1001_001.pdf

Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
416.362.2111 MAIN
416.862.6666 FACSIMILE

OSLER

Toronto

Montréal

Calgary

Ottawa

Vancouver

New York

Privileged & Confidential

September 20, 2016

Jacqueline Code
Direct Dial: 416.862.6462
jcode@osler.com

Jana Steele
Direct Dial: 416.862.6625
jsteele@osler.com

SENT BY ELECTRONIC MAIL

PRIVILEGED AND CONFIDENTIAL

Mr. Len Hatzis
Deputy Director, Treasury Board Secretariat Legal Services
Ferguson Block
77 Wellesley Street West
9th Floor
Toronto, ON M7A 1N3

Dear Sir:

Interpretation of *Auditor General Act*

You have requested our opinion regarding whether the Auditor-General of Ontario (the "Auditor General") is under a statutory obligation under the *Financial Administration Act* (Ontario) (the "FAA") and the *Auditor General Act* (Ontario) (the "AG Act") to audit the consolidated financial statements that form the basis for the public accounts of Ontario (the "Public Accounts") and to provide a report regarding this audit to the Government of Ontario (the "Government") prior to the deadline (the "Deadline") imposed under the FAA for the Government to table the Public Accounts before the Legislative Assembly (the "Assembly").

This opinion is requested by the Government in order to clarify the relationship between the Government's obligations under the FAA and the duties of the Auditor General under both the FAA and the AG Act.

Summary of Opinion

For the reasons set out below, it is our opinion that, although the matter is not free from doubt, the better view is that both the FAA and the AG Act require the Auditor-General to conduct the audit of the consolidated financial statements and provide the report, including her audit opinion, prior to the Deadline.

The FAA and the AG Act do not impose an express obligation on the Auditor-General to conduct the audit and provide her report prior to the Deadline. In our opinion, however, the wording of the applicable legislative provisions, interpreted in light of the statutory scheme as a whole, analogous case law and past administrative practice, provide the Government with a good argument that the Auditor-General is under an implied statutory duty to conduct the audit and provide the report, including her audit opinion, before the Deadline.

Scope of Review

In providing this opinion, we have reviewed:

- The FAA;
- The AG Act;
- Legislative history, such as Committee Reports;
- Samples of the Public Accounts; and
- Applicable legal authorities (case law and texts).

In addition, we have relied upon certain information provided in conversations with representatives of Government.

The consequences if the Auditor General is not complying with her statutory duties and the remedies or steps available to the Government in such circumstances are beyond the scope of this opinion.

Analysis

FAA Requirement to Table Public Accounts

Section 1.0.26(1) of the FAA provides that the Public Accounts for each fiscal year shall be prepared under the direction of the Minister of Finance and that the Public Accounts shall include, among other items, the consolidated financial statements of the Province for the fiscal year and the report of the Auditor General concerning his or her examination of the consolidated financial statements.[1]

1 *Financial Administration Act*, R.S.O. 1990, c. F.12, as amended, s. 1.0.26(2)(b) and (c) [FAA].

The FAA requires the Government, except in extraordinary circumstances, to submit the Public Accounts for each fiscal year to the Lieutenant Governor in Council on or before the 180th day after the end of the fiscal year (the Deadline). The Lieutenant Governor in Council is then required to lay the Public Accounts before the Assembly if the Assembly is in session or alternatively, to make them public and then lay them before the Assembly on or before the 10th day of the next session.[2]

As set out below, the terms of the FAA, the AG Act, analogous case law and past administrative practice support our opinion that the better view is that (a) the Auditor General owes an implied statutory duty under the FAA to audit the consolidated financial statements and provide her report prior to the Deadline; and (b) that the "report" that is required to be provided in accordance with the FAA must contain the Auditor General's audit opinion.

A. Obligation to Audit and Report Prior to the Deadline

i. Implied Duty under the FAA

Although section 1.0.26(1) of the FAA requires the Public Accounts to include the Auditor General's report concerning her examination of the consolidated financial statements, neither section 1.0.26(1) of the FAA nor any other provision of the FAA imposes an express obligation on the Auditor General to conduct the audit of the consolidated financial statements and provide her report prior to the Deadline. We have also found no case law interpreting section 1.0.26 of the FAA.

The applicable provision of the FAA is drafted in the passive voice ("The Public Accounts shall be prepared under the direction of the Minister of Finance… and shall include…the report of the Auditor General"). As a matter of statutory interpretation, the word "shall" is presumptively interpreted as imposing a mandatory obligation.[3]

In the absence of any statutory obligation under the FAA for the Minister of Finance to direct the preparation of the Public Accounts, it is our view that this language would likely be read as imposing a positive obligation on the Minister of Finance to direct the preparation of the Public Accounts.

Equally, in the absence of an express statutory obligation for the Auditor General to audit the consolidated financial statements and provide her report prior to the Deadline, it is our view that section 1.0.26(1) of the FAA would likely be read as imposing an implied obligation on the Auditor General to audit the consolidated financial statements and

2 FAA, s. 1.0.26(5).

3 *Re Manitoba Language Rights*, [1985] 1 S.C.R. 721 at p. 737.

provide the report regarding the examination of the consolidated financial statements before the Deadline. This implied obligation flows from the fact that the Public Accounts must include the Auditor General's report and the Government cannot table the Public Accounts without it.

It is our view that this implied duty arises not only from the purpose and wording of the FAA, but also by reference to the terms of the AG Act, which form part of the overall legislative scheme for ensuring that the Auditor General provides objective scrutiny of the Public Accounts.

ii. Obligations Under the AG Act

Section 9 of the AG Act imposes a statutory obligation on the Auditor General to audit, on behalf of the Assembly and in such manner as the Auditor General considers necessary, the accounts and records of the receipt and disbursement of public money forming part of the Consolidated Revenue Fund.[4] The Auditor General has further audit or audit oversight obligations in relation to an "agency of the Crown" that is not audited by another auditor,[5] Crown-controlled corporations,[6] and certain broader public sector institutions or organizations and other grant recipients.[7]

Although section 9 of the AG Act does not specifically mention the obligation to audit the Public Accounts, we understand that the Public Accounts subsume the audited financial information of the Government (including the Consolidated Revenue Fund) and the agencies and public sector bodies set out in sections 9. Section 9 is the primary section in the AG Act that imposes the duty on the Auditor General to perform the audit function for which the Auditor General is appointed. In our view, section 9 supports the position that the Auditor General is under a statutory obligation to audit the consolidated financial statements that will form the basis for the Public Accounts that must be tabled in accordance with the FAA.

Section 9 does not impose an express obligation on the Auditor General to conduct the audit by the Deadline or to provide a report regarding this audit. However, section 79 of the *Legislation Act* provides that "...duties that are imposed on a person shall be performed, whenever the occasion requires."[8] Although we have found no case law

4 *Auditor General Act*, R.S.O. 1990, c. A.35, s. 9(1) [AG Act].

5 AG Act, s. 9(2). "Agency of the Crown" is defined in section 1 of the AG Act.

6 AG Act, s. 9(3).

7 AG Act, s. 9.1.

8 *Legislation Act, 2006*, S.O. 2006, c. 21, Sched. F, s. 79.

Privileged & Confidential

interpreting section 79, the wording of this provision supports the conclusion that the Auditor General's audit duties under section 9 should be interpreted as being required to be performed prior to the Deadline because this is required in order for the Government to comply with its obligations under the FAA to table the Public Accounts by the Deadline.

The Auditor General is required under section 12 of the AG Act to report annually to the Speaker of the Assembly. This annual report shall be made after each fiscal year is closed and after the Public Accounts are laid before the Assembly. The deadline for such report is no later than the 31st of December in each year, unless the Public Accounts are not laid before the Assembly by that day.[9] In the annual report, the Auditor General shall express his or her opinion as to whether the consolidated financial statements of Ontario, "as reported in the Public Accounts", present fairly information in accordance with appropriate generally accepted accounting principles and the Auditor General shall set out any reservations he or she may have.[10]

The wording of section 12 of the AG Act provides further support for the position that the FAA imposes an implied obligation on the Auditor General to audit the consolidated financial statements and provide a report prior to the Deadline. The requirements under both subsections 12(1) and (3) depend on the Public Accounts having been prepared and tabled in accordance with the FAA. The Auditor General's functions under these subsections cannot be performed in a scenario in which the Public Accounts have not been tabled because the Government's obligations under the FAA – including the requirement to include the Auditor General's report in the Public Accounts – cannot be satisfied.

In our view, therefore, interpreting the FAA as imposing an implied duty on the Auditor General to audit the consolidated financial statements and provide her report prior to the Deadline is consistent with the provisions and the scheme of the AG Act. The contrary interpretation would arguably allow the Auditor General to frustrate the scheme that the Legislature has implemented under the FAA and the AG Act to provide objective scrutiny of the Public Accounts.

iii. Applicable Case Law

Although we have found no case law interpreting either section 1.0.26 of the FAA or sections 9 and 12 of the AG Act, there is precedent in other cases for interpreting a statutory provision as imposing an implied duty on a statutory actor where the legislative

9 AG Act, s. 12(1).

10 AG Act, s. 12(3).

scheme requires it. This case law, while not determinative when taken in isolation, provides general support for interpreting section 1.0.26 of the FAA as imposing an implied duty on the Auditor General to conduct her audit and provide a report before the Deadline.

For example, the Saskatchewan Court of Appeal has interpreted a statutory obligation to provide a claimant with a written decision to include an implied obligation to do so in a timely manner (i.e. sufficiently in advance of the expiry of a statutory appeal period). Such an implied obligation was held to arise from the scheme of the statute as a whole.[11] Similarly, under immigration law, an obligation by the Minister to process an application for refugee sponsorship has been held to include an implied duty to provide the necessary application to the potential immigrant.[12] Finally, child protection legislation has been interpreted to include an implied duty to investigate and present evidence to support a particular child placement.[13]

Moreover, although the Auditor General is not subject to an order of *mandamus*, it is instructive that, as a matter of administrative law, an order of *mandamus* – which compels a public official to perform a statutory duty – can be based on an implied duty.[14]

iv. <u>Past Administrative Practice</u>

Past administrative practice by the Auditor General, although not binding, can also be an aid to interpretation of a statutory scheme.[15] Administrative interpretation of a statute can be either express or implied.[16] The basis for accepting administrative practice as an aid to statutory interpretation is two-fold: (a) the administrator of a statute develops expertise

---

11 *Saskatchewan Government Insurance v. Schmidt*, 2008 SKCA 167 at para. 22.

12 *Nguyen v. Canada (Minister of Employment & Immigration)*, 1993 CarswellNat 92 (F.C.A.) at paras. 28 and 34-36.

13 *Children's Aid Society of Algoma v. R.M.*, 2001 CarswellOnt 2204 (C.J.) at paras. 63 to 65.

14 Brown & Evans, *Judicial Review of Administrative Action in Canada*, Vol. 1 (Toronto: Thomson Reuters, 2016 (looseleaf)) at para. 1:3220.

15 *Harel v. Quebec (Deputy Minister of Revenue)*, [1978] 1 S.C.R. 851 at p. 859; *Will-Kare Paving & Contracting Ltd. v. Canada* (2000), 188 D.L.R. (4th) 242 (S.C.C.) at p. 267.

16 Cote, *The Interpretation of Legislation in Canada*, 3rd Edition (Scarborough: Thomson Canada Limited, 2000) at p. 547 [Cote]; *Sullivan on the Construction of Statutes*, 6th Ed (Markham: LexisNexis, 2014) at para. 23.118 [Sullivan].

and perspective by administering legislation on a day-to-day basis; and (b) consistent administrative interpretation creates legitimate expectations and reliance.[17]

In our view, the Auditor General would likely be viewed as the "administrator" of the scheme established by the Legislature to scrutinize Government spending. This scheme includes both the FAA and the AG Act. As such, the Auditor General's historic interpretation of the obligations imposed on her under the FAA and the AG Act would likely be given some weight in ascertaining the interpretation of the applicable provisions under both Acts.

It is our understanding that since at least 1999, the Auditor General has audited the consolidated financial statements and provided his or her report prior to the Government's deadline for tabling the Public Accounts, as that deadline was prescribed at the relevant time.

The Auditor General's website also describes the Auditor General's role in performing an "Attest Audit" of the Public Accounts. The website indicates that after the audit, the Auditor General expresses an opinion on the financial statements of the province. The opinion is then reproduced in both the Public Accounts of the province and in the Auditor General's annual report.[18] While not determinative from a legal perspective, these public statements arguably demonstrate the Auditor General's own view that she is required to conduct her audit and provide her opinion prior to the Deadline so that the opinion can be reflected in the Public Accounts.

B. Obligation to Provide Audit Opinion

We have considered whether the "report" that is required to be provided under the FAA is required to include the Auditor General's audit opinion.

Section 1.0.26(1) of the FAA provides that the Auditor General is required to provide "the report of the Auditor General concerning his or examination of the consolidated financial statements of the Province." There is no express reference in this provision to an audit opinion.

The language of the FAA can be contrasted with the wording of section 12(3) of the AG Act. Section 12(3) expressly provides that the Auditor General, in her annual report, shall "express his or her opinion" as to whether the consolidated financial statements present fairly information in accordance with appropriate generally accepted accounting

17 Sullivan, above, at para. 23.111; Cote, above, at p. 549.

18 http://www.auditor.on.ca/en/content/aboutus/whatwedo.html: "The Kinds of Audits and What is Audited".

principles. Section 12(3) also contemplates that the Auditor General shall set out any reservations that he or she may have.

It could be argued that the explicit reference to the audit opinion in section 12(3), as contrasted with the reference to a "report" in section 1.0.26(1) of the FAA, means that the Auditor General is only required to provide her audit opinion in the annual report. Under section 12(1) of the AG Act, the annual report only has to be delivered after the Public Accounts have been tabled.

In our view, this is not the better interpretation of the FAA provisions. We have reviewed selected excerpts of the Canadian Auditing Standards (CAS), which indicate that an "auditor's report" is required to include the auditor's audit opinion.[19] Assuming that, as a matter of auditing standards, an audit necessarily entails an "auditor's report" and that an "auditor's report" is required to include the audit opinion, we believe the better view is that "report" in section 1.0.26(2) of the FAA would be interpreted to mean an auditor's report, including an audit opinion.

In our view, this interpretation is consistent with section 9 of the AG Act, which is the principal source of the obligation imposed on the Auditor General to "audit" the Public Accounts. Arguably, the Public Accounts have not been "audited" if the Auditor General has not expressed an audit opinion in respect of them.

Furthermore, the requirement to provide an audit opinion under the FAA prior to the Deadline for tabling the Public Accounts is consistent with the objectives of the FAA. If section 1.0.26(1) is interpreted as not requiring the Auditor General's report to include the audit opinion, the effect would be to require the Government to table the Public Accounts in an unaudited form. This appears contrary to the purpose for tabling the Public Accounts before the Assembly.

Finally, we understand that the Auditor General's own administrative practice – and the public statements on the Auditor General's website – indicate that the Auditor General's own view is that the audit opinion is required to be provided twice. It is required to be provided prior to the Deadline in order to include it with the Public Accounts and again in the annual report.

---

[19] Canadian Auditing Standards CAS 700: Forming an opinion and reporting on financial statements, paras. 20-45.

Although not free from doubt, therefore, it is our opinion that the better view is that section 1.0.26(1) of the FAA would be interpreted as requiring the Auditor General to provide a full auditor's report, including an audit opinion, prior to the Deadline.

Yours very truly,

Osler Hoskin & Harcourt LLP.

Osler, Hoskin & Harcourt LLP
JC/JS:

Letter to Len Hatzis re Surplus Rights in regards to Ontario and BC Plans - September 23 2016 (3).pdf

KOSKIE MINSKY

JUSTICE MATTERS

September 23, 2016

Murray Gold
Direct Dial: 416-595-2085
Direct Fax: 416-204-2873
mgold@kmlaw.ca

Via E-mail – len.hatzis@ontario.ca

Len Hatzis
Deputy Director
Legal Services Branch | Treasury Board Secretariat
77 Wellesley Street West, 9th Floor
Toronto ON M7A 1N3

Len

Dear Mr. Hatzis:

Re: Legal Opinion Concerning Surplus Rights in regard to the Ontario Teachers' Pension Plan, the OPSEU Pension Plan, the British Columbia Municipal Pension Plan, the British Columbia Public Service Pension Plan, the British Columbia Teachers' Pension Plan and the British Columbia Colleges Pension Plan
Our File No.: 162080

You have requested our legal opinion concerning the authorities of the sponsors and plan administrators of the above-captioned Plans with respect to ongoing surpluses in those plans.

In general, the sponsors of these pension arrangements are governments and sometimes other employer associations (the employer sponsor), and trade unions (the employee sponsor, or 'partner'). The 'plan administrators' of each Plan are either boards of trustees or, in the case of the OTPP, a board of directors. Plan administrators are independent entities that owe fiduciary obligations to the members of the Plan they administer.

The constating documents for each Plan set out the respective rights of the sponsors of each arrangement, and describe as well the powers of the fiduciary administrator of each Plan. In some cases, there is a clear differentiation between the powers of the sponsors and the powers of the plan administrators; in other cases, both the sponsors and the fiduciary administrator may have powers with respect to the same issue.

Below, we briefly review the relevant provisions of the constating documents for each of these Plan arrangements. Then, we summarize our opinions concerning the respective powers of the Plan sponsors and the fiduciary administrators in regard to surpluses arising under each arrangement.

This opinion is based on the documents referenced herein. In the event that there are any other constating documents with respect to any of the Plans described below, the conclusions expressed in this opinion may change and cannot be relied upon.

In general, the Plans' constating documents sometimes refer to "surplus", and other times to "actuarial gains" or "excess assets". The term "surplus" may refer either to an ongoing surplus, or to a surplus that is crystalized upon the termination and wind-up of a plan. For the purposes of this opinion, we treat these terms as being equivalent.

I. ONTARIO PLANS

A. *Ontario Teachers' Pension Plan ("OTPP")*

The OTPP is governed by:

(a) the *Teachers' Pension Act*, R.S.O. 1990, c.T.1 (the "TPA");

(b) Plan text for the OTPP (the "Plan text");

(c) an Agreement between Her Majesty the Queen in right of the Province of Ontario represented by the Minister of Education and Training (the "Minister") and The Ontario Teachers' Federation represented by its Executive (the "OTF"), dated July 15, 1991 (the "Partners' Agreement"), as amended; and

(d) a Funding Management Policy, attached as Appendix "A" to the Partners Agreement.

The TPA provides, at sections 5(1) and 5(1.1), that the Minister of Finance is required to pay from the Consolidated Revenue Fund contributions payable by the Minister of Education and provides that the total amount of such contributions "...shall not exceed the amount of contributions payable by or on behalf of active Plan members in respect of credited service for that year" (section 5(1.1)). The Plan text requires, at section 25, "that the Minister of Education contribute to the OTPP an amount equal to the required contributions made during the year before the preceding year by or on behalf of those members for whom the Minister is required to make employer contributions" (section 25(1)). Additional provisions of section 25 of the Plan text contain other provisions with respect to the Minister's obligation to make contributions to the OTPP.

The Partners' Agreement stipulates, at section 8 that the Partners are generally responsible for benefits and contribution rates:

> "8. The partners will be responsible for designing the plan structure, setting the benefits of the plan, developing new policy, deciding what the contribution rate will be, what the funding levels, margins and contingency reserves will be, making changes to the plan, this agreement or other plan documents, deciding whether or not to file a valuation more frequently than required by the *Pension Benefits Act,* appointing the Board, and defining the role of the Board."

By contrast, section 19 of the Partners Agreement sets out the responsibilities of the OTPP Board, and does not confer any authority on the OTPP Board to change benefits or contribution rates that are provided under the OTPP. This means that the OTPP Board has no authority to use ongoing surpluses either to improve benefits or reduce contributions. Only the partners to the OTPP have the authority to utilize ongoing surpluses.

The process governing the use of ongoing surpluses by th Partners is set out in the partners' Agreement. It anticipates that the OTPP Board will prepare an actuarial valuation of the OTPP every three years (section 73). The Partners are then required to bargain in good faith with respect to the disposition of any surpluses, or any adjustments to address Plan deficiencies (section 74). Section 77 of the Partners' Agreement anticipates that the Partners may appoint a mediator to assist them and sections 84 and 86 of the Partners' Agreement provide for the appointment of a Board of Arbitration to make a final and binding order with respect to the utilization of an ongoing surplus disclosed by the actuarial valuation. A Board of Arbitration is empowered to change contribution rates and/or benefits under the Plan, or to keep an amount of surplus in reserve, but is subject to certain limits that are set out in section 92.

B. *The OPSEU Pension Plan ("OPTrust")*

The OPTrust is governed by:

(a) a Sponsorship Agreement made as of April 18, 1994 between Her Majesty the Queen in right of the Province of Ontario as represented by the Chair of the Management Board of Cabinet ("Ontario") and the Ontario Public Service Employees' Union ("OPSEU") (the "Sponsorship Agreement");

(b) an Agreement and Declaration of Trust of the Trust Fund dated October 25, 1994 (the "Trust Agreement"); and

(c) OPTrust Plan text.

Section 56 of the Sponsorship Agreement addresses the use of actuarial gains disclosed under an actuarial valuation report prepared after March 31, 1997. Section 56(d) provides that once the 'Transferred Initial Unfunded Liability' of the OPTrust has been fully liquidated (we understand that it has been liquidated), then actuarial gains disclosed by a valuation of the OPTrust are divided into two equal pools, one of which "...shall be used for the benefit of Ontario, to be applied against any special payments required to be made by Ontario and thereafter to reduce Ontario's normal costs..." and the other pool is to be used by OPSEU for the benefit of Plan Members (section 56(c) of the Sponsorship Agreement). Section 56(d) also anticipates that OPSEU and Ontario may collectively bargain an allocation of gains that is different from 50/50. This means that each of Ontario and OPSEU may utilize their pools, subject to applicable legislation, without the agreement of the other party.

The Trust Agreement provides that only the Sponsors (Ontario and OPSEU) may amend the Plan (section 4.02), and further specifies that the plan administrator, i.e. the Board of Trustees of the OPTrust, "...shall have no power to amend either the Plan or this Agreement" (section 4.03). Accordingly, under the Sponsorship Agreement and Trust Agreement, the OPTrust plan administrator has no authority to utilize actuarial gains. Rather, that authority is conferred, by section 56 of the Sponsorship Agreement on the Sponsors, being Ontario and OPSEU. Moreover, the OPTrust Board of Trustees is not able to increase OPTrust benefits using ongoing surpluses, as only the Sponsors of the OPTrust are able to amend the Plan.

II. BRITISH COLUMBIA PLANS

In British Columbia, the Municipal Pension Plan, the Colleges Pension Plan, the Teachers' Pension Plan and the Public Sector Pension Plan were all converted from employer sponsorred pension plans to jointly sponsored plans in accordance with the *Public Sector Pension Plans Act*, S.B.C. 1999, c.44 (the PSPPA").

A. British Columbia Municipal Pension Plan (the "MPP")

The MPP is governed by:

(a) Municipal Pension Plan Joint Trust Agreement (consolidated), updated to September 30, 2015 (the "MPP Trust Agreement"); and

(b) Municipal Pension Plan Rules effective April 1, 2000 (current to November 19, 2015).

Under the MPP Trust Agreement, the following rules govern the Sponsors of the MPP and the Board of Trustees of that arrangement in regard to Plan surpluses:

The Board of Trustees may amend the MPP to utilize surpluses under section 11.5, provided that the conditions in 11.5(a) and (b) are met. These provisions permit the Board of Trustees to utilize Plan surpluses to improve Plan benefits for Plan members, provided that the surplus is sufficient to fund the benefit improvement "based on the open group of Plan Members and using a twenty-five year amortization schedule for the Plan actuarial excess to be used to fund the benefit improvement". Any benefit improvement made by the Board of Trustees cannot result in increased contribution rates nor can it create an unfunded liability. Any such improvement must also be consistent with the Trustees' fiduciary responsibilities. Within these parameters, however, the Board of Trustees of the MPP does have the authority to utilize Plan surpluses on an ongoing basis.

The MPP Partners may also amend the MPP using ongoing surpluses in accordance with section 11.3 of the MPP Trust Agreement. This section permits the Partners to direct the Board of Trustees to amend the Plan rules and requires the Board of Trustees to comply with that direction so long as three conditions are met: (a) the Partners first receive and consider the advice of the Board respecting the proposed amendment, (b) the proposed amendment is compliant with the Trustees' fiduciary responsibilities and (c) the proposed amendment will not result in the Plan failing to be funded in accordance with the PBSA going concern funding requirements. Significantly, the MPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the MPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

Accordingly, under the MPP, both the Partners and the plan administrator may utilize Plan surpluses by amending the Plan terms in regard to either or both of contribution rates and benefits.

It should be noted that, during a Transitional Period, the use of actuarial gains in the MPP is prescribed by Appendix "B" to the MPP Joint Trust Agreement. During the Transitional Period, all gains must first be used to eliminate unfunded liabilities. Then, actuarial gains must be applied to both (a) reconfigure employer contribution rates and (b) make specified benefit improvements. Employer contribution rates are to be reconfigured by eliminating the 'doubling' feature of employer contribution rates applicable to employees in certain Plan membership categories once they reach either 45 or 50 years of age (depending on the employment category). The transitional provisions prescribe the new base rates for each of the 5 categories of members in the BC, but also stipulate that employer contribution rates for two of the five categories will be increased beyond those base rates to reflect the differential current service cost for those two groups. The surplus implications of the reconfiguration of employer contribution rates are not predictable, and depend, at least in part, on the relationship between the 'base rates' under the transitional provisions and the actual rates being paid by employers at the time of the reconfiguration. Once the employer contribution rates are reconfigured and the specified benefit improvements are made, then 50% of any additional actuarial excesses must be used to fund a contribution rate stabilization reserve, and the balance of the actuarial excess must be transferred to the Inflation Adjustment Account to an aggregate total of $1 billion. The contribution rate stabilization reserve is intended to be shared on an equal (50/50) basis between Plan members and employers in order to maintain or reduce future contribution rates. Until such time as the objectives identified for the Transitional Period are fulfilled, there is no discretion left to either the Partners or the Board of Trustees to utilize ongoing MPP surpluses.

B. British Columbia Public Service Pension Plan ("PSPP")

The PSPP Joint Trust Agreement contains provisions regarding the authority of the Partners and the Board of Trustees to utilize ongoing surpluses that are equivalent to the provisions cited above with respect to the MPP. Accordingly, under the PSPP, both the Partners and the Board of Trustees have the authority, in the circumstances and subject to the conditions described in relation to the MPP, to utilize ongoing surpluses to reduce contributions or improve Plan Member benefits.

In this regard, section 10.3(c) of the PSPP Joint Trust Agreement expressly provides the Board of Trustees[1] with the authority to apply ongoing surpluses (the term used in the PSPP Joint Trust Agreement is "surplus assets") in one or more of the following manners:

1. transfer all or portions of surplus assets to the reserve established within the Pension Fund for stabilising contribution rates;

2. transfer all or portion of the surplus assets to the Inflation Adjustment Account;

3. apply all or a portion of the surplus assets to an equal reduction or elimination of Employer and Plan Member contributions to the Basic Account for a period of time;

4. apply all or a portion of the surplus assets to fund changes to the PSPP's benefit provisions provided that any change to benefits does not result in contribution rate increases, does not create or increase an unfunded liability, is consistent with the Trustees' fiduciary obligations and does not conflict the requirement (in s. 13.5) that, upon the termination and wind-up of the PSPP any remaining assets are to be equally shared between the employees and the employers.

At the same time, as is the case for the MPP, the Partners have the authority, pursuant to s.11.3 of the PSPP Joint Trust Agreement, to direct the Board of Trustees to amend the PSPP Plan rules and change either or both of the PSPP's contribution rates or benefits so long as the

[1] It is noteworthy that s. 14.2(c) of the PSPP Joint Trust Agreement stipulates that the Trustees are not acting in a fiduciary capacity when they make decisions that apply ongoing surpluses, and may take account of the financial and other interests of the party that appointed them.

Partners have received and considered the advice of the Board respecting both the cost and administrative impact of any proposed amendments, the amendment is not inconsistent with the Trustees' fiduciary responsibilities or any funding policy adopted by the board and the proposed amendment will not result in the PSPP failing to be funded in accordance with British Columbia's Pension Benefits Standards Act. Significantly, the PSPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the MPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

Section 15.4 of the PSPP Joint Trust Agreement provides that certain benefit improvements must be made using Plan surpluses that are identified in actuarial valuations dated March 31, 2001 and March 31, 2002. Unlike with respect to the MPP, the PSPP does not appear to have an indefinite 'Transitional Process' that commits all ongoing surpluses until the Transitional objectives are accomplished. Rather, the PSPP Trustees and Partners have had discretionary authority with respect to ongoing PSPP surpluses

C. British Columbia Teachers Pension Plan ("TPP")

The TPP is governed by:

(a) a Joint Trust Agreement made as of April 2, 2001 between Her Majesty the Queen in right of the Province of British Columbia as represented by the Minister of Finance and Corporate Relations (the "Government") and the British Columbia Teachers' Federation ("BCTF");

(b) the TPP Rules.

The Joint Trust Agreement contains provisions permitting both the Partners and the TPP Board of Trustees to amend the Plan rules using ongoing Plan surpluses (section 11 of the Joint Trust Agreement). These provisions are the equivalent of the MPP Joint Trust Agreement provisions regarding the same matters, as described above. In particular, it is significant that the TPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution for either Partner in the event that the they cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

As well, Appendix "B" to the TPP Joint Trust Agreement adopts special funding rules for a "Transitional Period" during which the Board of Trustees is directed to use surpluses to achieve specified contribution and benefit improvement outcomes. The transitional objectives for the TPP are not the same as for the MPP, although they entail both contribution rate changes and benefit improvements. In the case of the TPP, however, the transitional provisions build in a 4% reduction in the employer contribution rate from its July 1, 2010 level. As with the MPP, the Transitional Period is of indefinite duration, and only ends when the transitional objectives have been satisfied. During the transitional period, all ongoing surpluses are committed to the transitional objectives and no ongoing surpluses are available for discretionary reductions in contributions or surplus withdrawals.

D. *British Columbia Colleges Pension Plan ("CPP")*

The CPP is governed by:

(c) the CPP Joint Trust Agreement made April 4, 2011; and

(d) the CPP rules, effective June 22, 2012 (current to April 1, 2016).

The CPP Joint Trust Agreement allocates powers and authorities with respect to ongoing surpluses in the same way as the other BC Plans.

The Partners have the authority (s.14(2) of the Joint trust Agreement) to direct the Board to amend the Plan rules, and the Plan Board is required to amend those rules, provided that the Partners "first receive and consider the advice of the Board respecting both the cost and the administrative impact of implementing the proposed amendment" and the proposed amendment is not inconsistent with applicable law or the Trustees' fiduciary responsibilities. Significantly, the CPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the CPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses

Pursuant to subsection 14(4) of the CPP Joint Trust Agreement, the Board of Trustees is also permitted to amend the Plan rules and to utilize Plan surpluses so long as there is no resulting increased in contribution rates, there is no creation of, or increase in, an unfunded liability and the proposed amendment is consistent with the Trustees' fiduciary responsibilities. As with the other BC Plans, the Board of Trustees must use a twenty-five year period for the amortization of the Plan surplus.

Unlike the MPP, TPP and PSPP, the CPP Joint Trust Agreement has no transitional provisions that direct the Board of Trustees as to the application of ongoing surpluses during a transitional period.

III. SUMMARY AND CONCLUSIONS

A. *Ontario Plans*

OTPP - The governance arrangements with respect to the OTPP provide that the Partners that sponsor that arrangement, being the Minister of Education and the OTF, may utilize ongoing surpluses as they believe appropriate, subject only to the Ontario *Pension Benefits Act*, R.S.O. 1990, c.P.8 (the "Ontario PBA"). The Board of Directors of the OTPP, being the OTPP administrator for purposes of the PBA, has no authority with respect to the use of Plan surpluses. The OTPP Partners' Agreement anticipates that the Partners will, on a triennial basis, review the results of a preliminary actuarial valuation and determine whether and how they wish to adjust Plan benefits or contribution rates in view of any existing funding deficiencies or ongoing surpluses. The Partners are obliged to bargain in good faith with each other with respect to the disposition of ongoing surpluses, and may have recourse to mediation and final and binding arbitration should they not reach an agreement on their own. An arbitration panel may apply ongoing surpluses to improve benefits or reduce contributions, subject to the limitations set out in section 92 of the Partners Agreement.

OPTrust - The OPTrust governing documents also stipulate that it is the Sponsors of the OPTrust, being the Province of Ontario and OPSEU, who have the authority to utilize ongoing Plan surpluses. OPTrust's Board of Trustees, being the OPTrust administrator for purposes of the Ontario PBA, has no authority to utilize ongoing Plan surpluses. Pursuant to section 56(c) of the OPTrust Sponsorship Agreement, ongoing surpluses are divided into two equal pools (although the equal division may be altered through collective bargaining), and each of Ontario and OPSEU may utilize those pools without the agreement of the other party. In other words, Ontario may unilaterally determine the disposition of its pool, and OPSEU may unilaterally determine the disposition of its pool, subject only to Ontario's PBA. Neither OPSEU nor Ontario requires the agreement of the other party in order to utilize its allocated amount of ongoing surplus.

B. BC Plans

Ongoing Surpluses - All of the BC Plans follow the same pattern with respect to the authority to use ongoing surpluses. In the normal course, the Boards of Trustees of the BC Plans, unlike their Ontario counterparts, are permitted to utilize ongoing surpluses through the amendment of the Plan rules governing contributions and benefits, so long as the amendment of the Plan rules does not result in an increased contribution rate for employees or employers, does not create or increase an unfunded liability in the Plan and is otherwise compliant with applicable legislation and the Trustees' fiduciary obligations.

At the same time, each of the BC Plans also permits the Plan Partners to utilize ongoing surpluses by directing the Board of Trustees to amend the Plan rules. The Partners may so direct the Board of Trustees after receiving advice from the Board with respect to the costs of any Plan amendment and the administrative implications of such an amendment, and so long as the proposed amendment is compliant with law and with the Trustees' fiduciary obligations. However, unlike for the OTPP, the BC Plans' constating documents provide neither Partner with a right of recourse to a third party for a final and binding determination concerning surplus utilization.

Transitional Period - In addition, three of the four BC Plans we have reviewed (MPP, TPP and, for only two years, the PSPP) contain special rules governing the utilization of ongoing surpluses during a "Transitional Period". In these cases, the Transitional rules require that ongoing surpluses that emerge during the Transitional Period are to be used to restructure the employer contribution obligation and improve benefits. In the cases of the MPP and TPP, the Transitional Periods do not come to an end until all of the intended uses of ongoing surplus during the Transitional Period have been fulfilled. We are not currently aware as to whether the Transitional Periods for the MPP and the TPP remain ongoing, or have terminated. Until such time as the objectives identified for the Transitional Periods are fulfilled, there is no discretion left to either the Partners or the Board of Trustees to utilize ongoing MPP surpluses.

We trust that these comments have been of assistance to you. Should you have any questions in regard to them, please do not hesitate to contact the undersigned.

Yours truly,

KOSKIE MINSKY LLP

Murray Gold

MG:jn

Opinion dated September 20 2016.pdf

Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
416.362.2111 MAIN
416.862.6666 FACSIMILE

OSLER

Toronto
Montréal
Calgary
Ottawa
New York

September 20, 2016

Jana Steele
Direct Dial: 416.862.6625
jsteele@osler.com

Douglas Rienzo
Direct Dial: 416.862.5683
drienzo@osler.com

SENT BY ELECTRONIC MAIL

PRIVILEGED AND CONFIDENTIAL

Len Hatzis
Deputy Director, Treasury Board Secretariat Legal Services
Ferguson Block
77 Wellesley Street West
9th Floor
Toronto, ON M7A 1N3

Paul Kaufman
Counsel, Treasury Board Secretariat Legal Services
Ferguson Block
77 Wellesley Street West
9th Floor
Toronto, ON M7A 1N3

Dear Sirs:

Accounting Treatment of Surplus in the Ontario Teachers' Pension Plan

I. BACKGROUND

We understand the pertinent background facts to be the following:

1. The Ontario Teachers' Pension Plan (the **"OTPP"**) is a jointly-sponsored defined benefit pension plan established under the *Teachers' Pension Act* (Ontario) and is, subject to certain exceptions, required to comply with the *Pension Benefits Act* (Ontario) as well as the *Income Tax Act* (Canada).

2. The sponsors of the OTPP are the Province of Ontario (the **"Province"**) and the Ontario Teachers' Federation (the **"OTF"**) (collectively, the **"Sponsors"**).

3. We understand that as at March 31, 2016 the Province's Statement of Financial Position (the **"Public Accounts"**) includes a pension asset totalling $10.6 billion (the **"Pension Asset"**) related in part to an accounting surplus under the OTPP.[1]

4. The Office of the Auditor General has indicated that because the Province does not have the legally enforceable right to unilaterally access the assets of the plan, and in the absence of that right, because the Province does not have an agreement in place with the OTF as of March 31, 2016 with respect to how the surplus would be utilized such that it would provide a benefit to the Province, the Pension Asset as presented in the Public Accounts should be removed.[2]

You asked us to consider the processes pursuant to which the Province may utilize surplus assets in the OTPP in accordance with the Plan Documentation (as defined below), and to identify any considerations that might inform the expectations of the Province as a Sponsor regarding the basis upon which decisions will be made relating to surplus utilization. We are not providing an opinion on the proper application of the accounting standards to the present situation, as that is an issue for the accountants to address.

II. SCOPE OF OPINION

For the purposes of our opinion, we considered the following documentation (collectively, the **"Plan Documentation"**):

1. The Ontario Teachers' Pension Plan (the **"OTPP"** or **"plan"**);

2. The Agreement between Her Majesty the Queen in right of the Province of Ontario represented by the Minister of Education and Training and The Ontario Teachers' Federation represented by its Executive (the **"Partners' Agreement"**);

3. The Funding Management Policy (the **"FMP"**), which forms Appendix "A" to the Partners' Agreement; and

4. The Term Sheet agreed to by the Sponsors dated March 13, 2013 (the **"2013 Term Sheet"**) describing the implications of the Freeze Period (as defined below) on the FMP.

---

1 See letter from Bonnie Lysyk (Auditor General) to Greg Orencsak (Deputy Minister, Treasury Board) and Scott Thompson (Deputy Minister, Ministry of Finance), dated September 13, 2016. Part of the surplus relates to another pension plan; we understand that $10.1 billion relates to the OTPP.

2 *Ibid.*

We have also considered the following legislation/regulations:

1. The *Teachers' Pension Act* (Ontario) (the **"Teachers' Act"**); and
2. The *Pension Benefits Act* (Ontario) (the **"PBA"**) and the regulations thereunder (the **"PBR"**).

As per your instructions, we have not evaluated the ability of the Province to benefit from the *withdrawal* of surplus assets from the OTPP (although certain provisions of the FMP cited herein relate to both the withdrawal and other utilization of surplus). Rather, this opinion identifies the processes pursuant to which the Province may receive a financial benefit through the *utilization* of OTPP surplus (e.g., as a result of either a temporary reduction in the Province's contribution obligations (a contribution holiday) or through changes to the contribution formula that reduce the Province's contribution obligations).

We note that the concept of an *accounting* surplus is distinct from surplus identified in a funding valuation prepared in respect of the OTPP (a **"Funding Valuation"**). Where surplus has been identified in a Funding Valuation, the Plan Documentation provides the Sponsors with certain avenues pursuant to which the Funding Valuation surplus can be utilized. Any reference to "surplus" in this opinion, unless expressly stated otherwise, relates to the surplus identified by the actuary for the OTPP in a Funding Valuation and not to the accounting surplus identified in the Public Accounts. We understand that pursuant to the applicable accounting standards, the recognition of part or all of the accounting surplus on the Public Accounts depends on the ability of the Province to benefit from any surplus in the pension fund over the life of plan.

This opinion does not purport to draw any conclusions, express or implied, about the application of the accounting standards to the present circumstances; rather, it is solely intended to provide the Province with information concerning the legal framework governing the utilization of surplus under the OTPP so as to allow the Province's accountants to determine whether a related Pension Asset should appear on the Public Accounts.

III. SUMMARY OF OUR CONCLUSIONS

A brief summary of our material conclusions is set forth below (all capitalized terms are defined herein):

1. Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized. We note that the Sponsors have in fact entered into such an agreement, in the form of the Partners' Agreement (to which is appended the FMP).

2. The Plan Documentation (specifically the FMP) and applicable legislation allow for the Sponsors to utilize surplus in a variety of ways, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may receive a financial benefit through the utilization of surplus (the three "zones" describe different levels of surplus, a greater amount of surplus being required in order for the next "zone" to come into play):

    a. In the Restoration Zone, a Restoration Contribution Reduction may be approved once certain other requisite conditions have been met.

    b. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (i.e., a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

    c. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

    Notwithstanding the foregoing, under the FMP the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner.

3. Any enforceable legal right to obtain some value from any surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract. As the relevant provisions of the FMP require the Sponsors to agree upon the manner in which surplus is to be utilized, neither Sponsor has a legally enforceable right to unilaterally utilize surplus in the OTPP. As such, the provisions in the FMP that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus would not, in and of themselves, give rise to a legally enforceable right. What the Province does have, however, is a right to negotiate with the OTF the use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

4. Notwithstanding the foregoing, the Plan Documentation and applicable legislation give rise to the following considerations which may shape the Sponsors' expectation as to the basis upon which surplus will be utilized (and potentially lead to an expectation of equal sharing of the benefit of any surplus, at least over time):

    a. The Teachers' Act prohibits the total amount of the contributions payable by the Province (and other participating employers) to exceed the amount of contributions paid by or on behalf of active members in respect of credited service for the year (subject to certain exceptions for payment of a solvency deficiency and where there are insufficient cash and liquid assets in the fund).[3] In practice, this has resulted in 50/50 sharing of the regular contribution costs between the participating employers (including the Province) and plan members since the OTPP became jointly sponsored.[4]

    b. The history of surplus utilization after the OTPP became a jointly-sponsored plan and prior to the date that the FMP was established demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the financial benefits of surplus utilization, although surplus was not shared equally each time. Since the time the FMP was established, the OTPP has not reached the requisite level of surplus such that the Sponsors could negotiate its utilization under the Temporary Improvement Zone or Permanent Improvement Zone.

    c. The inability for either party to unilaterally require surplus to be utilized in a particular manner (subject to the OTF Call Right), and the requirement to negotiate and agree (or in the absence of agreement, arbitrate) presents the Sponsors with an equal opportunity to benefit from surplus utilization.

    d. One could argue that the obligation to bargain in "good faith" found in the Partners' Agreement may include the obligation to take into account the

---

[3] Teachers' Act, subsections 5(1.1), (3) and (7).

[4] We note that for the period from January 1, 2008 to December 31, 2008, the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the Year's Maximum Pensionable Earnings (**"YMPE"**) (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference. See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf

"sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

We note that it is our understanding that it is certainly the Province's expectation that the benefit of any surplus under the plan will in fact be shared equally between the Province and the members, over time.

5. In the event that the Sponsors cannot agree upon how surplus is to be utilized in the Restoration Zone, the Temporary Improvement Zone or the Permanent Improvement Zone, the matter can be submitted to an arbitration board of three arbitrators. Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, the arbitral award must meet certain mandatory conditions set forth in the Partners' Agreement. Among other things, the arbitral award is required to ensure that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners' Agreement).

   As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described herein: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

IV. FRAMEWORK IN THE PLAN DOCUMENTATION FOR SURPLUS UTILIZATION BY THE SPONSORS

1. Joint Sponsorship Plan Design and Cost Sharing

The OTPP qualifies as a "jointly sponsored pension plan" (**"JSPP"**) under the PBA, which has three material implications relevant to the present analysis:

1. Plan Governance – Under a JSPP, the employers (or any persons or entities who make contributions on behalf of the employers or represent the employers) and the members of the pension plan (or any representatives of the members) are jointly responsible for making all decisions about the terms and conditions of the pension plan and any amendments to the pension plan.[5]

2. Funding – The OTPP (and certain other prescribed JSPPs) are exempt from solvency funding requirements under the PBR.[6]

3. Cost Sharing – In a defined benefit pension plan which does not qualify as a JSPP, the employer is solely responsible for funding any going concern unfunded liability or solvency deficiency. Given that the OTPP qualifies as a JSPP, however, the PBA permits members to be required to make contributions in respect of any going concern unfunded liability or solvency deficiency.[7]

With respect to the cost-sharing principle referred to in #3 above, the Teachers' Act contains limitations on the contributions that the Province (and other participating employers) may make under the OTPP:

> 5(1.1) The total amount of the contributions payable by the Minister of Education and the employers who contribute under the pension plan in respect of any year shall not exceed the amount of contributions payable by or on behalf of active plan members in respect of credited service for that year.

Despite this general principle, under the Teachers' Act the Province is required to make additional contributions to the OTPP fund in the event that there are insufficient assets to make required payments out of the fund in any particular year.[8] The Province is also permitted to make additional contributions in respect of a solvency deficiency[9] (although, as noted above, solvency funding is not required under the OTPP). Notwithstanding that subsection 5(1.1) of the OTPP provides a *cap* on the Province's normal cost contribution obligation, rather than requiring 50/50 cost sharing, we understand that in practice there has been 50/50 cost sharing of the normal contribution cost under the OTPP since the OTPP became jointly sponsored (and for the majority of periods of time since the

---

5 PBR, subsection 3.1(1).

6 PBR, subsection 1.3.1(3).

7 See PBA, subsection 1(2) and subsection 55(4).

8 Teachers' Act, subsection 5(3).

9 Teachers' Act, subsection 5(7).

inception of the plan in 1917).[10] The plan text itself also provides for equal contributions, at the basic level (see sections 25(1) and 26(1)).

Currently, the Sponsors are also required to mutually agree upon how any plan deficits are to be addressed.[11] While not binding upon the Sponsors, the FMP indicates that deficits may be addressed through increases to the contribution rates, lowering the amount of indexation and/or other decreases in benefits.

Joint governance and cost sharing form two of the core features of the OTPP. Consistent with the equal sharing of risk permitted under the JSPP plan design, there is a requirement for decisions relating to plan design and plan amendments to be made jointly by the Sponsors. In this regard, the FMP requires the Sponsors to negotiate and agree upon decisions relating to surplus utilization. Accordingly, the Sponsors can be said to have equal *opportunity* to benefit from surplus utilization through the negotiation process.

2. Provisions in the Legislation and Plan Documentation Relating to the Utilization of Surplus

(a) *Pension Benefits Act*

While they do address surplus withdrawals (which are not addressed in this opinion), the PBA and PBR do not otherwise mandate any particular use of ongoing surplus that may arise in a pension plan, e.g. for benefit improvements or contribution holidays. One must therefore look to the Teachers' Act, and to the Partners' Agreement and FMP in order to determine how ongoing surplus is dealt with under the OTPP.

(b) *Teachers' Pension Act* (Ontario)

Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement (i.e., the Partners' Agreement) that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

---

[10] See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf As noted above, for the period from January 1, 2008 to December 31, 2008 the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the YMPE (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference.

[11] See, for example, Section 3.09 and 3.11 of the FMP.

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized.

(c) Partners' Agreement and FMP

While the Partners' Agreement itself does not address the utilization of surplus, the notion that the Sponsors have "agreed to establish a partnership" for the purposes of designing and administering the OTPP and managing the OTPP fund[12] is reinforced throughout the Partners' Agreement. For example, Section 4 of the Partners' Agreement provides that "[t]he partnership established by this agreement is intended to govern all aspects of the plan and the fund..." Similarly, Section 8 of the Partners' Agreement notes that the partners are jointly responsible for "designing the plan structure, setting the benefits of the plan, developing new policy, deciding what the contribution rate will be, what the funding levels, margins and contingency reserves will be, making changes to the plan, this agreement or other plan documents, deciding whether or not to file a valuation more frequently than required by the *Pension Benefits Act*, appointing the Board, and defining the role of the Board". The expectations of the Sponsors regarding how surpluses are to be utilized are presumably informed by the commitment noted above for the partnership established "to govern all aspects of the plan and the fund".

The procedures pursuant to which surplus may be withdrawn or utilized from the OTPP are identified in the FMP (which forms Appendix "A" to the Partners' Agreement).

We understand that the FMP was first established in March 2003, as a supplement to the Partners' Agreement, to provide a guidance framework to the Sponsors for decision-making when the OTPP has a funding surplus or shortfall. Prior to the creation of the FMP, the OTPP was considered fully funded (and surplus could be utilized, including through permanent benefit improvements) where assets equalled at least 100% of liabilities. The FMP is intentionally conservative through prioritizing the preservation of assets until a sufficient surplus "cushion" has been built to justify the utilization of surplus for contribution reductions or benefit improvements.

The FMP contemplates five "funding zones", each defined by a range. These funding zones provide the Sponsors with guidance as to when, based upon the funding level of the plan, it may be appropriate to (amongst other things) increase or decrease benefits, raise or lower contribution rates or conserve assets. The Sponsors always have the discretion, however, to agree to pursue a course of action that is not expressly provided for in the

12 Partners' Agreement, section 1.

FMP. As will be discussed below, the ultimate discretion of the Sponsors is reflected throughout various provisions of the FMP.[13]

In the context of plan surpluses, three funding zones are of relevance, each of which is discussed below in greater detail.

(i) Restoration Zone

Article III of the FMP (Funding Zone – Restoration) (the **"Restoration Zone"**) is the "fully funded" zone where assets equal at least the liabilities, determined on the basis set out in the FMP. It is our understanding that the OTPP is currently in the Restoration Zone.

In the Restoration Zone, benefits cannot be improved and contributions cannot be reduced until certain actions are taken to restore past benefit reductions or past contribution increases. In this regard, Section 3.06 of the FMP provides the following:

> Section 3.06 *Application of Restoration Basis Excess*: For purposes of clarity, excesses identified pursuant to Section 3.05 shall be applied in the following order, provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors:
>
> (a) *Bring Escalated Adjustments to 50% for Post-2013 Service*: to provide escalated adjustments up to 50% of the CPI adjustment in respect of service accrued after 2013 for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (b) *Bring Escalated Adjustments to 100%*: to provide escalated adjustments up to 100% of the CPI adjustment for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (c) *Restore Escalated Adjustments for Post-2013 Years*: to provide escalated adjustments to increase, to the extent possible, the current accumulated adjustment ratio for each year after 2013, to the current accumulated adjustment ratio for the period from 2010 to 2013, beginning with the first year in which current escalated adjustments were less than 50% of the run-rate escalated adjustments;
>
> (d) *Restore Escalated Adjustments for Post-2009 Years*: to provide escalated adjustments to increase, to the extent possible, the current

[13] See, for example, the opening words of Section 3.06 of the FMP, which section provides for various uses of surplus: "… provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors". See also Section 4.05 and 5.05.

> accumulated adjustment ratio for each year after 2009 to the run-rate accumulated adjustment ratio, beginning with the first year in which current escalated adjustments were less than run-rate escalated adjustments;
>
> (e) *Provide Benefit Increases or Contribution Rate Reductions*: to provide the following:
>
> (i) an increase in benefits, where the present value of current benefits is less than the present value of run-rate benefits,
> (ii) a reduction in contribution rates, where the present value of current contributions exceeds the present value of basic contributions, or
> (iii) a combination of (i) and (ii).

In summary, the Restoration Zone allows for surplus to be utilized to "restore" foregone indexation (Sections 3.06(a)-(d))[14] and then to either increase benefits to the "run-rate benefit" level (i.e., the long-term target level) or to lower contributions to the basic target rate (or a combination of these two options) (Section 3.06(e)). While the FMP contemplates that the actions will typically be taken sequentially (i.e., starting with Section 3.06(a) and ending with the actions in Section 3.06(e)), the Sponsors are required to first agree to the actions taken under Section 3.06 and have the discretion to apply the actions in a different order or to take different action (or to take no action to utilize the surplus).[15]

As noted, under Section 3.06(e), surplus can be utilized to reduce contribution rates "where the present value of current contributions exceed the present value of basic contributions" (the **"Restoration Contribution Reduction"**). We understand that in 2001 the Sponsors agreed to a 1.1% increase to both member/employer contributions (phased in over a three year period) to address a funding deficit in the OTPP and that the Restoration Contribution Reduction under Section 3.06(e) would permit these additional contributions to be eliminated, thus restoring contributions to the "basic" level.

The 2013 Term Sheet sets out an agreement between the Sponsors that is in effect from December 31, 2012 to December 30, 2017 (the **"Freeze Period"**), the terms of which are reflected in the FMP. Under Section 3.08 of the FMP, there are certain limits (relating to

---

14 This is achieved by first increasing go-forward indexing to 50% for the post-2013 service period, then to 100% on all post-2009 service periods and next, by restoring current pension amounts to a certain prescribed level starting with the years where indexing was less than 50% until all years of partial indexation are restored to the same level and then by restoring indexation to 100% for all service periods.

15 As noted above, pursuant to Section 3.06 of the FMP, "the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors..."

the funded status of the OTPP) on the ability to make escalated adjustments or to improve benefits pursuant to Section 3.06 during the Freeze Period.

As noted below, no action can be taken under the Temporary Improvement Zone (as defined below) or the Permanent Improvement Zone (as defined below) until all restorative actions under Section 3.06 of the FMP have been provided for (subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).

(ii) Temporary Improvement Zone

Article IV of the FMP (Funding Zone – Temporary Improvements) (the **"Temporary Improvement Zone"**) was added to the FMP in March 2015 and allows for: (i) temporary contribution decreases (a contribution holiday), (ii) surplus distribution, and/or (iii) benefit improvements, provided in each case that the plan's funding level reaches thresholds set out in the FMP.

We understand that in this zone the plan is considered well-funded and able to afford temporary changes, so long as they do not increase the long-term cost of the OTPP. Surplus cannot be utilized under the Temporary Improvement Zone until the Sponsors have provided for all of the changes specified in Section 3.06 of the Restoration Zone (again, subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).[16]

In all cases the Sponsors' prior agreement is required in order for there to be a temporary contribution decrease, a surplus distribution or a benefit improvement.[17] Where the Sponsors agree to a change that would result in surplus being distributed or utilized for a temporary benefit improvement, the Sponsors are required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any surplus distribution or temporary improvement of benefits that is reflected in the value of the liabilities."[18] We understand that this provision is a recognition of the partnership of the Province and the OTF, and requires the Sponsors to enter into an agreement addressing the possible value to be obtained by the Province where there is a decision to provide value to the members (but the provision is not a guarantee that such value will in fact be provided to the Province).

We note that, as a temporary measure, the OTF has "first call" rights on 100% of the surplus disclosed in valuation report with a valuation date after December 30, 2017, up to

[16] FMP, section 4.03

[17] FMP, section 4.05.

[18] FMP, section 4.06

certain amounts as set out in the FMP (the **"OTF Call Right"**).[19] The 2013 Term Sheet indicates that "[t]his is a one-time arrangement intended to compensate Plan members for absorbing 100% (rather than 50%) of funding shortfalls arising in the government initiated Freeze Period." In other words, this one-time opportunity to benefit from surplus utilization is directly linked to the asymmetrical assumption of risk by OTPP plan participants during the Freeze Period. In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Temporary Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[20]

To summarize, the OTF has a contractual right to the future utilization of surplus, up to the value of the OTF Call Right. OTF cannot utilize any surplus available in the OTPP under this negotiated right until the Freeze Period has ended (on December 30, 2017) and a valuation after such date identifies the existence of surplus available for utilization. In light of this negotiated right, surplus cannot be utilized under the Temporary Improvement Zone or the Permanent Improvement Zone (e.g., to cause a temporary or permanent reduction to contributions) until the OTF Call Right has first been satisfied. Once the OTF Call Right has been satisfied, the *status quo* under the FMP will be restored (i.e., the agreement of the parties will be required for any utilization of surplus). In other words, the OTF Call Right reflects a "one-time" agreement and is expressly "without prejudice or precedent for any future situation".[21] It is our understanding that the quantum of the OTF Call Right is not presently expected to be material.

(iii) Permanent Improvement Zone

Where the surplus reaches certain levels as set out in the FMP, Article V of the FMP (Funding Zone – Permanent Improvements) (the **"Permanent Improvement Zone"**) will apply. We understand that in the Permanent Improvement Zone adequate funding security is considered to exist to support permanent changes (either an improvement in benefits or a reduction in contributions).

Under the FMP framework, these changes can be introduced only once the Sponsors have already provided for the changes specified in Section 3.06 (i.e., no further action to restore benefits remains to be taken under the Restoration Zone), subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP.[22]

---

19 FMP, section 6.03.

20 See FMP, subsection 1.05(f) and sections 4.05 and 4.09.

21 2013 Term Sheet, paragraph 11(d).

22 FMP, section 5.03.

The Sponsors are required to mutually agree to any change made in the Permanent Improvement Zone. As in the Temporary Improvement Zone, where the Sponsors have agreed to a change which would result in an improvement to member benefits, the Sponsors would be required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any change in current benefits that is reflected in the value of the liabilities."[23]

In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Permanent Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[24]

3. History of Surplus Utilization

The history of OTPP surplus utilization from the time the OTPP became a jointly-sponsored pension plan[25] to the date that the FMP was established (in March 2003) demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the benefits of surplus utilization:

Valuation Date	Surplus/(Deficit)	OTF	Ontario Government	Surplus Remaining
1990	$(7.8 billion) unfunded liability	Increased contributions by 1% to 8.9%	Agreed to make a series of special payments to eliminate the unfunded liability and match increased contributions	Special payments considered an asset bringing the plan to a $0 surplus
1993	$1.5 billion	$325 million to offset social contract days	Eliminated special payments for $1.2 billion saving	$0
1996	$0.7 billion	$0.6 billion for benefit improvements and RCA contributions	N/A	$0.1 billion
1998	$6.8 billion	$2.2 billion for benefit improvements	$4.6 billion to reduce the value of remaining special payments	$0

23 FMP, section 5.05(b).

24 See FMP, sections 5.05 and 5.08.

25 The Partners' Agreement is dated July 15, 1991.

1999	$3.5 billion	N/A	$3.5 billion to reduce the value of remaining special payments	$0
2001	$6.8 billion	$6.2 billion for benefit improvements	N/A	$0.6 billion
2002	$1.9 billion	Sponsors agreed not to make any changes to benefits or contributions		$1.9 billion
Total		**$9.3 Billion**	**$9.3 Billion**	

* Source: Ontario Teachers' Pension Plan Board "Report on Funding" (April 2002)

Although surplus utilization prior to 2003 may not have been 50/50 each time, from 1990 to 2002 the aggregate value obtained by each of the Sponsors was equal. In certain instances where the Province received a disproportionate share of the financial benefits from surplus utilization, a commitment was made to the OTF that they would receive future surplus available for utilization. In 1998, $6.8 billion in surplus was utilized to cause a $2.2 billion benefit improvement and to provide the Province with a $4.6 billion reduction in the value of special payments owed by the Province. As part of this negotiation, the OTF and the Province agreed to allow future surplus to be utilized to eliminate the Province's remaining special payments (which resulted in $3.5 billion surplus being utilized in 1999 to reduce the value of the Province's remaining special payments) and a commitment was made for the next $6.2 billion in surplus to be available to OTF for benefit improvements (such surplus being utilized for benefit improvements in 2001).[26]

As noted above, the FMP was introduced in March 2003 to provide a guidance framework to the Sponsors when the OTPP has a funding surplus or shortfall. It is our understanding that there have been at least 2 material amendments to the FMP framework since its introduction. Below is a summary of the key funding decisions since the introduction of the FMP:

Year	Valuation Status and Key Decisions
2003	$1.5 billion surplus; no changes to benefits or contribution levels. Funding Management Policy adopted by plan sponsors.
2005	A preliminary $6.1 billion shortfall was resolved, leaving plan with a $0.1 billion surplus. Shortfall resolved with special contribution rate increases, totalling 3.1% of base earnings by

[26] See Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990", available at: https://www.otpp.com/documents/10179/765840/-/d4e2fea5-624d-420f-af15-e2daf9bc2711/Key+Funding+Decisions.pdf

	2009 for teachers, the Ontario government and other employers. OTF used the $76 million contingency reserve set aside in 2001 to reduce contribution rate increases for members in 2008.
2008	A preliminary $12.7 billion shortfall was resolved with the introduction of conditional inflation protection for pension benefits earned after 2009 and an increase in the basic contribution rate for members and the government to 9% from 8%. Employers agree to make special payments equal to any annual pension increases retirees forgo to a maximum of 50% missed inflation.
2009	A preliminary $2.5 billion shortfall was resolved primarily by assuming a slightly higher long-term rate of return on investments: yield on real-return bonds plus 1.5%, versus real-return bonds plus 1.4%. Other minor changes made to assumptions to reflect recent plan experience.
2011	A preliminary $17.2 billion shortfall was resolved with a 1.1% contribution rate increase (phased in over three years), slightly smaller annual cost-of-living increases for teachers who retired after 2009, and recognition of current contribution rate as the permanent base rate.
2012	$9.6 billion preliminary shortfall adjusted to reflect changes in mortality assumptions and impact of two-year freeze on teachers' salaries. 2012 shortfall resolved by making inflation protection for pension credit earned after 2013 fully conditional on plan's funded status and providing slightly smaller pension increases, beginning in 2014, for members who retired after 2009. These changes enabled the plan to assume a slightly higher discount rate. The changes left the plan with a $200 million surplus at Jan. 1, 2012.
2014	$5.1 billion preliminary funding surplus used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided each year since they retired. The surplus funds were also used to raise conditional inflation protection to 60% of the increase in the cost of living for the portion of retirees' pensions earned after 2009. Both changes are effective with January 2015 pension payments.
2015	Some of the $6.8 billion preliminary funding surplus was used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided on January 1, 2015. The surplus funds were also used to raise conditional inflation protection for pension credit earned after 2009 to 70% from 60% of the increase in the cost of living. Both changes were effective January 2016. In addition, some surplus funds were reserved to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs.

* Source: Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990"

In September 2016, the Sponsors announced that a portion of the $13.2 billion in funding surplus would be utilized to restore inflation increases, with the remaining surplus funds to be reserved "to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs".[27]

In summary, surplus has been utilized three times since the FMP was introduced – in each of 2014, 2015 and 2016 escalated adjustments were provided to increase the pensions of members who had retired after 2009. As noted above, the OTPP is currently in the Restoration Zone which, pursuant to Section 3.06, prioritizes the utilization of surplus to "restore" foregone indexation before any other actions are taken with respect to surplus. In other words, since the FMP was established the OTPP has not reached a level of surplus under the FMP which would allow for the Sponsors to enter into an agreement regarding its utilization under the Temporary Improvement Zone or the Permanent Improvement Zone.

It is also notable that, consistent with the 50/50 cost sharing principle under the plan, there is recent precedent for the Sponsors agreeing to equally share in the cost of funding a plan deficit (as with the case of surplus utilization, the Sponsors are required to mutually agree upon how to address any funding deficit in the OTPP). Specifically, the preliminary $17.2 billion shortfall identified in 2011 was resolved through a 1.1% increase to the contribution rate for both the participating employers and plan members (phased in over a three-year period).

Given the historical use of surplus under joint sponsorship of the OTPP prior to the adoption of the FMP, and the fact that over that time the Sponsors shared equally in surpluses, it may be that the Sponsors will expect to also share future surpluses on an equal basis, at least over time (we understand that it is certainly the Province's expectation that this will happen). In any event, based on the Plan Documentation, both parties will have an equal opportunity to benefit from surplus utilization through the negotiation process.

V. LEGAL RIGHT OF THE PROVINCE TO UNILATERALLY UTILIZE SURPLUS

As discussed in Part IV of this opinion, the Plan Documentation allows for the Sponsors to agree to utilize surplus in a variety of circumstances, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may potentially receive a financial benefit through the utilization of surplus:

---

[27] Ontario Teachers' Pension Plan, "Funding News", available at: https://www.otpp.com/corporate/plan-funding/funding-updates. We assume that a written agreement was reached by the Sponsors in this regard; however, we have not been provided with a copy of such agreement.

1. In the Restoration Zone, a Restoration Contribution Reduction may be agreed upon, once certain other requisite conditions have been met.

2. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

3. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

Notwithstanding the foregoing, as noted above, the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner agreed upon. (For example, Section 5.05 which relates to the Permanent Improvement Zone provides that "the partners may apply all or part of the [surplus] to change current benefits, current contributions, or both", subject to certain conditions.)

Any enforceable legal right of the Province to utilize surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract, the Partners' Agreement and the appended FMP being a contract between the Sponsors. A contract is an agreement "...which gives rise to an obligation that may be enforced in the courts."[28] It is our view that the relevant provisions in the Partners' Agreement[29] that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus do not, by themselves, give rise to a legally enforceable right to unilaterally dictate the use of surplus. Such a legally enforceable right would only arise by agreement between the Sponsors, either through negotiations or mediation, or if an order were issued by a board of arbitration as contemplated by the dispute resolution mechanisms found in the Partners' Agreement (see Section VI of this Opinion for further discussion of the impact of binding arbitration on the Sponsors' legal rights).

In this regard, the FMP can be thought of as being similar to an "agreement to agree," which does not create an enforceable legal interest in relation to the utilization of surplus.[30] What the Province does have, however, is a right to negotiate with the OTF the

---

28 CED – Contracts – I Basis of Contract – 1 – Contract Defined.

29 Article III, Section 3.06; Article IV, Section 4.05; and Article V, Section 5.05.

30 For a statement of the principle that an "agreement to "agree" is not an enforceable legal interest, see, for example: *Simpson v. Canada (Attorney General)*, 2011 ONSC 5637 at para. 60 citing *Ward v. Ward*, 2011 ONCA 178 and *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.*, 1991 CanLII 2734 (Ont CA). See also G. H. L. Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Carswell

use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

In addition, when a valuation is prepared to be filed and the Sponsors have to discuss the treatment of a surplus disclosed in the valuation, section 74 of the Partners' Agreement requires the Sponsors "to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan". One might therefore argue that that obligation of good faith may include the obligation to take into account the "sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

As will be discussed below, where the Sponsors are unable to agree upon the utilization of surplus pursuant to the negotiation/mediation processes set forth in the Partners' Agreement, there is an ability for the Sponsors to submit the matter to arbitration. The issuance of an order by an appointed board of arbitration regarding the use of surplus funds under the OTPP would create a legally enforceable right, as the submission to the board of arbitration would constitute a proceeding under the *Arbitrations Act* – as specified in paragraph 87 of the Partners' Agreement – that is enforceable by a court.[31]

VI. IMPACT OF BINDING ARBITRATION ON THE SPONSORS' LEGAL RIGHTS

Section 8.01 of the FMP provides the following:

> Section 8.01 Unless the partners mutually agree to the contrary, they shall follow the procedures described in paragraphs 74 to 100 when determining the plan changes arising from Section 3.07.

We first note that the mediation/arbitration process would not be triggered unless there is an actuarial valuation to be filed with the regulators that requires the Sponsors to agree on how any surplus or deficit is to be addressed. If a valuation is prepared in a year when no filing is required (filings generally only being required every three years), and the Sponsors do not agree to file the valuation, then the Sponsors do not necessarily have to address funding and benefit issues and therefore no negotiations may occur.

The processes in paragraphs 74 to 100 of the Partners' Agreement that are referred to in Section 8.01 of the FMP provide, amongst other things, for the following:

Publishing, 2011) at 23 where the author states "There cannot be a contract to enter into a contract. Nor can there be a contract to negotiate, i.e., an agreement to agree."

31 Section 50(1) of the *Arbitration Act, 1991*, SO 1991, c 17 states "A person who is entitled to enforcement of an award made in Ontario or elsewhere in Canada may make an application to the court to that effect."

- The Sponsors are required to meet to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan (section 74);
- The parties may at any point appoint a mediator by agreement of the parties or by a method to which they agree at that time (section 77);
- If the parties agree, the mediator may be appointed as a mediator/arbitrator in which case the appointee will decide on the process and time frame for conducting mediation/arbitration (section 80);
- Within 30 days of appointment, the mediator will prepare a confidential report setting out his or her views on the positions of the two partners and containing a recommendation (section 82);
- If the partners do not accept the report within 14 days of its being delivered to them it will be destroyed and an arbitration board will be appointed (section 84);
- This agreement together with a referral to a board of arbitration constitutes a submission under the *Arbitration Act, 1991*[32] (section 87);
- The board of arbitration in making an award will consider prevailing economic conditions and the overall state of the provincial economy (section 91);
- The award made by the board of arbitration, must comply with certain prescribed requirements, including to "provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members" (section 92(c));
- The Board will prepare a final valuation of the plan which implements all of the changes to the plan which have been awarded or agreed to by the partners (section 94);
- The Sponsors may agree to change the procedure described in this agreement, either for one round of negotiations or for all future negotiations; and
- Pursuant to Section 8.02 of the FMP, certain limitations on amendments set out in the FMP also apply to an award made by a board of arbitration (generally, these limitations are intended to ensure that the plan is adequately funded after providing for the utilization of surplus).

[32] SO 1991, c. 17 (the "***Arbitration Act***").

The Partners' Agreement and the FMP contain no general arbitration clause governing all disputes relating to the agreement, although Section 14 of the Partners' Agreement provides for the possibility of voluntary arbitration. We are not aware of any instance where the arbitration provisions have been invoked by the parties since the FMP was established. It is not immediately clear whether disputes relating to the utilization of surplus under Article IV of the FMP (i.e., the Temporary Improvement Zone) and under Article V of the FMP (i.e., the Permanent Improvement Zone) would be subject to arbitration.[33] It is our understanding from discussions with OTPP's internal legal counsel, however, that the arbitration provisions in the FMP would be expected to apply to disputes relating to the utilization of surplus under each of these provisions.

Where a matter has been submitted to arbitration, case law has established that the agreement between the parties that is being arbitrated is the fundamental source of subject matters that come within the arbitration board's jurisdiction.[34] The parties are free to design their own procedures, including setting the scope of the arbitration board's jurisdiction and specifying the potential outcomes of the arbitration (subject to certain default appeal rights and mandatory grounds to set aside an award under the *Arbitration Act*). The arbitration board is empowered to make binding decisions because of the arbitration agreement, including any limitations on that authority. Canadian courts have traditionally granted deference to arbitration awards.

Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, as noted above, under section 92 of the Partners' Agreement, the arbitral award must meet certain mandatory conditions. Among other things, the arbitral award is required to provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners'

---

[33] On the one hand, Section 8.01 of the FMP provides for the procedures in the Partners' Agreement relating to arbitration to apply "when determining the plan changes arising from Section 3.07". This may suggest that only disputes relating to the utilization of surplus under Article III (i.e., the Restoration Zone) can be arbitrated. On the other hand, Section 8.03 of the FMP provides that "Subject to the 2013 Term Sheet, nothing in Article II to Article IX affects the timing of the triennial negotiation, mediation and arbitration process referred to in paragraph 72 to 100", which may suggest that any agreement relating to the utilization of surplus, including under Article IV or Article V of the FMP, may be subject to arbitration (when a valuation is to be filed the parties have to agree on how any surplus – including surplus in the Temporary Improvement Zone and Permanent Improvement Zone, if any – will be used).

[34] See for example: *Desputeaux v. Éditions Chouette* (1987) Inc., [2003] 1 SCR 178, para. 22.

Agreement). The arbitration board does not have discretion to ignore this mandatory provision, although the provision would need to be given effect within the context of the relevant documents and applicable statutes, interpreted as a whole, and other relevant factors, such as past conduct of the parties. As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described above: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

Yours truly,

Osler, Hoskin & Harcourt LLP

Osler, Hoskin & Harcourt LLP
JS/DR/JM:jm