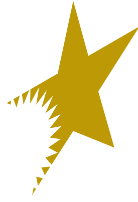

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LIABILITY IN THE ADMINISTRATION OF PENSION PLANS

September, 2006

by

Elizabeth J. Forster
416.593.3919
eforster@blaney.com

and

Allan Socken
416.596.2899
asocken@blaney.com

Blaney McMurtry LLP
2 Queen Street East, Suite 1500
Toronto, ON M5C 3G5
www.blaney.com

The recent publishing of the *Guidelines for Capital Accumulation Plans* ("CAP Guidelines") in May, 2004 has heightened the awareness of pension plan sponsors and administrators of their potential areas of exposure to liability. The CAP Guidelines do not have the force of law. However, they do, in many respects, reflect the existing legal obligations of plan administrators. As such, they provide excellent guidance as to how to comply with an administrator's legal obligations.

The liability of an administrator of a Capital Accumulation Plan that is a pension plan can arise under either statute or common law. The administrator's statutory obligations are set out in the applicable pension benefits statutes. Common law liability is set out in case law. Until recently, there was very little case law regarding the legal obligations of an administrator under a pension plan. However, litigation in this area has increased significantly in the last few years, as baby boomers become more concerned about their pension entitlements and as the general population becomes more aware of its legal rights.

The purpose of this paper is to summarize some of the areas of liability which should be of concern to pension administrators.

1. STATUTORY LIABILITY

In Ontario, the *Pension Benefits Act* sets out a number of obligations of plan administrators. The sections imposing obligations on plan administrators are:

> Section 19. The administrator of a pension plan must ensure that the pension plan and the pension fund are administered in

accordance with the Act and the regulations, and in accordance with the terms of the pension plan.

Section 20. The administrator of a pension plan must file an annual information return each year

Section 22 (1). The administrator of a pension plan must exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.

Section 22 (2). The administrator of a pension plan must use in the administration of the pension plan and in the administration and investment of the pension fund all relevant knowledge and skill that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess.

Conflict of interest

Section 22 (4). An administrator, committee or a board of trustees, a member of the committee, or of a pension plan must not knowingly permit the administrator's interest to conflict with the administrator's duties and powers in respect of the pension fund.

Responsibility for agent

Section 22 (7). An administrator of a pension plan who employs an agent must personally select the agent and be satisfied of the agent's suitability to perform the act for which the agent is employed, and carry out such supervision of the agent as is prudent and reasonable.

Section 22 (9). The administrator of a pension plan must not receive any benefit from the pension plan other than pension benefits, ancillary benefits, a refund of contributions and fees and expenses related to the administration of the pension plan and permitted by the common law or provided for in the pension plan.

Section 22 (11). An agent of the administrator of a pension plan must not take any payment from the pension fund other than the usual and reasonable fees and expenses for the services provided by the agent in respect of the pension plan.

Section 25 (1). The administrator of a pension plan must provide in writing to each person who will be eligible or is required to become a member of the pension plan;

(a) an explanation of the provisions of the plan that apply to the person;

(b) an explanation of the person's rights and obligations in respect of the pension plan; and

(c) any other information prescribed by the regulations.

Pension plan amendments Notice of Proposed amendment

Section 26. The administrator of a pension plan must notify members of any proposed amendment to the pension plan that would result in a reduction of pension benefits accruing subsequent to the effective date of the amendment or that would otherwise adversely affect the rights or obligations of a member or former member or any of any other person entitled to payment from the pension fund.

Section 27. The administrator of a pension plan shall provide to each member an annual written statement containing the prescribed information in respect of the pension plan, the member's pension benefits and any ancillary benefits.

Statement of benefits

Section 28 (1). The administrator of the pension plan must give each member who ceases to be a member of a pension plan, or to any other person who as a result becomes entitled to a payment under the pension plan, a written statement setting out the prescribed information in respect of the benefits, rights and obligations of the member or other person.

Duty re payment of contributions

Section 56. The administrator of a pension plan and the agent, if any, must ensure that all contributions to the plan are paid when due. If contributions are not paid, the administrator must notify the Superintendent.

Duty to pension fund trustees

Section 56.1. The administrator must give the persons who are prescribed for the purposes of subsection 22 (6) (trustee of pension fund) a summary of the contributions required to be made in respect of the pension plan.

2. COMMON LAW LIABILITY

Most of the cases involving the liability of pension plan administrators fall within one of the following three categories:

1. Negligent Misrepresentation
2. Delegation of Authority
3. Fiduciary Duty.

(a) Negligent Misrepresentation

To date most of the court actions against pension administrators have raised allegations of negligent misrepresentation. Administrators owe a duty of care to members of the pension plan to provide accurate and reliable information. Administrators may be liable for negligent misrepresentation not only when they give pension plan members inaccurate information, but also in situations where they omit to give employees pertinent information.

For example, in **Spinks v. R** (1996), 134 D.L.R. (4th) 223, an employee of the Crown claimed that he was given erroneous advice when his employer failed to advise him that he could have purchased prior service credits under his pension plan. The court allowed the employee's action, and held that a failure to give pertinent advice constituted "erroneous" advice within the meaning of the federal pension benefits statute. The court noted that administrators owe a duty of care to members of the plan to give full and complete information as members of the plan are completely reliant upon administrators for pension information. It also noted that an administrator may mislead a member by failing to divulge irrelevant information as well as by providing information that is inaccurate or untrue.

In **Deraps v. Labourer's Pension Fund of Central and Eastern Canada,** [1999] O.J. No. 3281 a union employee (who was represented by the pension plan as the employee to speak to on any pension issue) failed to explain to the wife of a pension plan member that in waiving a joint and survivor option under the pension plan, she would lose any right to the pension when her husband died. At the time the woman signed the waiver, her husband was suffering from terminal cancer. The Ontario Court of Appeal confirmed that the failure to advise the wife of the significance of signing a waiver was a misrepresentation and a breach of duty to exercise reasonable care. The member's widow was awarded damages in the amount of the pension earnings she would have received had she not signed the waiver.

In **Bratkowski v. Ontario Teachers' Pension Plan Board,** [1997] O.J. No. 2775 a representative of the Ontario Teachers' Pension Plan Board incorrectly advised a member of the plan that he could not buy back credit for his working experience in a business related field. Again, the court held the Board liable to the employee as the Board and its employees owed a duty of care to the member of the plan to provide accurate information about his entitlement.

In **Gauthier v. Canada** (2000), 185 D.L.R. (4th) 660, an employee took early retirement based on information from a pension administrator as to the amount of his pension. Eight years after he retired, the pension plan administrator discovered that he had miscalculated the amount of the employee's pension. The court awarded the employee damages in the amount of his lost pension income less what he had received by way of

pension benefits in the preceding eight years. The court believed the employee's evidence that had he been given the correct information, he would not have taken early retirement.

The court held that the administrator held itself out as having knowledge and expertise in this area and was required to exercise reasonable care and diligence to ensure that its representations were accurate. The court also said that it was no excuse to simply say that the miscalculations were made honestly.

In **Graham v. St. Anne-Nackowic Pulp Co.,** [2004] N.B.J. No. 148 a number of employees were terminated and notified of their options with respect to the pension plan. The pension administrator incorrectly advised the employees of the amount of pension income they would receive if they left their money in the pension plan. Based on these representations, the employees left the money in the plan. The employees later discovered that their pension income was going to be much less than they had been told. The court held that the administrator owed a duty of care based on a special relationship and that it had breached that duty by providing misleading and inaccurate information.

In **Allison v. Noranda Inc.,** [2001] N.B.J. No. 241, Noranda terminated an employee and offered him the option of a severance package based on salary continuance or a lump sum. The company did not advise the employee that if he elected the lump sum payment, his pension income would be reduced by 60% whereas if he elected salary continuance, his pension income would only be reduced by 30%. The court held that Noranda breached its duty of care to the employee, and stated:

> …A person may be mislead by a failure to divulge relevant information as much as by advice that is inaccurate or untrue.
>
> …
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> …An employer is under an obligation to make significant disclosure to enable an employee to make an informed decision in cases where the employer asks an employee to make an election with respect to options that impact significantly on pension benefits.
>
> …
>
> …A person who is under an obligation to disclose information to another, and fails to do so, cannot avoid liability for negligent misrepresentation simply by arguing that the latter was given the opportunity to seek advice from a third party.

While the **Noranda** decision deals with an employers' liability for misrepresentation, the same principles apply to pension plan administrators.

Finally, in **Nuxoll v. Inco Ltd.,** [1997] O.J. No. 4680, a former employee elected to take early retirement. One month after he retired, Inco offered a full pension plus $30,000.00 to anyone who wanted to take early retirement. The employee claimed he was induced to take early retirement before this announcement, and he sued Inco for the same benefits. The employee's claim was dismissed. The court was satisfied that the decision to offer the early retirement package was not made until after the employee had retired, and that the employee therefore failed to prove that the company had made any misrepresentation to him.

(b) **DELEGATION**

The CAP Guidelines and the *Pension Benefits Act* recognize that there are times when an administrator may choose to hire outside expertise to assist in the administration of a pension plan. However, an administrator may be held liable if the person to whom the work has been delegated is negligent.

In **Froese v. Montreal Trust Co. of Canada** (1996), 137 D.L.R. (4th) 725, an employer established a pension plan for its employees and appointed a trust company to hold the contributions to the plan in trust. The trust agreement provided that the trust company was not responsible for collection of pension funds. The company stopped making contributions to the plan. When the plan terminated, there were insufficient funds to meet the liabilities under the plan. An employee sued the trust company claiming compensation for breach of trust or negligence. The action was dismissed at trial, but allowed on appeal. The court held that:

> In view of the fact that payments were flowing out of the fund, a prudent administrator …was required to make inquiries of the Company and possibly of the actuary. ….The duty of care it owed to the beneficiaries did not permit it to do nothing when the plan was at risk.
>
> …
>
> …The defendant breached its duty of care to the beneficiaries when it failed to respond to the discontinuance of Company contributions.

The trust company was also held liable because it knew or ought to have known that the actuarial report on which the winding up of the plan was based, was flawed. It should not have paid out the funds on this basis.

In **R. v Blair,** [1995] O.J. No. 3111, members of a pension investment committee were convicted under Section 23(7) of the *Pension Benefits Act*. Their appeal from the conviction was allowed. The allegation against them was that they had failed to supervise the investment manager who had invested more than 10% of the pension fund in company stock to thwart a take over bid. The court found that the members of this committee did

not act as administrator of the pension plan. However, it is clear from the decision that had they acted as the administrator, criminal liability may have resulted.

(c) FIDUCIARY DUTY

In the last few years, there have been a number of cases involving allegations of breach of fiduciary duty against pension administrators. Fiduciary duty was defined by the Supreme Court of Canada as follows:[1]

> Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:
>
> 1. The fiduciary has scope for the exercise of some discretion or power.
>
> 2. The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
>
> 3. The beneficiary is peculiarly vulnerable or at the mercy of the fiduciary holding the discretion or power.

At common law, fiduciary duties include the following:

1. A duty of care - a fiduciary is expected to bring to the task at hand a level of ordinary skill and prudence that a person would use in dealing with their own property (this standard is lower than the standard prescribed by the **Pension Benefits Act**).

2. A duty of loyalty - a fiduciary has a duty of loyalty to those persons he or she is protecting and he or she cannot take into account considerations other than the best interests of those persons.

3. Conflict of interest - a fiduciary must not allow his or her personal interest to conflict with his or her duties as a fiduciary.

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[1] ***Frame v. Smith,*** [1987] 2 S.C.R. 99

4. Profits - a fiduciary cannot profit from his or her position as a fiduciary and must account for any secret or undisclosed profit.

5. Even hand - a fiduciary must hold an even hand between competing interests of those on whose behalf he or she is required to act.

The following is a summary of some of the recent case law with respect to the extent of a fiduciary duty.

In **Anova Inc. Employee Retirement Pension Plan v. Manufacturers Life Insurance Co.** (1994), 121 D.L.R. (4th) 162, the court dealt with a request by the pension plan administrator for the advice and direction of the court with respect to the disposition of a surplus in a pension plan. The pension plan provided that employees had no entitlement to the surplus. The surplus was used to fund an unreduced early retirement pension for a Vice President. It was also used to give certain employees/ shareholders enhanced pension benefits in return for a lower purchase price on the sale of the company. The court held that the payout to the Vice President was valid and in the best interests of the company. However, the payment to the shareholders/ employees was invalid. The court held that the pension funds were subject to a trust and the trustees and administrators had fiduciary obligations to the beneficiaries. Payment to the shareholders/ employees meant that other employees would suffer.

In **Hembruff v Ontario Municipal Employees Retirement Board,** [2005] O.J. No. 4667, the court allowed the appeal of OMERS against a judgment against it in favour of 8 members of the OMERS Pension Plan. The members had resigned in 1998 and withdrew the commuted value of their pension. Benefit enhancements to the plan were approved

effective January 1, 1999. The employees claimed they had been wrongfully deprived of these benefits based on negligent misrepresentation and a breach of fiduciary duty.

The court held that the enhancement had not been approved at the time of the employee's resignation. It also stated that a "failure to disclose accurate and complete information regarding a pension plan's existing terms and options can amount to an untrue, inaccurate or misleading misrepresentation. However, information on what a pension plan's terms potentially might be is not highly relevant." The Board had no obligation to disclose it. The duty of the board does not extend to providing information of potential changes. A finding of breach of duty of good faith would require evidence of bad motives such as self-interest, ill will or a dishonest purpose.

In **Toronto (Metropolitan) Pension Plan v Aetna Life Assurance Co. of Canada,** [1992] O.J. No. 2472 Aetna was hired by a pension plan to invest and administer pension funds in mortgage loans. Aetna invested some of the funds in a senior citizens residence which did not qualify under its agreement with the pension plan. The pension plan therefore sued Aetna for losses on the investment and was successful in its suit. The court held that Aetna owed a fiduciary duty to the plan's beneficiaries, and that it breached that duty by failing to abide by the terms of its instructions. The court also stated:

> In the case of an agent who is paid for his services, a higher standard is expected than in the case of an agent acting without record. The care, skill or diligence required is not merely that which the agent in fact possesses, but rather is such as is reasonably necessary for the due performance of his undertaking.
>
> . . .

> The defendants owed a duty of disclosure to their principles which duty to their principals, which duty has been described as a duty of full disclosure of everything known respecting the subject matter of the transaction which would be likely to influence the conduct of the principal.

In **Boe et al. v Alexander et al,** (1987), 41 D.L.R. (4th) 520 , a union established a pension plan for its members, and gave its trustees full authority to determine all questions of coverage eligibility and provision of benefits. The trustees accepted contributions from employees who were not members of the local union. The court held the acceptance of contributions from non-members was illegal and held that the trustees breached their fiduciary duty to members of the Plan. Although the trustees had discretion they were "not freed of their responsibility of carrying out the trust imposed on them in accordance with the terms of settlement".

3. SUMMARY

The CAP Guidelines provide good framework for all administrators. Following the guidelines will certainly serve to limit any exposure for liability.