsor react to the “Monsanto” decision?

1. Have your company’s pension actuary advise on how much surplus is allocable to past partial wind-ups of your company’s defined benefit pension plan. Inquire as to whether your company’s defined contribution pension plan is at risk because of “Monsanto”. The actuary will say that there are many unanswered questions as to how to calculate the surplus as at the partial wind-up date, how to allocate it to the partially wound-up members, how to “roll it forward to a current date”, etc. Tell the actuary that where there is a question as to how to calculate/allocate the surplus, he should provide a range of possible answers, and describe the reasons for the uncertainties in each category of questions.
2. Determine if there have been any employee downsizings in the past where there was no partial wind-up of your company’s pension plan at the time. Is there a risk that the regulator could declare a partial wind-up with respect to those prior events?
3. Determine whether your company is entitled to surplus, based on the current and historical documents relating to the pension plan: trust agreements, employee booklets and plan texts, dating back to when the plan was established, including documents relating to plans that merged into your company’s plan. A legal opinion is usually required. It will likely be an expensive opinion.
4. Consider giving up all of the surplus to the partially wound-up members of the pension plan, if the amount is not worth fighting about. Determine if there will be disputes among the terminated members about your company’s proposed allocation of the surplus within the group. Determine if there will be objections from the remaining, active members of the pension plan.
5. Ensure that the appropriate people in your company’s finance group are aware that the pension plan could be subject to an order to pay out surplus amounts dating back to 1969 (in Ontario). These potential liabilities likely have never been reflected in the accounting for pension assets and liabilities. Someone in your company should make a decision as to whether they should be, now.
6. Caution your company not to make representations or warranties about the funded status, or compliance, of your company’s pension plan, in any sale or financing documents.
7. Get legal advice as to whether there’s some way to distinguish the application of the "Monsanto" decision to your company’s pension plan.

A final (futile?) reaction to the “Monsanto” decision is to lobby the provincial and federal governments for legislative change ... or, at least, more clarity as to how to deal with pension surplus.

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