

Security of Retirement Benefits in Canada: You Bet Your Life?

Ronald B. Davis*

This paper provides a careful review and analysis of employment-based pensions and other post-retirement benefits that may be available to Canadian workers when they retire, with particular emphasis on the extent to which such benefits are vulnerable to unilateral employer alteration or cancellation, or to the risks which arise in the event of the employer's insolvency. Taking stock of key differences between the rights of unionized employees and non-unionized ones, the author argues that the legal regimes governing common law employment, collective bargaining and pensions offer varying degrees of security for post-retirement benefits, depending on the type of regime applicable to the workplace and the type of benefit. However, as the paper goes on to explain, the situation changes dramatically if the employer becomes insolvent — all the more so because the federal legislation which regulates creditors' rights in an insolvency enjoys paramountcy over the provincial legislation that deals with employment, collective bargaining and pensions (including any provision made in that provincial legislation for so-called "deemed trusts"). The author sets out and weighs the numerous risks confronting employees' pension and post-retirement benefit entitlements in both an insolvency proceeding and in a restructuring, again drawing attention to the different dynamics that may come into play in unionized and non-unionized workplaces. In general, he finds, the security of pensions is stronger than that of non-pension benefits, but will still depend on the adequacy of the pension plan's funding before insolvency.

1. INTRODUCTION

The law of employment is replete with common law and statutory schemes designed to address the numerous contingencies that permeate the employment relationship — for example, workers' compensation, occupational health and safety, employment insurance, and the doctrine of reasonable notice of termination. Among those schemes is the provision of benefits for employees after they leave the employer's workforce through retirement.

* Associate Professor, Faculty of Law, University of British Columbia.

In this paper, I will focus on four main themes. Part 2 considers the rationale for making retirement benefits available through the employment relationship. Part 3 analyzes the legal status of various types of benefits under the law of employment, including the question of “vesting” of benefits and how the risks inherent in the provision of these benefits within the employment relationship affect their security. Part 4 explores how the employer’s insolvency changes the way those risks manifest themselves. Throughout the paper, I will be contrasting the provision of retirement benefits in unionized and non-unionized workplaces, both in respect of the degree of security of those benefits and in respect of the effect, in unionized workplaces, of the trade union’s bargaining authority. For certain benefits, however, employment law has been supplemented by a statutory minimum standards scheme that offers an additional layer of security against retroactive alteration or cancellation.

An employer’s insolvency adds a new dimension to the issue of security by imposing a separate set of rules on the retirement benefit security bet — rules which are grounded in the federal power over bankruptcy and insolvency, and which can therefore trump provincial employment law. In other words, where insolvency law rules conflict with (or have their purpose undermined by) employment law rules, federal constitutional paramountcy will render the employment law rules of no force and effect. This extends even to remedial minimum standards rules created by provincial legislatures with respect to certain benefits. Only where the funding arrangements for particular benefits fall within exemptions recognized in insolvency legislation will the benefits funded through those arrangements retain some security during an employer’s insolvency.

In Part 5, I conclude that the vulnerability of retirement benefits to the vagaries of chance (the bet!) varies with the type of employment relationship, the type of funding arrangement, the degree of regulatory oversight, and the ability of the insolvency regime to give retirees some bargaining power. The risk distribution can be improved with the adoption of certain changes, but the risk of reduction or elimination of retirement benefits will continue as long as the security of those benefits is based in the employment relationship. Given the intractability of that risk, it would be an important step forward to inform employees about it, and about how they might reduce it by diversifying the sources of their benefits as much as possible.

2. WHY RETIREE BENEFITS?

Among the explanations that have been offered for employer-provided benefits are the transformation of production in the Industrial Revolution, the advent of unions and other social movements, and the recognition by employers of the role that service-linked benefits could play in their industrial relations strategies. Government intervention to prevent perceived abuses has also played a role in the transformation of these benefits from gratuities granted for “faithful service” to full-blown, enforceable rights.

The nineteenth century saw production move from the rural, family-based farm or the independent craftsman to the urban industrial context where workers sold their labour to the employer-owner of the productive machinery.¹ It became impossible to meet the old expectation that people would work as long as they possibly could and then be cared for by their families or charitable welfare institutions. The wages paid to those able to work were not enough to allow for the cost of elder care, and employers were not willing to continue to employ those too old or sick to produce at acceptable levels.²

Provision of retirement benefits by employers grew out of their need for an administrative solution to these problems. Stephen Sass has pointed out that in addition to having welfare capitalist impulses, employers such as governments and railways had to rely on the delegation of power and responsibility to salaried officials. Pensions and other service-based benefits were seen as a way to “induce competent and faithful service” and address the need for effective management of an extended administrative apparatus, while allowing employers to retire less efficient managers without eroding employee morale.³

1 Hart D Clark, “The Development of the Retirement Income System in Canada” in Task Force on Retirement Income Policy, *The Retirement Income System in Canada: Problems and Alternative Policies for Reform*, vol II (Appendices), *Report of the Task Force on Retirement Income Policy to the Government of Canada* (Ottawa, 1980) 1 at 1; Stephen A Sass, *The Promise of Private Pensions: The First Hundred Years* (Cambridge: Harvard University Press, 1997) at 4-9.

2 Sass, *supra* note 1 at 8 & 14; Clark, *supra* note 1 at 9.

3 Sass, *supra* note 1 at 18-22, citing the 1874 Grand Trunk Railway of Canada Superannuation and Provident Association as the first North American use of this type of pension.

Tying pensions to levels of income offered a reward for long service and an incentive to seek advancement and maintain production levels.⁴ With respect to blue-collar workers, benefit plans provided for continued income in the event of disability, thereby addressing discontent among those employees (especially in the railways) over perceived employer indifference to safety, reducing the insecurity felt by many of the employees, and discouraging them from unionizing. Workers who were dismissed for cause were disentitled from receiving benefits, and this served to bind them to the employer.⁵

As the trade union movement gained in strength and membership, some employers implemented benefit programs in order to combat unionism among their employees. In addition, during the Second World War, wage controls meant that employers competing for scarce labour used benefit programs to retain or recruit workers, and this trend continued in the years immediately after the war.⁶

Although the origins of employer-sponsored retirement benefits were firmly rooted in managerial imperatives that accompanied the development of industrial production, their continued use can be attributed to many factors: their continued utility to management; the difficulties of removing benefits to which the active workforce has contributed; the resistance of unions; and the policies of successive governments that have constructed public programs based on the presence of private-sector, employment-based retirement benefits.

However, as Canada's manufacturing and extractive industries continue to undergo major restructuring and financial reorganization, the security of retirement benefits is facing increasing challenges from the dynamics of restructuring bargains, from the absence of funding sources other than the employer, and from the inability of regulatory schemes to generate sufficient funding when the employer faces financial constraints. To understand the problem, it is necessary to review some of the more prevalent types of retirement benefits — pensions, group life insurance, supplementary medical benefits and dental insurance — and how they are funded.

4 *Ibid* at 26-30.

5 *Ibid* at 25-27.

6 Pui-Ying Chan, "Historical Development" in Raymond Koskie *et al*, eds, *Employee Benefits in Canada*, 3d ed revised (Brookfield, Wis: International Foundation of Employee Benefit Plans, 2004) 5 at 5; Clark, *supra* note 1 at 13.

(a) Types of Retirement Benefits and Funding

One of the most important benefits provided through the employment relationship is the pension, or retirement income benefit. For those whose pre-retirement earnings are in the lowest 20 percent of income distribution, their pre-retirement income can be almost totally replaced by a combination of the Old Age Security/Guaranteed Income Supplement (OAS/GIS) benefits and Canada or Quebec Pension Plan (CPP/QPP) benefits, at least if they have had a long-term attachment to the workforce.⁷ For those in the upper 80 percent, employer-sponsored pension plans are more significant, because OAS/GIS and CPP/QPP benefits are deliberately designed to replace a maximum of 40 percent of the average industrial wage.⁸ In a study looking at the potential for maintaining pre-retirement levels of consumption based on net rather than gross income, Michael Wolfson concludes that “roughly half of Canadians born before 1970 who had mid-level earnings in their pre-retirement years will face declines of at least 25 percent in their living standards (i.e. consumption possibilities) post-retirement.”⁹ This shortfall is more likely for individuals who were not in employment-based pension plans before retirement.¹⁰

7 Sebastien LaRoche-Côté, John Myles & Garnett Picot, “Income Security and Stability During Retirement in Canada” (2008), Statistics Canada, Analytical Studies Branch Research Paper Series, online: <<http://www.statcan.gc.ca/pub/11f0019m/11f0019m2008306-eng.pdf>>.

8 Jinyan Li, “Separation, Linkage and Blurring in the Public and Private Pillars of Canada’s Retirement Income System” in Leroy O Stone, ed, *New Frontiers of Research on Retirement* (Ottawa: Statistics Canada, Unpaid Work Analysis Division, 2006) 95 at 100.

9 Michael Wolfson, *Projecting the Adequacy of Canadians’ Retirement Incomes: Current Prospects and Possible Reform Options*, IRPP Study No 17 (Montreal: Institute for Research on Public Policy, 2011) at 5.

10 Keith Horner, *A New Pension Plan for Canadians: Assessing the Options*, IRPP Study No 18 (Montreal: Institute for Research on Public Policy, 2011) at 5, where Horner calculates the proportion of benefits provided by various parts of the Canadian retirement income system: “Benefits from pillar 3 plans [pension plans and registered retirement savings plans] currently account for 44 percent of the total, with OAS/GIS accounting for 26 percent and the CPP/QPP 30 percent.”

(b) Pensions

The “bet” inherent in a pension plan is found in the many unpredictable factors that affect any arrangement which postpones some current consumption in order to provide for future consumption. These factors include longevity, future price levels (inflation rates), long-term rates of return on investments, and agency costs.¹¹ They can be summarized in this question: how much do I have to save today to generate an adequate income for the rest of my life after I retire? An exact answer requires an accurate prediction of all of such factors over the course of 60 or 70 years (working life plus retirement).

In defined contribution pension arrangements, the risk of being wrong about the future is explicitly borne by each pension plan member, because the employer is responsible only for making a fixed contribution to a member’s account. The member bears the risk that the amount contributed to that account will not provide adequate income when he or she retires. In defined benefit pension arrangements, the employer makes a contractual commitment to provide a fixed amount of pension to each qualifying employee for the rest of his or her life, based on the employee’s wage level and length of service. To meet this commitment, the employer must make regular contributions to a pension fund. The risk that inflation will erode the buying power of the fixed pension benefit remains with the employee, unless the employer indexes that benefit to the cost of living. However, the employer bears the risk that the pension fund will not be sufficient to pay the fixed benefit — unless the employer’s financial circumstances lead to insolvency proceedings. Most of the employers who provide defined benefit plans are corporations, and just as a corporation’s shareholders and unsecured creditors bear the risk of losing their stakes if the corporation becomes insolvent, so its employees bear the risk of the reduction or elimination of their pension benefits if the pension fund is not sufficient to cover those benefits.¹²

11 The role of these factors in the security provided by various forms of retirement income arrangements is discussed in Horner, *ibid* at 6-8, and in Wolfson, *supra* note 9 at 7-8.

12 James E Pesando, “Risky Assumptions: A Closer Look at the Bearing of Investment Risk in Defined-Benefit Pension Plans” (June 2008), 266 C.D. Howe Institute Commentary.

(c) **Non-Pension Retirement Benefits**

Group life insurance benefits provide term insurance policies that pay a fixed amount on the death of a covered employee from any cause. These policies' premiums are lower than individual coverage premiums because of marketing and administrative savings, and are based on the average age of the group rather than on each individual's age.¹³ An employee whose employment with the group's employer terminates is offered the opportunity to convert the group coverage to individual coverage without proof of insurability. Typically the group coverage is terminated or reduced beginning at age 65, with the employee again having an opportunity to convert to individual coverage at a higher premium.¹⁴ Thus, the continuation of group life insurance beyond retirement is a benefit that will most likely be, at best, gradually reduced until age 70 or 71 because insurers factor actuarial mortality rates into a group's premium. The effect of including even a few older employees in the group can be dramatic. For example, a group of eleven employees, of whom ten are 35 years old and the eleventh is 70, will have a premium almost four times higher than if all were 35.¹⁵ The rapid cost escalation of group life insurance premiums when many older workers are included makes it very expensive to offer this benefit as more employees retire and as the active workforce continues to age.

Post-retirement extended health care benefits provide reimbursement for such expenses as prescription drugs, dental and eye care, out-of-province medical insurance, and ambulance transportation — expenses not typically covered by provincial health insurance. As those eligible for extended health care benefits grow older, their use of most of these benefits increases, as does the cost of providing them.¹⁶

13 Pui-Ying Chan, "Plan Design and Administration" in Koskie *et al*, eds, *supra* note 6, 143 at 145.

14 Chan, *ibid* at 145; Frank Zinatelli & Ronald Sanderson, "Comments on Ontario's Consultation Paper on Ending Mandatory Retirement" (2004), online: <<http://www.clhia.ca>>.

15 Zinatelli & Sanderson, *supra* note 14.

16 William D Anderson & Murray Gold, "Post-Retirement Benefit Issues" in Koskie *et al*, eds, *supra* note 6, 177 at 179.

(d) Accounting Treatment

Until recently, employers included the current year's cost of post-retirement benefits in their yearly balance sheets. However, accounting standards for post-retirement benefits now require that the balance sheet include as a form of deferred compensation the expected cost of providing future benefits promised to employees. As a result, the impact of those costs on the financial status of the employer has become an issue for investors, who would previously have seen only the costs of the current year's benefit provisions.¹⁷ As well, the calculation of the cost of providing future benefits faces the same uncertainties as the calculation of pension costs. Thus, even if an employer were to set aside assets to be used to fund future benefit claims, whether those assets were sufficient to fund the benefits would not be known until the actual costs were incurred, many years in the future.

The remainder of this paper will discuss the two main issues that affect the security of post-retirement benefits. The first is the vulnerability of promises of pensions and post-retirement benefits to unilateral alteration or cancellation by the employer, either before or after an employee retires. The question here is, to what degree is an employer who wishes to alter or cancel benefits subject to legal constraints? The second issue concerns the extent to which such benefits are protected from the risks created by the employer's insolvency, and what fate awaits those benefits in insolvency proceedings.

3. LEGAL STATUS OF POST-RETIREMENT BENEFITS

The law of the employment contract must deal with some of the features of the employment relationship that distinguish it from other contractual relationships. The contract of employment is often unwritten, it is often for an indeterminate period, and it gives the employer control over the employee's labour in exchange for the remuneration

17 See, for example, Jalal Soroosh & Espahbodi Pouran, "New Accounting Rules for Postretirement Benefits: How SFAS May Affect a Company's Financial Statements" (January 2007), CPA Journal, online: <http://www.nysscpa.org/cpa_journal/2007/107/essentials/p28.htm>. The authors calculate that the impact of the new U.S. accounting rule would decrease owners' equity on the 2004 balance sheet for pharmaceutical giant Merck by U.S. \$1.8 billion.

promised. In the case of post-retirement benefits, there is the additional factor of a decades-long time lag between the provision of the services that entitle the employee to a promised future benefit and the triggering of the employer's obligation to pay that benefit.

Much of the content of the employment contract is derived from the common law and from remedial legislation such as employment standards statutes. In the case of unionized employees, many of the terms of the contract are incorporated into a collective agreement, but this document is also subject to a body of jurisprudence developed by labour arbitrators under the statutory regime applicable to collective bargaining. The differences between the law on non-unionized and unionized employment relationships have an important effect on the legal protections available for post-retirement benefits. Finally, whether an employer can change the terms of its promised post-retirement benefits for those who have already retired depends on whether the employer can unilaterally vary its contractual obligations towards its retirees. Again, the answer varies considerably as between non-unionized and unionized employees.

(a) **The Non-Unionized Regime**

In a non-unionized workplace, changes in the terms of the employment contract are usually initiated by the employer. However, to conform to the contractual model of creating a binding legal obligation, there must be sufficient evidence of agreement to the change by the employee to constitute a new employment contract incorporating the changed term. Does an employee's continued provision of services constitute sufficient evidence of such an agreement?¹⁸

There are two approaches to the legal effect of the employer's announcement of a change in terms of employment. One approach, exemplified by two old British Columbia Supreme Court cases, treats that announcement as a unilateral offer which the employee accepts by continuing to work.¹⁹ The other approach, exemplified by two

18 *Kornerup v Raytheon Canada Ltd*, 2007 BCSC 584 at para 20, 282 DLR (4th) 434, rev'd 2008 BCCA 241 on the ground that the offer was revoked before the employee began to fulfill the conditions needed to make it binding.

19 *Sloan v Union Oil Co of Canada*, [1955] 4 DLR 664 (BCSC); *Ballard v Canadian Fishing Co*, [1982] BCJ No 90 (QL) (SC).

other decisions of the same court, refuses to treat the continued performance of work as sufficient evidence that the employee agreed to the change.²⁰ In all four of those cases, the dispute was over the termination of benefits owed to dismissed employees. In the two cases where the continued employment was treated as an acceptance of the employer's unilateral offer, the offer was to pay more than what the employees were entitled to under the common law of dismissal without reasonable notice.²¹ In the two cases where the continued employment was held not to constitute acceptance of the employer's terms, the employer had offered less termination pay than the employees would have been entitled to under the common law.²² The Court noted this difference in the facts, and said that in the first two cases the offer of additional termination benefits was made to encourage the employees to continue working for the firms — an offer that was accepted by their continuation in employment — while no such acceptance could be inferred where the employer was trying to reduce the termination benefits.²³

Does this mean that any attempt by the employer to reduce or eliminate post-retirement benefits promised to active employees cannot succeed where there is no express agreement by those employees to such a change? The answer seems to depend on which party has the burden of establishing the legal significance of the employee's continued performance of his or her duties following the employer's announcement of its intentions regarding future post-retirement benefits. In an early case where the employer had begun deducting amounts from salespersons' commissions for uncollectable accounts, McKay J.A. of the Ontario Court of Appeal concluded that such a change in the terms of employment generated the following options:

... it cannot be said, as a matter of law, that an employee accepts an attempted variation simply by the fact alone of continuing in his employment. Where an employer attempts to vary the contractual terms, the position of the employee is this: He may accept the variation expressly or impliedly in which case there

20 *Rahemtulla v Vanfed Credit Union* (1984), 51 BCLR 200, [1984] 3 WWR 296 (SC); *Starcevich v Woodward's Ltd* (1991), 58 BCLR 254 (SC).

21 *Sloan v Union Oil Co of Canada*, *supra* note 19; *Ballard v Canadian Fishing Co*, *supra* note 19.

22 *Rahemtulla v Vanfed*, *supra* note 20; *Starcevich v Woodward's*, *supra* note 20.

23 *Kornerup v Raytheon*, *supra* note 18 at para 32.

is a new contract. He may refuse to accept it and if the employer persists in the attempted variation the employee may treat this persistence as a breach of contract and sue the employer for damages, or while refusing to accept it he may continue in his employment and if the employer permits him to discharge his obligations and the employee makes it plain that he is not accepting the variation, then the employee is entitled to insist on the original terms.²⁴

This early articulation imposes an obligation on the employee to “make it plain” to the employer that the employee is not accepting the adverse variation while continuing to perform his employment duties and if the employer permits this to occur, then the employee can insist on the original benefit.

This reasoning was applied in the Ontario Court of Appeal decision in *Wronko v. Western Inventory Services Ltd.*, holding that a unilateral attempt by the employer to reduce the two-year termination pay provisions of an employee’s contract gave the employee the three options outlined by McKay J., above.²⁵ If the employee chose to reject the change, the Court described the employer’s options as follows:

Having been made aware of Wronko’s opposition to the new contract in September 2002 and his continued opposition thereafter, Western had two choices: it could advise Wronko that his refusal to accept the new contract would result in his termination and that re-employment would be offered on the new terms. If Western were to take this position, the termination provision in the December 2000 contract would be triggered. Alternatively, Western could accept that there would be no new agreement and that Wronko’s employment would continue on the existing terms. Having failed to choose the former course, Western must be taken to have acquiesced to Wronko’s position and to have accepted that the terms of the existing contract remained in effect. Western’s decision to terminate Wronko in September 2004 thus carried with it the consequence that Wronko was entitled to two years termination pay pursuant to the terms of his existing employment contract.²⁶

Where the employee clearly and continuously rejects the employer’s unilateral change to the employment contract, and the changes do not have an immediate effect on working conditions, the next move is up to the employer. It can either tell the employee immediately that his

24 *Hill v Peter Gorman Ltd* (1957), 9 DLR (2d) 124, [1957] OJ No 188 (QL) at para 44 (CA).

25 *Wronko v Western Inventory Services Ltd*, 2008 ONCA 327, leave to appeal to SCC refused, [2008] SCCA No 294 (QL).

26 *Ibid* at para 40.

or her employment is terminated and offer re-employment under the new terms or, by allowing the employee to continue to work, accept the rejection of the proposed change.

However, the employee's continuing to work without making clear that he or she refuses to accept a change to post-retirement benefits will eventually be considered to be acquiescence in the change. The length of time during which the employee's continued performance will not be treated as such acquiescence is based on what the common law would regard as reasonable notice of termination of the employment contract in the particular case. This is because the common law treats unilateral changes to fundamental or substantial terms of the contract as a termination of the contract, entitling the employee to consider him- or herself "constructively dismissed" and to sue for damages in lieu of notice.²⁷ At the same time, the employee must mitigate his or her losses arising from the constructive dismissal. Therefore, in cases where continued employment is a viable option, the employee may be obliged to stay on the job for the period of reasonable notice. Working during that period will not be treated as a waiver of the employee's right to insist on the original terms of the employment contract if the employee seeks damages for constructive dismissal because of the changes to post-retirement benefits. In a constructive dismissal claim based on a transfer by the employer, the British Columbia Court of Appeal expressed the concept in these terms:

In my judgment a very heavy burden would rest upon the employer to show that there was a real waiver, regardless of whether constructive dismissal was asserted at the time of the transfer or not. At the end of the day, however, the question of whether the employer has repudiated the employment will be a question of fact to be decided upon consideration of all the circumstances. The employer cannot have it both ways, that is, mitigation and waiver, and it will be rare indeed when an employer will succeed on a plea of waiver after an employee has mitigated his or her damages after accepting a new position. It would be different, of course, if the employee continues in the new employment after the expiration of a reasonable period roughly equivalent to what the law would impose by way of a reasonable notice.²⁸

27 *Farber v Royal Trust Co*, [1997] 1 SCR 846 at 864.

28 *Cayen v Woodward's Stores Ltd* (1993), 100 DLR (4th) 294, [1993] BCJ No 83 (QL) at para 41 (CA).

Thus, if an employer unilaterally decides to alter or terminate post-retirement benefits, active employees can make their opposition clear to the employer and face dismissal, or they can work through the period of reasonable notice and bring an action alleging constructive dismissal.²⁹ In both instances, unless the employer fails to dismiss an employee who refuses to accept the change, the employee will be unemployed and his or her only compensation will be whatever damages a court may find to flow from the dismissal without notice.³⁰

There are exceptions to this unenviable choice in cases where employees can point to losses of post-retirement benefits which had vested while they were still actively employed. Thus, where the employees claimed damages for losses arising from the employer's negligence and breach of fiduciary duty in the advice it gave them on the conversion of their accrued pension plan benefits from a defined benefit basis to a defined contribution basis, they did not need to show that the change amounted to a constructive dismissal.³¹ In a class certification motion in which the class plaintiff was an active employee, the court accepted that a cause of action was disclosed by the employer's alleged failure to pay the previous year's bonus payments, together with the employer's substitution of a defined contribution plan for a defined benefit plan, the employer's reduction of its contributions to that plan, and its removal of post-retirement benefits for those already retired, allegedly without sufficient notice of these changes.³²

29 *Russo v Kerr Brothers Ltd*, 2010 ONSC 6053, 326 DLR (4th) 341.

30 While these damages can include compensation for benefits that may have accrued during the period of reasonable notice, they will not typically include compensation for a vested benefit unless the benefit would vest during the period of reasonable notice, as was the case for enhanced early retirement benefits in *Kerfoot v Weyerhaeuser Co*, 2012 BCSC 640, [2012] BCJ No 868 (QL).

31 *Dawson v Tolko Industries Ltd*, 2010 BCSC 346, [2010] BCJ No 479 (QL); see also *Weldon v Teck Minerals Ltd*, 2011 BCSC 489, [2011] BCJ No 705 (QL), aff'd 2012 BCCA 53, [2012] BCJ No 201 (QL), involving a similar claim.

32 *Somerville v Catalyst Paper Corp*, 2011 BCSC 331, [2011] BCJ No 464 (QL). The employer subsequently entered insolvency proceedings, and any damages owed to those employees will be paid through a distribution to unsecured creditors. It is not known whether the damages will be fully paid. Further information on the Catalyst Paper Corporation insolvency proceeding is available on the webpage maintained by the court-appointed monitor, Price Waterhouse Coopers, at <<http://www.pwc.com/ca/en/car/catalyst-paper-corporation/index.jhtml>>.

Thus, in a non-unionized employment relationship, the employer may legally alter or cancel post-retirement benefits owing to its active employees if it recognizes that this is a constructive dismissal and is willing to provide reasonable notice or pay in lieu of notice. An interesting question remains as to whether a court might award some form of damages to indemnify the employee for any deferred compensation element in the cancelled benefit, on the ground that the employee's cash compensation had been reduced to reflect the cost of providing that benefit. However, this possibility does not affect the fact that post-retirement benefits of active employees (except for pensions) are not secure from unilateral employer cancellation or alteration, subject only to the right of reasonable notice of such a change.³³ To the extent that active employees have "bet" on receiving those benefits during their retirement, the legal odds of winning that bet are very slim unless they can remain employed until a point when their retirement date falls within the period of reasonable notice of termination.

(b) Retirees

Once an employee retires and thus fulfills the condition for receipt of post-retirement benefits, those benefits may have "vested" or "crystallized" and no be longer subject to unilateral employer alteration. However, vesting or crystallization is not guaranteed merely by retirement. Whether a benefit is immune from employer modification will turn on the courts' interpretation of the benefit promise. Retired employees whose benefit promises are contained in a collective agreement face additional questions about access to adjudication of the claim that the benefits have vested and cannot be modified. Thus, the

33 If the benefit plan requires that the employee retire while an active employee of the company, then unless the employee becomes eligible for retirement during the period of reasonable notice, his or her claim for damages is likely to be defeated by the argument that he or she has not qualified for the benefit in question and therefore suffered no damages from the dismissal. See *Vorvis v Insurance Corp of British Columbia*, [1989] 1 SCR 1085 at 1096-1097; *King v Gulf Canada Ltd*, [1992] OJ No 2761 (QL), 45 CCEL 238 (CA). The issue is discussed in more detail by Ronald B Davis, "Doomed to Repeat History? Retiree Benefits and the Reform of Canada's Insolvency Laws" in Janis P Sarra, ed, *Annual Review of Insolvency Law, 2004* (Toronto: Thomson Carswell, 2004) 199.

British Columbia Supreme Court recently held that Weyerhaeuser's attempt to reduce the post-retirement health benefits of MacMillan-Bloedel's retired, non-unionized salaried employees after taking over MacMillan-Bloedel's business was a breach of the rights acquired by those employees at the moment of their retirement.³⁴ On similar reasoning, after cancelling a retired employee's post-retirement health benefits, an employer was ordered to pay damages to that employee in "an amount to permit him to acquire the additional benefits covered in his retirement package."³⁵

In order to reach this level of legal protection, post-retirement benefits must survive several doctrinal arguments to the effect that, even if the employee has met the conditions for receipt of the benefit, the right to receive is not vested because it can still be unilaterally modified or terminated by the employer. One such argument is that if the benefit was instituted after the employees were hired, there was no consideration for it, and so the employer's promise to pay it did not form part of the contract of employment created on hiring.³⁶ This makes the question of whether a retiree benefit has vested turn on the courts' assessment of the facts surrounding the creation of the benefit and its communication to the employee. It will not be enough that the employee has met the conditions for receipt of the benefit; the circumstances surrounding its creation will also determine whether it constitutes a binding promise or merely a non-binding representation of the employer's intention.

Among other arguments that have been offered in support of the position that non-pension benefits have not vested are these: the presence of an employer right to amend benefits through communication to employees about the benefit plan must be interpreted as including

34 *Lacey v Weyerhaeuser Co Ltd*, 2012 BCSC 353, [2012] BCJ No 481 (QL).

35 *Kennedy v Canadian Salfish Corp* (1995), 136 Nfld & PEIR 250, [1995] NJ No 368 (QL) (SC (TD)).

36 *Bennett v British Columbia*, [2009] BCSC 1358, aff'd 2012 BCCA 115, where the Court held that because premium-free hospital insurance had been provided "long after hiring and at a time when retention was not truly an issue," the retirees could not claim that their continuation in employment constituted consideration for this promise. This distinguished the case from *Sloan v Union Oil Co of Canada*, *supra* note 19.

a right to terminate or curtail the benefits being received by retirees;³⁷ the absence of a statutory regime prohibiting alteration of post-retirement benefits should lead to a presumption against the vesting of such benefits, such that there is an evidentiary burden on employees to prove that vesting was intended; the benefits were provided through insurance contracts that expressly gave the employer the right to amend or terminate coverage;³⁸ and intergenerational equity requires the curtailment of post-retirement benefits to current retirees so that active employees will have an opportunity to enjoy some benefits later on.³⁹ That these arguments could potentially succeed illustrates the vulnerability of non-pension post-retirement benefits to an *ex post facto* decision by a court that the particular benefits did not vest because of the factual matrix surrounding the promise to employees.

(c) Retirees Whose Post-Retirement Benefits Are in a Collective Agreement

As mentioned earlier, retirees whose post-retirement non-pension benefits are set out in a collective agreement face the same interpretive challenges to the vesting of benefits as other retirees.⁴⁰ In addition, their position is somewhat more complex; although a union is permitted to negotiate post-retirement benefits for retirees,

37 *Gustavson v TimberWest Forest Corp*, 2011 BCPC 272, [2011] BCJ No 1943 (QL), aff'd 2012 BCSC 1232, [2012] BCJ No 1724 (QL). However, the Court rejected these arguments because the plaintiff had a separate early retirement agreement which allowed only changes that did not result in any "substantial" reduction in benefits.

38 *British Columbia Nurses' Union v Municipal Pension Board of Trustees*, 2006 BCSC 132. The Court held that the collective agreement requirement that active employees participate in the pension plan did not give retired employees any guarantee of a particular level of benefits under the specified insurance policies, but only the right to the level of post-retirement health benefits provided for under the particular policies as amended from time to time.

39 This is a summary of the employer arguments in *Lacey v Weyerhaeuser*, *supra* note 34. Although the arguments were not accepted, they might, on different facts, persuade a court that the right to post-retirement benefits is contingent on the employer's willingness to continue funding them.

40 See *British Columbia Nurses' Union v Municipal Pension Board of Trustees*, *supra* note 38.

it is certified as the bargaining agent only of the employer's active employees, and the union's duty of fair representation may extend only to active employees.⁴¹ Moreover, the grievance and arbitration process is the sole forum for adjudicating collective agreement rights, and only the union normally has access to that process.

In *Dayco v. C.A.W.*, the Supreme Court of Canada held that an arbitrator had jurisdiction under an expired collective agreement to hear a grievance that the employer had violated the agreement by terminating post-retirement benefits for retirees.⁴² The Court reasoned that a contract (in that case, a collective agreement) was capable of creating rights that survived its termination, and that those rights were subject to the arbitration clause governing all disputes over rights created by the agreement.⁴³ Justice La Forest also suggested that if an employee retired with a certain level of post-retirement benefits under a collective agreement, those benefits "would survive subsequent collective bargaining that purported to divest such rights."⁴⁴ This suggestion would be consistent with the fact that a union is not the bargaining agent of retirees and thus cannot adversely affect rights gained under the terms of an earlier collective agreement.⁴⁵

As mentioned above, a further potential complication lies in the fact that access to the grievance arbitration mechanism requires that the union be willing to pursue a grievance and incur the costs of arbitration, if necessary. This complication is made more daunting by the now longstanding principle that the courts must defer to grievance arbitration, by refusing to entertain any dispute that arises from the terms of a collective agreement.⁴⁶ This raises the danger that the union could well be within its rights in deciding not to pursue a grievance by retirees, leaving them with no other avenue for legal redress.

41 *Pulp and Paper Industrial Relations Bureau v Canadian Paperworkers Union* (1977), 77 CLLC ¶16,109 (BCLRB), holding that nothing in collective bargaining legislation prevented the union from bargaining for increases in retirees' pensions.

42 *Dayco (Canada) Ltd v CAW – Canada*, [1993] 2 SCR 230.

43 *Ibid* at 276.

44 *Ibid* at 305.

45 *Bathgate v National Hockey League Pension Society*, [1992] OJ No 2168 (QL) (Gen Div), aff'd [1994] OJ No 265 (QL) at para 190 (CA).

46 *St Anne-Nackawic Pulp & Paper Co Ltd v Canadian Paperworkers Union, Local 219*, [1986] 1 SCR 704; *Bisailon v Concordia University*, [2006] 1 SCR 666.

This possibility occurred to La Forest J. in *Dayco*, even though the union in that case had advanced the retirees' grievance on their behalf. He suggested that retirees might have access to the courts if a union refused to pursue a grievance.⁴⁷ Other courts have permitted retirees to bring actions for post-retirement benefits even though some or all of those rights had accrued under a collective agreement.⁴⁸ Therefore, although the union veto over access to the grievance and arbitration process is a complicating factor in assessing the degree of security of retirement benefits under collective agreements, it does not bar retirees from seeking to enforce their right to such benefits.

(d) Unionized Active Employees

Unlike a non-unionized employment relationship, an employment relationship governed by a collective agreement is not terminable on reasonable notice but only for just cause or for other reasons specified in that agreement. Nor are collectively agreed terms and conditions subject to unilateral amendment by the employer; they can be modified only by agreement between the union and the employer.⁴⁹ Unionized active employees can therefore resist any attempt by the employer to alter the promised benefits, at least while a collective agreement is in force or the employer is subject to the statutory prohibition on altering terms and conditions during bargaining for the renewal of the agreement.⁵⁰ This means that negotiated post-retirement benefits for active unionized employees are relatively

47 *Supra* note 42 at 304.

48 *Bohemier v Centra Gas Manitoba* (1999), 170 DLR (4th) 310 (Man CA), leave to appeal to SCC refused, [1999] SCCA No 185 (QL); *Ormrod v Hydro-Electric Commission of Etobicoke (City of)* (2001), 53 OR (3d) 285, [2001] OJ No 754 (QL) (Sup Ct J).

49 For example, in the British Columbia *Labour Relations Code*, RSBC 1996, c 244, section 49 requires the parties to a collective agreement to carry out its terms, section 84 requires every collective agreement to provide for binding arbitration of all disputes over the interpretation of the collective agreement, and section 95 requires all parties to comply with an arbitration award.

50 The obligation on both parties to bargain in good faith has been interpreted to prohibit merely going through the motions. Brian A Langille & Patrick Macklem, "Beyond Belief: Labour Law's Duty to Bargain" (1988) 13 *Queen's LJ* 62.

secure, at least while the union and its members have sufficient bargaining power to maintain those benefits.

(e) Insurance and Employee Life and Health Trusts

As discussed above, non-pension benefits are often provided through insurance policies which cover employees for these benefits in return for the payment of insurance premiums by the employer. However, until 2010, income tax law allowed the employer to deduct the cost of premiums for only the current year's coverage, not for future coverage.⁵¹ New provisions in the *Income Tax Act* permit the employer to contribute to an employee life and health trust, and to deduct the cost of premiums for current coverage and the costs of administering the plan, as well as any excess contributions when premiums are paid in subsequent years.⁵² However, if that trust is a multi-employer arrangement, all contributions are deductible when made, if they meet the requirements for multi-employer contributions set out in the Act.⁵³

There is some potential for pre-funding of the expected costs of retiree benefits insurance, especially through a multi-employer trust, but several constraints in the income tax rules make this form of funding only partially effective. First, individual employers cannot receive immediate tax deductions for any excess contributions. Second, if contributions are invested, any income that exceeds the premiums and administrative costs for the current year is taxable at the highest marginal rate. Therefore, a strategy of paying for retiree benefits through investment of contributions is hampered by potential tax liability. Nevertheless, employee life and health trusts do represent an incremental improvement in the security of non-pension post-retirement benefits.

51 Mark Zigler & Andrea McKinnon, "Long-term Disability and Other Post-Employment Benefits in Insolvency Proceedings" in Janis P Sarra, ed, *Annual Review of Insolvency Law, 2010* (Toronto: Butterworths, 2011).

52 *Income Tax Act*, RSC 1985, c 1 (5th Supp), s 144.1.

53 *Ibid*, ss 144.1(6). The contributions must be required under a collective agreement, they must be calculated by reference to the number of hours worked, and the trust must have at least 15 contributing employers.

The problem of providing a long-term disability plan without insuring the benefits through a third-party insurer was brought into sharp focus by the insolvency of Nortel Networks. Nortel had a long-term disability plan that was funded on a pay-as-you-go basis, with the result that benefits owing to nearly 400 disabled employees ceased as of December 31, 2010.⁵⁴ In response to the argument that employers might choose to provide these benefits on an uninsured basis because of perceived cost savings in the difference between the premiums required by an insurer and the yearly payouts to disabled employees, the Canadian Life and Health Insurance Association suggests that the costs are equivalent if all benefits are actually paid, because the insured costs include reserves used to pay benefits even if the employer is no longer paying premiums in respect of the disabled employees.⁵⁵ Subsequent amendments to the *Canada Labour Code* prohibit federally regulated employers from offering long-term disability benefits without insurance, with some exceptions to be set out by regulation.⁵⁶

(f) Pensions: All Retirees

Unlike the situation with non-pension post-retirement benefits, the same legal regime regulating the security of *pension* benefits applies to both non-unionized and unionized employees. This regime is found in provincial and federal statutes which establish minimum standards that must be met by employers who provide pension benefits for their employees. Those statutes prohibit amendments to a pension plan that reduce benefits which have accrued up to the

54 Richard J Brennan, "Disabled Nortel Employees Face a Bleak Future," *The Toronto Star*, 19 December 2010, online: <<http://www.thestar.com/news/canada/article/909500—disabled-nortel-employees-face-a-bleak-future>>.

55 Canadian Life and Health Insurance Association, *Protecting Canadians' Long-Term Disability Benefits*, September 2010, at 4, online: <<http://www.clhia.ca>>.

56 *Jobs, Growth and Long-term Prosperity Act*, SC 2012, c 19, adding ss 239.2 & 239.3 to the *Canada Labour Code*, RSC 1985, c L-2. These provisions are not yet in force.

time of the amendment.⁵⁷ However, this form of security is entirely retrospective; nothing in the pension regulatory statutes prohibits an employer from prospectively amending the terms of a pension plan or terminating it altogether to the extent permitted by applicable minimum standards pension legislation. The legal constraints on employer-initiated prospective changes are the same as those discussed above regarding changes to non-pension retirement benefits for active employees, as differentiated by their status as non-unionized and unionized employees.

In addition to provisions prohibiting retrospective reduction of accrued benefits for active employees, pension legislation also “vests” these accrued benefits in employees after a certain period of enrollment in the plan.⁵⁸ The effect of this vesting is to give individual employees whose employment is terminated before retirement age an irrevocable right to receive a pension from their former employer’s plan, based on their accrued pension benefits, or to elect to transfer the commuted value of those accrued benefits to another retirement vehicle. Thus, in contrast to non-pension post-retirement benefits, employees do not lose their entitlement to pension benefits if their employment is terminated before they reach retirement age, as long as they are employed until their rights vest under the applicable legislation.

As can be seen from the above discussion, the legal regime governing employment, collective bargaining and pensions offers varying degrees of security for post-retirement benefits, depending on the type of employment law regime applicable to the particular workplace and the type of benefit. However, to this point we have assumed that the employer has the funds to fulfill its promises to retirees. The situation is dramatically altered if the employer’s financial position

57 See, for example, the Ontario *Pension Benefits Act*, RSO 1990, c P.8, s 14, and the British Columbia *Pension Benefits Standards Act*, RSBC 1996, c 352, s 59. These prohibitions apply in the case of single-employer defined benefit pension plans. If the plan is a multi-employer or target benefit plan, reductions will be permitted where funding is inadequate to pay promised benefits.

58 See, for example, the Ontario *Pension Benefits Act*, *supra* note 57, ss 36 & 37, and the British Columbia *Pension Benefits Standards Act*, *supra* note 57, s 26 (vesting after two years, or after ten years for pre-1987 service in Ontario). Ontario legislation now provides for immediate vesting for those who did not reach normal retirement age under the pension plan before July 1, 2012.

deteriorates to the point where it must enter insolvency proceedings. In such circumstances, all bets on the security of post-retirement benefits are off!

4. SECURITY OF POST-RETIREMENT BENEFITS DURING INSOLVENCY PROCEEDINGS

Insolvency proceedings fall within federal legislative power.⁵⁹ Therefore, to the extent that provincial legislation on employment, collective bargaining or pensions conflicts with federal insolvency legislation or undermines its purpose, the constitutional law doctrine of paramourcy means that the provincial legislation will be of no force and effect. Insolvency proceedings (except in the case of banks and insurance companies) are governed by two federal statutes, the *Bankruptcy and Insolvency Act (BIA)*⁶⁰ and the *Companies' Creditors Arrangement Act (CCAA)*.⁶¹ Such proceedings can result in a variety of outcomes, ranging from the closing of the employer's business and sale of its assets (liquidation) at one end of the continuum to the continued operation of the business and its emergence with new financing arrangements (restructuring) at the other end. There are also innumerable possibilities between those two extremes.

Among the key factors affecting the security of post-retirement benefits in the event of insolvency are the status of claims for post-retirement benefits pursued by active employees and retirees where there is no continuation of the business, and the status of such claims where a new employer continues some or all of the business. Another key factor is the type of employment or type of benefit involved. In addition, an element not mentioned above — the degree of pre-funding of the benefits in question — is also relevant, because the dominant paradigm in insolvency is that the employer's business, as currently structured, has insufficient money to meet its obligations. In discussing these factors below, we will divide the topics by type of employment and type of benefit, as was done above.

59 *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3, s 91(21).

60 RSC 1985, c B-3.

61 RSC 1985, c C-36.

First, however, it is necessary to understand the difference between the two types of insolvency proceedings: liquidation proceedings and restructuring proceedings. In liquidation proceedings, the business (and the relationship of the various creditors to it) is at an end, and the issue is how to divide the remaining value among creditors. Restructuring proceedings, in contrast, often result in the business being carried on in some form once the proceedings are over.

In liquidation proceedings, decisions that favour one class of creditors will have a proportional adverse impact on other classes. Thus, changes in the law which raise the priority of one class of creditors can affect the willingness of other creditors to lend money to the business, or can lead them to charge higher interest rates. One of the obstacles to securing post-retirement benefits for retirees is the relatively low priority assigned to retiree benefit claims in federal insolvency law. It is beyond the scope of this paper to consider what potential effect raising the priority of those claims would have on the availability of credit to the business, and whether the outcome would be “better.” It is sufficient to point out that a decision to change priorities in insolvency proceedings will affect a much broader set of stakeholders than the retirees themselves.

(a) Liquidation: Non-Pension Benefits

This discussion of the outcome of liquidation proceedings is based on the assumption that there is no possibility that sale of the assets of the business could be considered a transfer to a successor employer under employment standards or collective bargaining legislation. Once the liquidation process is complete, the proceeds are distributed pursuant to the scheme of priorities set out in the *BIA*.⁶² This scheme gives first claim to secured creditors, followed by a statutory list of preferred creditors in order of priority. Creditors who are higher on the list must have their claims paid in full before the next lower priority creditor will receive anything. After all of the preferred creditors have been paid in full, any remaining assets are distributed to a pool of unsecured creditors on a *pro rata* basis, in accordance

62 *BIA*, *supra* note 60, s 136.

with the size of each creditor's claim in proportion to the total claims of all unsecured creditors.

Typically, unsecured creditors recover extremely little in such circumstances.⁶³ Active employees have recently received an important increase in priority, through a combination of two developments: an amendment to insolvency legislation giving them a fourth-ranking secured claim on the employer's current assets for up to \$2,000 for unpaid compensation, and the implementation of a federal program that guarantees payment of up to \$3,000 in unpaid compensation.⁶⁴ However, since neither development applies to retirees, their claim for non-pension benefits remains unsecured — and in fact, the increased priority of unpaid employee compensation will likely reduce the amount available for distribution among unsecured creditors. Thus, any recovery of non-pension, post-retirement benefits would likely be insufficient to compensate for the lost benefits. In this case, it would not matter whether the workplace is unionized or not, as the insolvency regime does not differentiate between claims on that basis. It would matter whether the claim was being made by a retiree or an active employee, because an active employee's claim would likely be rejected on the ground that he or she had not satisfied the conditions necessary to be entitled to any post-retirement benefits.⁶⁵ In addition, the retiree may have to prove that the promised post-retirement benefits were vested and not subject to alteration or termination by unilateral employer action. Thus, the liquidation option will essentially eradicate the security offered by an employment contract or a collective agreement for non-pension post-retirement benefits, and the odds of collecting on that bet are virtually zero.

63 Kevin Davis & Jacob Ziegel, "Assessing the Economic Impacts of a New Priority Scheme for Unpaid Wage Earners and Suppliers of Goods and Services" (1998), Study Prepared for the Corporate Law Policy Directorate, Industry Canada, in Industry Canada Consultation Papers on Business Insolvencies, online: <[http://strategis.ic.gc.ca/epic/internet/incilppdc1.nsf/vwapj/unpaid_ws.pdf/\\$FILE/unpaid_ws.pdf](http://strategis.ic.gc.ca/epic/internet/incilppdc1.nsf/vwapj/unpaid_ws.pdf/$FILE/unpaid_ws.pdf)>. On the basis of data from 94 business bankruptcies in 1991, this study reported that employees received an average of only 7 percent of their unsecured wage claims.

64 The secured claim for unpaid compensation is found in sections 81.3 (for bankruptcies) and 81.4 (for receiverships) of the *BIA*, while the federal guarantee is in the *Wage Earner Protection Program Act*, SC 2005, c 47, s 1.

65 See discussion of this issue in note 33, *supra*.

An exception to those dismal odds arises when an employer has set aside funds to cover its expected future costs for post-retirement benefits. If the employer has effectively transferred those funds to a third party (such as an insurance company) or has put them into a trust fund, they will not form part of the estate to be liquidated and will not be distributed among creditors under the *BIA* scheme of priorities.⁶⁶ In such a case, the post-retirement benefits will be secured to the extent that the amount set aside is sufficient to fund those benefits. If it is insufficient, the retirees' claims for any shortfall will form part of the pool of unsecured claims mentioned above.

In short, creating a trust or an insured arrangement to pre-fund future retiree benefits will enhance the security of those benefits in a liquidation proceeding, with the degree of enhancement being dependent on the adequacy of the funding model used to calculate the employer's contributions to the fund. In this sense, the situation is similar to that of pension benefits, although there are some special provisions applicable to pension claims in insolvency legislation.⁶⁷

(b) Liquidation – Pension Benefits

A liquidation proceeding will put an end to the accrual of any benefits for active employees, and will thus leave them with a smaller pension benefit on retirement. However, the security of accrued pension benefits is significantly increased by the legislated requirement that the employer pre-fund those benefits by making contributions to the pension fund as the benefits accrue.⁶⁸ In addition, the pension

66 Section 67 of the *BIA*, *supra* note 60, exempts property held in trust for any other person by the bankrupt from inclusion in the amounts available for distribution to creditors under the Act, and transfer of funds to a third party extinguishes the claims of the bankrupt employer's creditors to those funds.

67 The biggest factor affecting the adequacy of the pre-funding of non-pension benefits is the tax treatment of contributions and investment income in such funds, which discourages extensive pre-funding. See the discussion of employee life and health trusts, *supra* text accompanying notes 51 to 53.

68 The Ontario *Pension Benefits Act*, *supra* note 57, s 55, imposes a general obligation to provide enough funding to cover the benefits. This obligation is supplemented by the *Pension Benefits Act Regulation*, RRO 1990, Reg 909, ss 3-6.04, which set out a detailed regime of obligatory actuarial calculations of the amounts required to fund the benefits, periodic checks on the adequacy of the funding, and a requirement of additional payments if those checks disclose a shortfall in funding.

fund must be held in trust or be transferred to third parties, thus protecting it from the claims of the employer's creditors.⁶⁹ However, as in the case of pre-funded non-pension benefits, the degree of security depends on the adequacy of the assets in the fund to pay for all of the promised benefits. Pension legislation requires that a final calculation be made of the liabilities owed and the value of the assets in the fund, with the employer being liable to make up any shortfall in the assets ("wind-up liability").⁷⁰

There are two important points to note here. First, the scheme for regulating the funding of pension benefits is an example of a provincial legislative attempt to overcome the insecurity of post-retirement benefits caused by the unsecured nature of the claim in insolvency and the paramountcy of federal insolvency law. Second, it is the intervention of another federal statute — the *Income Tax Act* — which in part limits the effectiveness of the provincial scheme. Numerous provisions of the income tax regime impose maximum limits on pension contributions, and on asset values in pension funds that appear to be in excess of the amounts needed to fund the promised benefits. Those provisions have gone so far as to suspend employer contributions if the maximum is exceeded.⁷¹

In a liquidation proceeding, claims of the pension fund for arrears of any of the monthly contributions the employer was obliged to make for the normal cost of accrued pension benefits are given priority by the *BIA* over the claims of other creditors, including secured creditors.⁷² This secured claim was the result of amendments

69 *Pension Benefits Act*, *supra* note 57, s 22(6), and *Pension Benefits Act Regulation*, *supra* note 68, s 54. For a more detailed description of these protections, see Ronald B Davis, *Report for the Ontario Expert Commission on Pensions No. 10: Protecting the Pension Fund* (Toronto, 2007) at 79.

70 *Pension Benefits Act*, *supra* note 57, s 70(1) (obligation to file report) and s 75(1) (obligation to make up shortfall).

71 The federal government has announced its intention to amend income tax legislation to increase the maximum surplus from 10 percent of assets to 25 percent: "Minister of Finance Modernizes Federal Pension Framework," 2009 Backgrounder, online: <http://www.fin.gc.ca/n08/data/09-103_1-eng.asp> .

72 Sections 81.5 and 81.6 of the *BIA* provide for a statutory secured charge over the employer's assets that ranks ahead of all other secured claims except certain other statutory secured charges in the *BIA*. See David Baird & Ronald Davis, "Labour Issues" in Anthony Duggan & Stephanie Ben-Ishai, eds, *Canadian Bankruptcy and Insolvency Law* (Markham, Ont: LexisNexis, 2007) 67.

to insolvency legislation enacted and brought into force in the period 2005-2009. However, arrears of contributions required to make up any deficiency disclosed by periodic checks of the funded status of the plan (often called “special payments”), and any wind-up liabilities calculated on the termination of the plan, were not included in the amendments providing for this statutory secured charge under the *BIA*. The amounts of these latter two types of shortfall are likely to be much larger than the normal cost contribution arrears.⁷³

Do the policy considerations that apply to these amounts differ? Elsewhere, I have argued that the rationale for raising the priority of contribution arrears (including arrears of special payments) is distinct from that for raising the priority of any wind-up liabilities existing at the time of insolvency, based on the different reasons for the existence of the arrears and the wind-up liability as well as on the different incentives created by a priority change. I suggested that contribution arrears and arrears of special payments are the result of a deliberate decision not to pay amounts owing pursuant to a statute when payment is due, and the effect of such a decision is to favour non-pension creditors who receive a preference in the form of payments made to them to keep the business going. Granting a post-insolvency secured claim for these arrears diminishes the incentive to grant such preferences to non-pension creditors. In contrast, a wind-up liability does not result from a deliberate decision, but from the fact that an actuary’s predictions of future investment returns or wage levels were inaccurate. As there is no element of deliberate action in the case of a wind-up liability, and no attempt to privilege other creditors, the policy rationales for giving higher priority for arrears do not exist.⁷⁴ Yet the recent amendments differentiated between arrears of normal cost contributions and arrears of special payments required to eliminate funding shortfalls without any explanation for the difference in

73 For example, in the *AbitibiBowater* insolvency proceeding, the employer had a pension deficit of \$960 million. See *Re AbitibiBowater*, File No 500-11-036133-194, 4 May 2010 (Qc SC) (unreported) [unofficial English translation]. In *Re Timminco Ltd*, 2012 ONSC 506, [2012] OJ No 472 (QL), the normal cost contributions for a pension plan were \$9,125 per month, while the special payments were \$41,710 per month.

74 Ronald B Davis, “A Case of Constitutional Apples and Oranges: A Functional Comparison of Pension Priority and Benefit Guarantees in the U.S., U.K. and Canadian Insolvency and Pension Law Regimes” (2009) 18 *Int’l Insolvency Rev* 135 at 145-146.

treatment, even though both types of arrears involve the same type of deliberate preference for non-pension creditors.

The case for increasing the priority of wind-up liabilities must face the concern that such a change would have a profound effect on credit-granting decisions. I have summarized this concern as follows:

... the volatility of pension shortfalls ... make[s] any credit-granting decision uncertain because of the unknown dimensions and probability of the credit risk involved in a defined-benefit pension fund. When a financial institution considers granting credit to a business, it tries to assess the risk that the loan will not be repaid in full. The degree and probability of that risk will determine whether, how much and at what interest rate the loan will be made. While normal cost pension contributions typically are a known cost of the business that will increase only as the workforce expands, a pension shortfall is the result of a complex interplay of internal and external economic forces that yield unpredictable results. If a shortfall were given priority over the secured claims of financial institutions in insolvency proceedings, these institutions would have to charge higher interest and would tend to lend smaller amounts to firms with defined-benefit pension plans in order to protect themselves from the unpredictable risk that giving priority in payment to a pension shortfall would create to their security.⁷⁵

The scheme of distribution in the *BIA* is challenged by clauses in provincial pension benefits legislation which (if effective) would raise the priority of pension benefits and thereby make them more secure. One such clause is a “deemed trust” provision, which deems an amount equal to both normal cost and special payment contribution arrears to be held in trust by the employer until it is transferred to the pension fund.⁷⁶ A second deemed trust provision deems an amount equal to any employer contributions accrued to the date of the plan’s termination, but not yet due under the legislation, to be held in trust by the employer pending transfer to the pension fund.⁷⁷ In the *Indalex* case, a majority of the Supreme Court of Canada interpreted this provision as applying to any wind-up liabilities on termination.⁷⁸

75 Ronald B Davis, *Is Your Defined Benefit Pension Guaranteed? Funding Rules, Insolvency Law and Pension Insurance*, IRPP Study No 16 (Montreal: Institute for Research on Public Policy, 2011) at 16, online: <http://www.irpp.org/pubs/IRPPstudy/IRPP_Study_no16.pdf>.

76 *Pension Benefits Act*, *supra* note 57, s 57(3).

77 *Ibid*, s 57(4).

78 *Sun Indalex Finance LLC v United Steelworkers*, 2013 SCC 6, rev’g *Re Indalex Ltd*, [2011] OJ No 1621 (QL) (CA).

If these deemed trusts are recognized as amounts held in trust by the employer in the insolvency proceeding, the *BIA* will exclude any contribution arrears and wind-up liabilities from the amounts available for distribution to the employer's creditors.⁷⁹

However, a number of court decisions have interpreted those *BIA* provisions as applying only to those trusts which meet the common law requirements for the creation of a trust, and have found that these requirements are not met by a "deemed trust," at least where the specific subject-matter of the trust cannot be identified.⁸⁰ Another provincial statutory pension benefits provision declares that the plan administrator has a security interest in the form of a lien and charge on the employer's assets, in the amount of the deemed trust.⁸¹ However, this claim to a secured charge was rejected by the Ontario Court of Appeal in 2007 on the ground that the contributions were owed to the pension fund and not to the plan administrator, and the definition of a secured creditor under the *BIA* requires that in order to be a secured charge, the charge or lien must secure a debt owed by the debtor to the individual holding the charge.⁸² Since the arrears were owed to the pension fund, not the administrator, the lien and charge were not a secured charge under the *BIA*.⁸³

The final pertinent legislative provision is found in the Ontario statute on the creation of security interests in personal property. This provision grants a security interest in an employer's inventory and accounts for amounts subject to a deemed trust under pension legislation — an interest that ranks ahead of all other security interests in those assets.⁸⁴ In the *Indalex* decision, a majority of the Supreme Court of Canada recognized that this provision would "enable the Salaried Plan's members to recover from the reserve fund, insofar

79 *BIA*, *supra* note 60, s 67.

80 *British Columbia v Henfrey Samson Belair Ltd*, [1989] 2 SCR 24; *Re I.B.L. Industries Ltd* (1991), 2 OR (3d) 140, [1991] OJ No 12 (QL) (Gen Div). See *Edmonton Pipe Industry Pension Plan Trust Fund (Trustees of) v 350914 Alberta Ltd*, 2000 ABCA 146, [2000] AJ No 583 (QL), where the Court held that the common law requirements had been met.

81 *Pension Benefits Act*, *supra* note 57, s 57(5).

82 *BIA*, *supra* note 60, s 2, "secured creditor."

83 *Harbert Distressed Investment Fund LP v General Chemical Canada Ltd*, 2007 ONCA 600, [2007] OJ No 3296 (QL) at paras 20-30.

84 *Personal Property Security Act*, RSO 1990, c P.10, s 30(7).

as it relates to an account or inventory and its proceeds in Ontario, ahead of all other secured creditors.” However, it also held that this security interest could be subordinated to the interim financing charge priority granted by the court under the *CCAA* as a result of federal paramountcy.⁸⁵ Thus, while provincial legislation that attempts to provide additional security to the amounts owed to pension funds may have some effect outside of proceedings under the *BIA*, once those *BIA* proceedings have commenced, federal paramountcy will restrict the priority of pension plan claims to those amounts granted priority under the *BIA*.

Accordingly, the security of pension benefits in liquidation situations is far superior to that of non-pension benefits, but it remains dependent on the adequacy of the funding provided before insolvency, with little chance of obtaining significant additional funds from any distribution from the employer’s bankruptcy estate. The courts have a background concern that the constitutional division of powers not be undermined by the provinces’ use of their legislative power over property and civil rights to reorder the priorities for distribution set out in federal insolvency legislation.⁸⁶ Thus, the courts have rendered largely ineffective attempts by the provincial legislatures to increase the security of pension benefits during insolvency proceedings, with the result that claims for pension fund shortfalls have been treated as unsecured claims. Overall, in liquidation situations the insolvency regime can completely eliminate the security of non-pension retirement benefits, and it offers little additional security for pension benefits if the pension fund is in shortfall.

Nevertheless, the outcome of many insolvency proceedings is that the business is not liquidated but is carried on in some form once the proceeding is over. Whether post-retirement benefits fare any better in such situations depends on the answers to a number of questions which I will now consider: the matter of successor employer rights, the “disclaimer” of contractual obligations, the special status accorded to a collective agreement in insolvency proceedings, and the

85 *Sun Indalex Finance LLC v United Steelworkers*, *supra* note 78 at paras 48-60.

86 *Husky Oil Operations Ltd v Minister of National Revenue*, [1995] 3 SCR 453 articulates this concern, which was also touched upon but not decided in *Harbert v General Chemical*, *supra* note 83 at paras 34-36.

degree to which insolvency legislation permits the business to shed its “legacy costs.”

(c) Restructuring and the Fate of Post-Retirement Benefits

In this section, the assumption will be that some identifiable portion of the business continues to operate and to have employees both during and after the insolvency proceeding. These types of proceedings are often called restructuring proceedings because the debtor remains ostensibly in control, subject to some supervision by court-appointed officers. The goal of restructuring proceedings is to preserve as much value as possible for creditors, and to have a viable business emerge at the end of the process. The basic assumption is that businesses can generate more value if they remain in operation than if their assets are sold piecemeal.

The first question that arises is the identity of the employer after insolvency proceedings begin. The start of such proceedings often brings the appointment of certain officers of the court, who exert a greater or lesser degree of control over the operations of the employer. These officers can be a monitor appointed under the *CCAA*, a receiver appointed under the *BIA*, or a trustee in bankruptcy appointed under the *BIA*. They are all members of accounting firms, and their appointment can have different consequences for the identity of the employer.

For the sake of simplicity, I will proceed on the assumption that the pre-insolvency employer remains the entity responsible for fulfilling the enterprise’s obligations to employees.⁸⁷ In such cases, the factor that has the greatest impact on the security of post-retirement

87 The actual situation will vary depending on the particular circumstances. For example, in *Syndicat national de l’amiante d’Asbestos v Jeffrey Mines Inc* (2003), 40 CBR (4th) 95, QJ No 264 (QL), the Quebec Court of Appeal held that a monitor who exercised almost complete control over the corporation after the resignation of its directors was not the employer, because the monitor was merely acting in place of the absent directors. On the other hand, in *GMAC Commercial Credit Corp – Canada v T.C.T. Logistics Inc*, 2006 SCC 35, [2006] SCJ No 36 (QL), the Supreme Court of Canada held that the courts could not insulate a receiver and trustee in bankruptcy from being the subject of a successor employer application under labour relations legislation when the issue concerned the receiver’s actions while in control of an insolvent company that continued to operate during the insolvency proceeding.

benefits in the short term is the imposition of a stay of proceedings,⁸⁸ which prohibits anyone from bringing proceedings against the insolvent employer or its directors for breaches of its legal obligations. A stay is used regularly to permit the employer to stop making special payments into pension funds, and payments for other retirement benefits, on the reasoning that such payments add to the employer's financial stress without giving the employer any immediate advantage.⁸⁹ The rationale applied by the courts is that pension and benefit obligations arise from pre-insolvency services, and that it is necessary to justify any requirement that those obligations be met before the payment of other debts owed to unsecured creditors, as not all unsecured debts will be paid in full.⁹⁰ The courts recognize that provincial pension benefits legislation requires employers to make special payments, but they see federal insolvency statutes as giving them the jurisdiction to permit the employer to stop making such payments, and they will use the doctrine of federal paramountcy to override provincial statutory requirements which in their view contradict the objectives of the federal legislation.⁹¹

There is only bright spot in this rather bleak picture. The courts recognize that employers must continue to make pension contributions (and other benefit plan contributions) for post-insolvency service, because section 11.3 of the *CCAA* provides that nothing in a court-ordered stay prevents anyone from requiring immediate payment for services rendered. This provision has been interpreted as prohibiting an employer from unilaterally refusing to pay all amounts owed under a collective agreement for work performed after the insolvency proceeding began.⁹² In addition, though, the courts adopt the narrow interpretation that the employer is required to make such payments only with respect to services rendered after the insolvency commenced.⁹³

88 The stay is imposed by order of the court pursuant to the discretionary power granted to it by section 11.02 of the *CCAA*.

89 See *Re Collins & Aikman Automotive Canada Inc* (2007), 63 CCPB 125, [2007] OJ No 4186 (QL) (Sup Ct J) in respect of special payment pension contributions, and *Re Nortel Networks Ltd*, [2009] OJ No 2558 (QL) (Sup Ct J), aff'd [2009] OJ No 4967 (QL) (CA) in respect of other post-retirement benefits.

90 *Re Collins & Aikman Automotive Canada Inc*, *supra* note 89 at paras 48-54.

91 *Jeffrey Mines Inc*, *supra* note 87 at paras 72-89.

92 *Ibid.*

93 *Re Nortel Networks Ltd*, *supra* note 89 at paras 66-67.

In the result, except for normal pension cost contributions, the security of pension benefits will be eroded by a stay of the obligations to make other pension contributions during the period of the insolvency proceeding, as will the security of non-pension retirement benefits.⁹⁴ However, even more threatening to the security of non-pension retirement benefits in an insolvency proceeding is the fact that the *BIA* and *CCAA* allow debtors to disclaim contracts during a restructuring, with the agreement of the court-appointed insolvency officer or the court,⁹⁵ where it would enhance the prospects for a viable restructuring and would not cause significant financial hardship to the other party to the contract. If a contract for non-pension retirement benefits is disclaimed, the retiree receives a provable claim that would be dealt with in the final restructuring plan or proposal.

This provision allowing disclaimer of contracts would severely impair the security of any non-pension retirement benefits that did not have a separate source of funding. It would allow the employer to completely escape its continuing obligations, and would leave the retirees with a claim that is unlikely to compensate them for their entire loss. Even more disturbing is the fact that where retiree benefits are provided for in a collective agreement, they may not be disclaimed, and any changes to them must be negotiated with the union as part of the restructuring plan.⁹⁶ While this is good news for retirees whose benefits arose from unionized employment, there does not seem to be any reason for treating them more favourably in this regard than other retirees.⁹⁷

In contrast to non-pension benefits, the pension benefits of both unionized and non-unionized employees are not affected by the disclaimer provisions, because pension benefits are separately funded and

94 For more on how the failure to pay special contributions erodes everyone's pension benefits, see Ronald B Davis, "Time to Pay the Piper: Pension Risk Sharing, Intergenerational Equity and Dissonance with the Conceptual Paradigm of Insolvency Law in Canada" in Sarra, ed, *supra* note 51 at 183.

95 These provisions are found in section 65.11 of the *BIA* and section 32 of the *CCAA*.

96 Section 32(9) of the *CCAA* provides for an exemption from the disclaimer provisions, and section 33 provides that the collective agreement remains in force unless the union agrees to amend it. Sections 65.11(10)(c) and 65.12 of the *BIA* are to the same effect.

97 See Davis, "Doomed to Repeat History?" *supra* note 33 for a more detailed discussion of this result and a proposal to adopt the U.S. model in such situations.

because the employer can decide to terminate a pension plan at any time as long as it is willing to meet any shortfall liability on termination.

(d) Restructuring: Exit Plan

The end goal of the classic restructuring proceeding is the negotiation of a compromise plan or proposal that will permit the insolvent business to operate on a more financially sound footing. Of course, what this actually means is that all creditors' claims are compromised, and everyone receives less than what they were contractually entitled to receive. The plan is then put to a vote of the creditors by classes, and in each class it must be supported by a numerical majority of creditors and by those whose claims amount to two-thirds of the total value of all claims. In addition, the court must sanction the plan after the vote of creditors.

Retirees face severe obstacles in these compromise negotiations. They have very little to "trade" with other creditors, except the right to receive their benefits. In contrast, other large creditors who will have an ongoing relationship with the business can exchange present concessions for future benefits. Retirees whose benefits are provided for in a collective agreement may have an advantage in that their concerns can be "bundled" with those of active employees who do have something to trade.⁹⁸ However, it is perhaps too much to expect complete altruism from active employees, and if active employees' bargaining power is weak, retiree benefits may be the first to go.⁹⁹

98 For example, in the Chrysler Canada restructuring after the 2008 global financial crisis, Chrysler commenced a class action against its employees and retirees seeking a declaration that it could unilaterally terminate all retiree benefits except their pensions. The class action was settled by Chrysler's agreeing to fund an independent employee health trust with cash and promissory notes totalling approximately \$1.3 billion. *Chrysler Canada Inc v Gatens*, 2010 ONSC 5467, [2010] OJ No 4185 (QL).

99 In *General Motors of Canada v Abrams*, 2011 ONSC 5338, 93 CCPB 97, a class action similar to that by Chrysler, *supra* note 98, regarding the creation of a trust for post-retirement health benefits was (as the Court noted) settled on much less favourable terms than the Chrysler action, with only enough funds to cover 81 percent of the benefits being provided to the trust. The Court nevertheless approved the settlement over the objections of some retirees, because the alternatives (liquidation or a decision that the benefits had not vested) would have been much worse for the employees and retirees.

With respect to pension benefits, the pressure to compromise usually means that the employer seeks more time to make up the shortfall in the assets of the pension plan than the pension legislation allows. This departure from legislated norms began with the Air Canada restructuring in 2003 and has become so widespread that legislators are making provision for such extensions of time within pension legislation, entirely outside of insolvency proceedings.¹⁰⁰ It should never be forgotten, though, that giving an employer more time to make up a shortfall increases the risk (borne by the plan members) that the shortfall will be exacerbated rather than diminished.¹⁰¹

In short, insolvency is not a friendly place for post-retirement benefits. The availability of contract disclaimer means that the odds are close to zero that non-pension, non-unionized retiree benefits will remain secure. The odds are better for pension benefits, at least to the level provided by the available funding. However, care has to

100 In one example, the Ontario government announced in its March 2012 budget that it was extending solvency relief measures first announced in 2009, which allow an employer to take twice as long to pay off a funding deficit. See James Pierlot, "Ontario Budget Introduces Major Pension Changes," *Benefits Canada*, 29 March 2012, online: <<http://www.benefitscanada.com/pensions/governance-law/ontario-budget-introduces-major-pension-changes-26964>>.

101 Air Canada was able to obtain an extension for funding its pension deficits during its 2003 CCAA proceedings. The company reached an agreement with its unions for a 21-month pension funding moratorium in June 2009. "Air Canada Reaches Agreements with ACPA, CUPE," *Travel Press*, 17 June 2009, online: <<http://travelpress.com/PHP/news.php?sid=8323>>. It was reported to have a \$2.1 billion deficit in its combined pension plans as of January 2011. "Air Canada Provides Update of Solvency Deficit in Registered Pension Plans," *Canada Newswire*, 17 February 2011, online: <<http://www.newswire.ca/en/story/786927/air-canada-provides-update-of-solvency-deficit-in-registered-pension-plans>>. Shortly before this article went to press, Air Canada received another extension of its special pension funding arrangements for a further seven years. Over that period, Air Canada must contribute a minimum of \$150 million per year in special payments, with the goal of a minimum total special payment of \$1.4 billion. "Government of Canada Extends Air Canada's Pension Funding Arrangements with Tough New Conditions," Canada, Department of Finance, 12 March 2013, online: <<http://www.fin.gc.ca/n13/13-034-eng.asp>>. At the start of 2012, Air Canada's total pension deficit was \$4.2 billion. Bret Jang, "Ottawa grants Air Canada pension reprieve, imposes executive pay freeze," *The Globe and Mail*, 12 March 2013, online: <http://www.theglobeandmail.com/globe-investor/ottawa-grants-air-canada-pension-reprieve-imposes-exec-pay-freeze/article9700077/>>.

be taken not to burden a pension plan with unreasonable additional risks by including in the restructuring plan an extension of the time limit for funding any shortfall. As for retirees who had unionized jobs and whose non-pension benefits are set out in a collective agreement, those benefits are vulnerable in that they may be subject to compromise during insolvency negotiations; however, they are safe from the contract disclaimer provisions in insolvency legislation.

5. CONCLUSION

Clearly, the odds of collecting on the highly regulated pension benefit are higher than for any other post-retirement benefits. Relatively short vesting periods make the pension benefit a good bet because it cannot be wiped out by either the termination of an employee's employment or of the pension plan itself before the date of retirement. The next best odds are for non-pension benefits provided under a collective agreement. However, because non-pension benefits do not vest before retirement, as pensions do, they are less secure until an employee retires. They may be eroded in an insolvency proceeding, but the odds of their survival are better than those for non-pension benefits of non-unionized employees. As explained above, non-pension benefits of non-unionized employees are vulnerable to unilateral employer action before retirement, and even after they have "vested," they are unlikely to survive the employer's insolvency, with its accompanying power to disclaim contractual obligations. The only way to increase the security of these benefits would be to set up a form of pre-funding through a trust or insurance arrangement protected from the claims of the employer's creditors. Such an arrangement would also further intergenerational equity by requiring that the cost of benefits for current employees be met from current cash flow, which would be far preferable to creating an ever-growing debt overhang that will have to be borne by future generations.