

The following is an excerpt from an ACPA newsletter sent out to clarify the “Deemed Trust” issue.

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MOU Clarification - Pension Review Letter and Deemed Trusts Pension Committee Newsletter #02 June 30, 2009

Fellow pilots,

Your concerns are obviously very real to each of you and I would like to address those that touch on pension matters. My comments and statements are not merely my opinions but stem from many, many hours and days of work on these issues and others with legal counsel, with specific expertise in the area of pension on behalf of labour. Also, I have been privy to numerous legal opinions ACPA has solicited on your behalf and attended discussions with insolvency lawyers whose general expertise is CCAA, bankruptcy and insolvency but who also specialize in pension matters in such situations. I shall try to stick to what I know are the facts.

Pension Review Letter

Firstly, let me discuss the "Pension Review Letter". This letter is a template of a letter all unions and the Company will receive from the Minister of Finance. The letter indicates that all parties will agree to a review of Air Canada's defined benefit pension plans of which there are ten (pilots have two). The review will assess the viability and sustainability of these pension plans "in light of current economic conditions". Given the fact that Air Canada has come to the Government twice for pension funding relief and in this case is also asking for hundreds of millions of dollars in financial assistance, it is understandable that the Government would want to learn what it should be doing differently (if anything) to protect our hard earned pension benefits.

The Minister of Finance can add "such additional points as may be suggested to the Minister after consultation with a person or persons skilled in the area of pensions." The Hon. J. Farley is the individual who drafted this "general template" and readily admits that he is not a pension expert and therefore included a clause that does reference counsel with such experts. This is a reasonable requirement, specifically that the Minister would get professional guidance on things that might also be included in the review.

It is the professional opinion of legal counsel that this letter does not give Farley or the Minister any new authority whatsoever to make changes to our pension plans. ACPA (the other unions and the Company) only agreed to a review. There was no request to implement the results of any review, which could be positive or negative for ACPA, and therefore definitely no agreement to change our two pension plans in any fashion.

ACPA did not agree to any form of arbitration. To pre-suppose an alternative outcome that is not even contemplated in the draft letter is just paranoia.

Finally, and this is most important, a review of all federally regulated pension plans is going to occur anyway. It is understood that the process currently underway by the federal government, designed to evaluate current funding regulations, will include such reviews as ACPA is suggesting you agree to now as part of this Pension Funding Relief package. In fact the template letter states, "While this request is being made of Air Canada and its pension stakeholders at this time, a similar review is being undertaken by the Government of Canada of all federally-regulated defined benefit plans". It is going to happen anyway and the Minister of Finance, who we approached for help, is only asking us to agree to go first.

Deemed Trusts and Our Pension Plans

Secondly, I would like to tackle the "deemed trust" issue. Again, it appears that many among us understand this topic with varying degrees of accuracy. I shall try to impart what I understand to be the facts as it relates to pension deficit and deemed trusts.

I have been copied and emailed often and asked about this quote supposedly posted on the forum somewhere: "The most powerful thing that differentiates our pension plans from the rest of the world is the fact our pensions ARE a deemed trust and shortfalls come before ANY other obligations in the event of a bankruptcy." My apologies to the writer if this is not the quote, however, this is what I have been receiving in emails and did not bother digging to see if it is actually posted. Regardless, it has obviously the concern and the attention of many. There is no way to sugar coat it, this statement is completely and utterly wrong. In fact the opposite is true.

Any amount due a creditor that is considered a deemed trust and is owed by a Company that subsequently enters CCAA or bankruptcy, that amount has super priority status among all debts. As it has been explained to us by counsel, "(any) deemed trusts remove the money from the property of the insolvent company so that they cannot be accessed by other creditors"; it gets paid first.

Let me present three potential situations our pension plans could fall under: (1) normal PBSA (Pension Benefits Standards Act, 1985) funding regulations; (2) new proposed regulations for temporary solvency funding relief; and, (3) the MOU your MEC recommends you support.

In general, CCAA does not permit the unilateral changing of your pension plans by the court (or judge). If a company under this protection is to restructure then pension benefits can only be modified if agreed to by the parties, namely current plan members and retirees. Any solvency deficiency (pension debt) must be paid in accordance with the current regulations, normally amortized over five years. Of course as we know, special relief from these funding requirements can be granted through a special amendment to the PBSA. This is what occurred in 2004 and is what we are seeking once again with this MOU.

The point in play here regarding deemed trusts, is what would happen in the event the Company becomes insolvent or liquidates. It is possible that a company could not restructure in CCAA and would have to liquidate, and in this case creditors would find themselves scrambling to ensure their bills are paid; pension plans would of course be one of those creditors. Ultimately the question becomes, "what happens to the funding of the pension plans if they are terminated or wound up?" How will they be funded and are they required to be funded under these circumstances?

It is only OSFI (Office of the Superintendent of Financial Institutions) who has the power and authority to unilaterally terminate a pension plan or reduce accrued benefits. It is likely that pension plan termination would occur in bankruptcy and depending on a company's potential (or lack of) for restructuring during CCAA, OSFI could exercise those same powers.

With these things in mind, the three potential situations for us today:

1. Under the PBSA, federally regulated defined benefit pension plans are not required by law to be funded upon termination. If OSFI were to terminate the plans there would be no requirement for funding at all. In this case we would not be entitled to anything beyond the current funding levels. There is no deemed trust status. If during CCAA and/or bankruptcy, any scheduled payments were missed then only those specific payments would be considered deemed trusts. I would like to emphasize that this would only apply to missed payments for current service or missed solvency payments that would normally occur quarterly. As you all know, the Company has a payment due Jul 30, 2009. If it missed that payment and filed for CCAA or bankruptcy Jul 31, 2009 then only that value would be a deemed trust. However, if it filed for CCAA or bankruptcy on Jul 29, 2009 then the Jul 30, 2009 payment would not be a deemed trust. At no time would the past service debt, currently estimated at \$2.85 billion, be a deemed trust.

2. This year (2009) under the proposed regulations to provide temporary solvency funding relief for federally regulated defined benefit pension plans, deemed trusts may apply. While the government is

finishing up its review of the funding regulations as a whole, it has elected (because it is moving too slowly to implement changes to the regulations this year) to provide some quick and temporary relief in the form of an increase to the amount of asset smoothing that may be used and is permitting the solvency payment period be extended to ten from five years; there are more details to the permissions but will not affect the deemed trust discussion. If a plan sponsor elects to take advantage of these temporary changes to the solvency funding calculation, then the plan sponsor must accept the imposition of a deemed trust on any "relief" gained. In other words, if they choose to do this then the difference in the required payments between the normal funding regulations and the temporary regulations would get the special status. The conditions surrounding termination of (1) above still apply and only the deemed trust portion would be payable not the entire deficit. The amount of relief these temporary regulations provide does not help Air Canada; they still can't make the payments and therefore are not opting to use these regulations.

3. The MOU your MEC asks you to support sets out a period of relief from any past service contributions to Jan 1, 2011 and then a predetermined schedule of payments out to Jan 1, 2014. Current service payments continue through the whole period. If any of these scheduled payments are missed and CCAA or bankruptcy ensues, they become deemed trusts as in (1) above. If you support the MOU, then the pension plans must be funded upon termination. The terminal funding requirement, lacking in the federal jurisdiction, has been written into this MOU. While the deficit still does not have deemed trust status, through the terminal funding clause, the amount of the total deficit does become due and payable at termination. Therefore, it would be on par with all the other unsecured debt existing at the time. That is not the case in (1) and (2) above as there is no requirement to fund the plans at termination. As our legal counsel puts it, "the MOU actually negotiates better protection, the terminal funding commitment which is arguably better than current law. Also the MOU's snap back provisions would eliminate all special relief given the Company and return it to the original status." The snap back would compare what has been paid to what should have been paid and that amount becomes due and payable.

Bill C55 Amendments

Thirdly, I would like to briefly comment on Bill C55 amendments. These amendments in effect codify the existing pension regime. They require current service cost payments to be made, but do not require past service special payments to be made. Past service payments are those required to fund the solvency deficit (pension debt). That is the current state of the law. The Bill C55 amendments also codify the principle that the collective agreement cannot be unilaterally abrogated. This Bill has been dormant since the spring of 2005 and there are no signs that it will be proclaimed in the near future.

Summary

In summary, the pension letter is merely an agreement to a review, a review that would be mandated by the government anyway. It in no way commits us to any changes to our pension plans. In fact our pension plans, including the Supplemental Employee Retirement Plans (SERPs), are covered by our collective agreement and therefore cannot be changed unless agreed to by both the Company and the Association.

Today, our pension plan deficit does not hold any special status in the event of CCAA or bankruptcy. Some small portions may attract the deemed trust status but in general the majority of the deficit does not. In fact, unilateral termination of the plans by OSFI does not even require that they be fully funded.

Under the proposed MOU, terminal funding is required in the event of termination and the snap back provisions would return the plans to their original status.

Sincerely,

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