

[A Pension Plan Deficit Can Put Your Corporate Reorganization Under The Spotlight](#)



The Superior Court recently authorized a class action in a case that could have a major impact on the way deficits in defined benefit pension plans are dealt with in the context of corporate reorganizations¹. The Court allowed a group of pension plan members to commence a class action against a company affiliated with their former employer and its directors personally for an amount in excess of \$65 million, which represents the aggregate amount of their pension plan termination deficiency and the amount of their loss of post-retirement benefits.

The facts date back to a corporate reorganization carried out in the fall of 2011 by an international conglomerate with plants in 15 countries. This reorganization of the conglomerate involved its Canadian operations in the home appliance business. Until then, the main economic activity was carried out by a single company whose production employees were unionized. In addition to unionized employees, there was also a group of managers and non-unionized employees employed by the same employer. There were two (2) defined benefit pension plans for these employees, one for unionized employees and the other for executives and non-unionized employees. The judgment does not speak to the precise financial state of the plans at the time of the reorganization, but we know that three years later in 2014, the plan for unionized employees was running a deficit of over \$35 million.

The purpose of the 2011 reorganization was to split the core Canadian economic activity and transfer part of it to a new corporation created for this reason. Thus, the company that operated the Canadian business and employed all the employees transferred all the assets from the commercial and administrative divisions and certain categories of employees (essentially, the management and non-unionized employees) to the new company for the price of \$1. The pension plan for these executives and non-unionized employees was also transferred to and assumed by the new company. The unionized production employees and their pension plan remained with the original Canadian company. It appears that following the reorganization, the original Canadian company was able to continue its operations without interruption for a period of 3 years during which inter-company services and charges were exchanged and billed through the newly created corporation to ensure business continuity. Both

companies had the same directors, senior managers and shareholders during the intervening period.

Later, in 2014, the original company that had kept the unionized employees in its employ along with their pension plans made a voluntary assignment of its assets under the *Bankruptcy and Insolvency Act*. This action had a drastic effect on the accrued benefits of unionized employees in their defined benefit pension plan and on retirees drawing pensions from this plan. At August 25, 2014, the plan had a substantial deficit, which became a debt that fell under the liabilities of the bankruptcy.

Generally, defined-benefit pension plans are considered to provide a fixed and stable pension to current and future retirees. It should be understood, however, that in the event of a financial failure that results in the termination of a pension plan of this nature, the pension credits and the pensions themselves may be seriously reduced.

The plaintiffs allege in their class action that the 2011 reorganization was a subterfuge by which the 2014 bankruptcy was orchestrated and the directors and their former employer's affiliate took actions to deprive the plaintiffs of the assets required to pay their pensions and benefits in retirement.

The Court concluded that the facts alleged were sufficiently precise and concrete to authorize the class action on three causes of action, namely: (1) the extra-contractual liability and abuse of right of the affiliate set up in 2011 and its directors under the *Civil Code of Québec*, (2) if the representative of the group of plaintiffs in the class action qualifies as a creditor in an oppression remedy under section 241 of the *Business Corporations Act*, and (3) whether the allegations of bad faith and abuse can give rise to an award of punitive damages by virtue of an unlawful and intentional infringement of the fundamental rights guaranteed by the *Charter of Human Rights and Freedoms*.

The case, of course, is only at the authorization stage of the class action, and the criteria in this regard in Québec are quite lenient. The defendants' potential defence under the principle that "decisions made to correct a company's financial situation do not generally constitute a fault" will be decided at trial on the merits of the case.

For the business community, practitioners and those who follow pension plans, this is a matter that must be closely monitored. Pension plans are often an issue in corporate transactions and the parties' disposition of them is fundamental. Similarly, for larger companies, internal reorganizations often take into account pension plans and other benefit programs.

Whether the defined benefit pension plan deficit was a major motivating factor in the 2011 reorganization and in the corporation's later reliance on insolvency laws is at the heart of the litigation and yet to be decided. We may question whether the result of the insolvency would be the same in the present legislative context following the enactment of Bill C-228, which Fasken has previously written about,² because defined benefit pension plan deficits are no longer unsecured debts in a bankruptcy. Nonetheless, as we have seen in this case, issues about pension plan deficits may spread and lead to litigation against persons and entities related to the insolvent corporation.

Footnotes

1. *Collerette c. MC Commercial inc.*, 2023 QCCS 4790. Leave to appeal denied on March 26, 2024.

2. Bill C-228: Death Knell for Private Sector Defined Benefit Pension

Plans? <https://www.fasken.com/en/knowledge/2022/12/bill-c-228-an-act-to-amend-the-bankruptcy-and-insolvency-act>

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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