I. GENERAL THRESHOLD ISSUES

1. THRESHOLD ISSUE #1 – TYPE OF TRANSACTION

Share Transaction
In a share transaction, the Buyer effectively steps into the shoes of the Seller and all of the pension and benefit plans remain unchanged – as do all of the associated obligations and liabilities.

Asset Transaction
In an asset transaction, the parties will negotiate the treatment of pension and benefit obligations and liabilities e.g. whether accrued liabilities will remain with Seller, whether accrued liabilities and associated assets will be transferred to Buyer etc.

These discussions will be impacted by a number of consideration including employment law considerations (e.g. whether non-unionized transferring employees will be offered employment on the same or similar terms and conditions of employment) and whether there are any unionized employees.

Mergers & Amalgamations
Mergers and amalgamations tend to be treated like share transactions for purposes of pension and employee benefit issues.

2. THRESHOLD ISSUE #2 – TYPE OF PLAN

Registered pension plans typically trigger the most significant issues regardless of the type of transaction, primarily because of they are subject to a number of legislative requirements and have the potential for the most significant cost liabilities.

Registered Pension Plans
- Registered under the *Income Tax Act* and pension benefits standards legislation
- General types of RPPs
  - Defined benefit plans
  - Defined contribution plans
  - Combination Plans – which have both DB and DC components

Registered Retirement Savings Plans
- Provide retirement savings and are tax assisted,
- Not subject to pension standards legislation.
• Should comply with “Guidelines for Capital Accumulation Plans” (“CAP Guidelines”) as a best practice.

**Supplemental Pension Plans**
- Provide retirement benefits in excess of those under registered pension plans.
- Not subject to any legislation.
- Funded or unfunded

**Multi-Employer Plans**
- Can provide retirement and/or health and welfare benefits
- Liability should be limited to set premium or contribution formula

**Health & Welfare Plans**
- Provide life, health, dental, disability coverages
- Can be fully underwritten by an insurer or self insured by the employer

**Retiree Benefits**
- Provides health and welfare benefits for retirees
- Can represent a significant legacy liability

3. **THRESHOLD ISSUE #3 – GOVERNING LAW**

When assessing the transaction, determine which pension, benefits or other laws apply. In Canada, for example, it must first be determined whether the affected employees and the pension and benefit plans are governed by federal or provincial laws.

The answer is based on the nature of the employer’s business. Businesses that are federally regulated include airlines, shipping and navigation, railways, banks, telecommunications etc. and these are governed by federal employment and pension benefits standards legislation.

For Canadian RPP the answer will also determine which regulator has principal supervisory authority over the pension issues arising in the transaction.

Even where a benefit plan is sponsored by the parent or other non-local business entity, there may be local employment law or human rights legislation which governs local employees participation under the plan.

4. **THRESHOLD ISSUE #3 – DUE DILIGENCE**

Due diligence is crucial whether acting for the Seller or Buyer. Attached as Appendix “A” is a typical Canadian pension and benefits due diligence document request list.

The Seller should complete due diligence before making any representations and warranties. The due diligence process may also be an opportunity to identify and resolve any issues related to the plan. This will be particularly important if plans or the underlying assets are being assumed by/transferred to the Purchaser.
The Purchaser will want to assess the types of plans provided by the Seller and determine how these plans are administered, the costs associated with the plans, outstanding member claims or regulatory issues.

Of particular importance in cross border transactions is determining whether the affected employees participate in multi-jurisdictional plans.

II. SPECIAL ISSUES RELATED TO REGISTERED PENSION PLANS

No “Safe Harbor” Rules
For all plans under which an employee has the ability to make investment decisions, there is the potential for liability related to the investment of assets.

Since there are no safe harbor rules in Canada, the due diligence review should confirm that the CAP Guidelines have been complied with for all defined contribution pension plans, group RRSPs, and any other capital accumulation plan.

Pension Standards Legislation Requirements
There are different sale of business provisions in each jurisdictions pension standards legislation. Generally, these provisions require that where a member of the Seller’s pension plan begins employment with the Buyer and participates in the Buyer’s RPP, there is a deemed continuation of employment for certain plan purposes (e.g. eligibility, vesting, locking in) regardless of whether there was a termination of employment at common law.

Asset Transactions – Complex Options Where RPP is Involved
When negotiating an asset transaction that involves an RPP, various considerations come into play. Some of the options are:

i) **Seller has RPP and Buyer does Not Provide One**

Seller will want to be indemnified against costs associated with wind up of plan (full or partial) if required to do so by regulators.

In addition, there is risk of common law termination/severance liabilities if affected employees reject offer of employer with Buyer because terms and conditions of employment are not substantially similar.

ii) **Buyer offers RPP, No Transfer of Assets/Liabilities**

Transferred employees participate in the Buyer’s plan on a prospective basis only.
Seller retains liability for all benefits accrued to closing date and transferred employees have a “frozen” benefit based on service and earnings as of the closing date.

There are a number of variations that can be explored including a “wrap-around” arrangement under which Buyer’s plan recognizes past service with seller for benefit calculation purposes, with an offset for the benefit payable under the Seller’s plan. This arrangement eliminates the potential shortfall for plan members that would otherwise exist, but the Buyer will have higher initial liabilities under it’s plan and may seek a purchase price adjustment to reflect this higher liability.

iii) **Buyer offers RPP, Accepts Transfer of Assets/Liabilities**

Seller retains no liability for any RPP benefits and transferring employees are kept whole.

Assets that can be transferred to cover assumed liabilities generally limited, under pension standards legislation, to the same proportion to which the Seller’s plan, as a whole, was funded.

Purchase price adjustments have to be negotiated to deal with any surplus or deficit that exists in plan.

There is an additional layer of purchase agreement provisions required to account for regulatory approvals that must be sought before transfer of assets can be completed. For example, since the Buyer will be taking on those assets, it will likely want to have some control over investment and administration of the assets during the time between closing and when the assets actually get transferred.

Significantly more involvement actuaries and other consultants throughout the entire transaction process, from due diligence to closing.

III. **PRACTICAL ADVICE**

There are different considerations that must be taken into account depending on whether acting for the Seller or the Buyer, particularly in an asset transaction. In a cross-border transaction, these considerations are guided by the common law and statutory principles related to employment law in Canada.

In Ontario, for example, all employment relationships are contractual and there is no automatic transfer of the contracts of employment in an asset transaction.

i) **Acting for the Seller**

When acting for the Seller, we want the Buyer to offer employment to all of the affected employees to avoid the costs associated with terminating employees who are not employed by the Buyer.
Generally, the Letter of Intent or Agreement of Purchases and Sale should require Buyer to:

- Provide the same or substantially similar pension and benefits to all of the transferring employees, conditional upon closing and
- Credit prior service with the Seller for all purposes

ii) **Acting for the Buyer**

When acting for the Buyer, in order to give the Buyer maximum flexibility, we try to have the Letter of Intent or Agreement of Purchase and Sale provide that the Buyer will provide to transferring employees the pension and benefit plans it deems appropriate, in its sole discretion.

iii) **Terms of the Agreement of Purchase and Sale**

When drafting or reviewing the Agreement of Purchase and Sale, all of the jurisdictions represented in the transaction must be covered.

In cross border transactions, we often have to “Canadianize” the terms of the agreement or else create stand-alone Canadian Plans provisions.

For example, if the definition of “Plans” is limited to ERISA plans, then the reps and warranties will likely not cover the pension and benefit plans of the other jurisdictions involved.

The representations and warranties, in particular, must either be broad enough to capture the plans in all jurisdictions or jurisdiction specific reps and warranties will have to be added.

iv) **Executive Compensation Issues**

The transaction will likely trigger change in control or other provisions in executive compensation arrangements that will accelerate or significantly increase liabilities.

For cross-border transactions, there is also the possibility that executives have transferred between the covered jurisdictions and may have pension and or other benefit entitlements in each of the jurisdictions which may or may not be guaranteed by the parent. All of these entitlements must be tracked and accounted for.

IV. **OTHER IMPORTANT STATORY CONSIDERATIONS**

For cross-border transactions, there is other non pension or employee benefit specific legislation that may apply to pension and benefit plans:

- **Labour Relations Legislation.** Governs unionized employees and has successor employer provisions.
Where there are unionized employees, in addition to the pension and benefit plans themselves, the applicable provisions of the collective agreement have to be reviewed to determine the full scope of the obligations under the agreement. If, for example, the collective agreement specifies that covered employees will participate in a specifically named pension plan, it is more likely than not that, unless an agreement can be made with the union, the Buyer will have to assume sponsorship of that plan from the Seller.

- **Human Rights Legislation.** Generally prohibits discrimination in employment, but makes exceptions for certain retirement and employee benefit plans where, for example, there is an actuarial basis for the discriminatory practice.

- **Employment Standards Legislation.** Generally requires continued participation in all employee benefit plans during periods of statutory leave (e.g. maternity, parental, family leaves etc.)
Appendix “A”

DUE DILIGENCE DOCUMENT REQUEST LIST

A typical Canadian due diligence pension and employee benefits document request will ask for the following:

1. Listing of all pension, bonus, deferred compensation, incentive compensation, stock purchase, retirement, supplemental retirement, supplemental unemployment benefit, productivity plan, severance benefits or termination pay, hospitalization, medical, dental, life insurance, disability or other insurance, salary continuation, vacation, profit sharing, union plans or golden parachute plans and all other employee benefit plans, programs, agreements or arrangements, whether written or unwritten, formal or informal, legally binding or not, maintained or contributed to or required to be contributed to by any person for the benefit of any employee or former employee or their dependents or beneficiaries, as well as the compensation practices and policies applicable to the employees of the Companies including practices and policies regarding vacations, sick leave, leaves of absence and all perquisites of employment, other than employee benefit programs mandated by statute (the “Plans”).

2. For each Plan, current and complete copies of the following:

   • each written Plan and all amendments thereto and a description of each unwritten Plan
   • if not contained elsewhere, a description of the category of employees eligible to participate, number of participants and annual expense data
   • Plan annual reports (including all schedules) and annual information returns (and any similar foreign equivalent) (pension)
   • recent annual actuarial valuation report or cost certificate for any Plan
   • if the Plan is funded, the Plan’s most recent funding, financial or information returns or statement (or foreign equivalent) in respect of each Plan
   • most recent summary Plan description, summary of material modifications and all other material employee communications, including employee booklets
   • any trust agreement, insurance contract or other funding or related agreement in relation to each Plan
   • insurance policies
   • evidence of registration with all applicable regulatory authorities
• all advance income tax rulings, professional opinions, and material correspondence, including without limitation, correspondence with regulatory authorities and internal memoranda relating to the Plans.

3. Information regarding any employees of the target who are currently disabled. (i.e., whether they have a waiver of premium on life insurance, person or entity currently responsible for these liabilities, and whether the Companies continue to provide other benefits to such disabled employees).

4. With respect to each Plan:
   • provide details of any outstanding claims, investigations and violations
   • if the Plan covers employees or dealers other than those of the business, provide details
   • if the Plan is a funded Plan, provide details of current funded status (i.e. amounts of surplus, unfunded liabilities, solvency deficiencies)
   • if the Plan is not a funded Plan, provide details regarding whether liabilities in respect of the Plan are reserved against on either business’s balance sheet, and extent of such liabilities
   • details regarding the total annual costs and expenses of the Plan
   • details regarding any retiree benefits, including information on the amount of post retirement benefit obligation liability as reflected on the either business’s balance sheet
   • details regarding ownership of reserves or experience credits under insurance policies
   • confirmation that all premiums have been paid under group policies; no disputes regarding claims and/or coverage
   • details of any benefits or compensation practices or policies already negotiated or announced, but not yet effective.

5. With respect to any pension Plan(s), have assets of the Plan been transferred to or from another Plan? If so, provide details of such transfer including but not limited to:
   • any complaints, claims, or actions outstanding, threatened, or anticipated
   • any fines or judgments pending or unsatisfied
   • evidence of approval of applicable regulatory authorities.
6. With respect to any pension Plan(s), has surplus been removed at any time? If so, provide details of such removal including but not limited to:

- any complaints, claims, or actions outstanding, threatened, or anticipated
- any fines or judgments pending or unsatisfied
- evidence of approval of applicable regulatory authorities.

The due diligence review also has to identify/confirm whether the Plans are sponsored by the local business entity or by the parent.