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Pension and Employee Benefits Law Briefing Note

R. v. Christophe (2009 ONCJ 586)

TRUSTEES CONVICTED OF REGULATORY OFFENCE

by Megan Kaneen

In a decision that stands as a cautionary note to trustees of pension and benefit plans, the Ontario Superior Court of Justice has found the Trustees of the Canadian Commercial Workers Industry Pension Plan (the "**Plan**") guilty of breaching the investment rules applicable to pension plans in Ontario.

1. THE FACTS IN *CHRISTOPHE*

The Plan's portfolio is valued at approximately $1 billion. Starting in the 1990's, the Plan made loans to various investment corporations, each of which was wholly owned by the Plan and each of which was associated with a specific investment property in the Caribbean. The Plan advanced money to the investment corporations, which in turn loaned money to RHK Capital Inc. ("**RHK**"), which loans were secured by specific Caribbean properties. In 2000, after RHK defaulted on its loans, the Plan's debt was restructured through PRK Holdings Ltd. ("**PRK**"). The investment corporations had full operating control of most of the Caribbean properties through PRK, and by the end of the year, investments in the Caribbean properties totalled more than $US 93 million (being roughly 9% of the portfolio). In 2002 and 2003 (the period in which the offences were alleged to have been committed), a further $US 12.5 million was loaned to the investment corporations (being roughly 10.5% of the Plan's portfolio).

2. QUANTITATIVE INVESTMENT LIMITS

The Ontario *Pension Benefits Act* requires that assets of the Plan be invested in accordance with Schedule III of the *Pension Benefits Standards Regulations, 1985* (Canada) ("**Schedule III**"). In turn, section 9 of Schedule III provides that a plan administrator may not directly or indirectly lend money of the plan equal to more than 10% of the total book value of the plan's assets in (a) any one person; (b) two or more associated persons; or (c) two or more affiliated corporations. Section 9, which is often referred to as the 10% rule, is designed to ensure adequate plan asset diversification and to limit a pension fund's exposure to risk in any one investment.

3. LIABILITY OF THE INVESTMENT COMMITTEE

(a) Application of the 10% Limit

As noted above, the initial loans made from the Plan were to investment corporations. Accordingly, the defendants argued that because investment corporations are exempt from section 9 of Schedule III, no offence was committed.

The Crown, however, contended that the Court should consider the investments at the PRK level rather than at the level of the investment corporations in determining whether the quantitative limits were exceeded. It argued that the Court should look beyond the formal investment structure to focus on where the investment risk actually lay, which was at the PRK level. The Court agreed with the Crown's argument that it was the advances to PRK that should be tested against the 10% rule.

Because PRK was not exempt from section 9 of Schedule III, and because the Investment Committee of the Board had advanced more than 10% of the book value of the Plan assets to PRK, the Court found that the Investment Committee members (who were all Trustees) had breached section 9 of Schedule III. It bears noting that the issue of whether to consider the quantitative limits offence at the PRK level was vigorously debated before the Court with the defendants arguing strongly that it should be the advances to the investment corporations and not to PRK that should be examined for the purposes of the 10% rule.

(b) What is the Relevant Time Period for the Offence?

The period of the offences was 2002-2003 as it was not until 2002 that the Plan became governed by the law of Ontario. If the Court was only to review the value of the advances made to PRK between 2002 and 2003, an offence was not committed because less than 10% of the book value of the Plan assets were invested in PRK during that period. However, the Crown argued, and the Court agreed, that the 10% rule requires an examination of the overall amount held in any one place. The Court held that if the prior advances are large enough that any further advance will result in the holdings exceeding the 10% limit, those further advances will constitute an offence. The Court noted that the purpose of the 10% rule is to ensure diversification of risk and that the defence argument on this point was inconsistent with the policy behind the rule.

(c) Due Diligence Defence

The defendants argued that their retention of auditors demonstrated their due diligence and should excuse them from liability. However, the Court found that there was no evidence that the auditors were asked to consider or monitor compliance with the 10% rule.

4. Liability of the Board of Trustees

(a) The Duty to Supervise

Section 22(7) of the Ontario *Pension Benefits Act* mirrors other pension regulatory statutes, requiring an administrator of a pension plan who employs an agent to be prudent and reasonable in its supervision of such agents. The Court examined the evidence to determine whether the Trustees had prudently and reasonably supervised the Investment Committee in respect of the investments that contravened the quantitative investment limits and concluded that the members of the Board of Trustees did not take any steps to fulfill their supervisory duties.

The Court noted that the Investment Committee could have been required to keep records and make presentations to keep the Trustees advised and informed, but the evidence revealed that no such recording of information or presentation of calculations had been given to the Board of Trustees. In addition, there was no evidence that the Board of Trustees had requested such information from the Investment Committee even though red flags should have been raised given that almost half of the monies advanced by the Plan went to PRK during the 2002-2003 period. Further still, the Board of Trustees did not ask the auditor to comment on the quantitative investment limits despite having retained an auditor for the Plan.

The Court held that the only inference that could be drawn from the evidence was that the Board "totally failed to supervise [the Investment Committee] with respect to the quantitative limits". Each Trustee was found guilty for the breach of supervisory duties.

(b) The Duty to Prudently Invest and Administer the Fund

The Crown had also laid a variety of charges against the Trustees and the Investment Committee members alleging a breach of the fiduciary standard of care required by the governing statute. These charges were related to the investments in the Caribbean properties, as well as to other investments. Although the Crown argued that the Trustees failed to meet the statutory standard of care in respect of these investment activities, it failed to adduce expert evidence to determine the standard that should be applied to the Trustees. The Crown argued that as the standard is one of ordinary prudence, an expert was not required for the Court to assess whether the Trustees fell below that standard. Ultimately the Court held that the evidence was complicated and that given the range of options open to an administrator, expert evidence was required to help determine whether the Trustees had failed to meet the statutory standard.

5. Conclusion

The consequences of the *Christophe* decision make it an interesting decision for all plan administrators in Canada. It is unusual for trustees of a plan to be charged with an offence under the regulatory scheme, and even more unusual to have findings of guilt. However, the obvious lessons to be learned from *Christophe* are that administrators must monitor the actions of their delegates, even if their delegates are also members of the board of trustees. Keep proper records and have a strong governance system in place to be sure that agents and delegates are monitored appropriately. The Court in *Christophe* did not hold the Trustees to an impossible standard, but rather a reasonable one, easily met by diligent trustees.

In terms of the quantitative investment limit in the *Christophe* case, the facts here were unique, as was the investment structure that created such difficulty for the Trustees. However, the decision does tell us that a reviewing court will be willing to look beyond the formal investment structure to apply the quantitative investment limits and will consider the policy and purpose of those limits when doing so.

We will be watching to see if this decision is appealed.

If you have any questions about the implications of this decision for your plan, please contact a member of our Pension and Employee Benefits Group.

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