

Dwight C. Harbottle 0584-01

December 2, 2003

WITHOUT PREJUDICE

Wajax Limited
3280 Wharton Way
Mississauga, Ontario
L4X 2C5

Attention: Neil Manning
Chief Executive Officer

Paul D. Sobey
Chairman, Wajax Limited
c/o Empire Company Limited
Head Office
115 King Street
Stellarton, Nova Scotia
B0K 1S0

Dear Sirs/Mesdames:

Re: Wajax Pension

We act for the employees and former employees of Wajax and affiliated companies concerning the ownership of the pension plan fund, surplus funds in the plan, the ability of the Company to make amendments to the pension which could, purport to, entitle the Company to share in the ownership of the fund, the legality of contribution holidays taken by the Company, pension plan expenses not paid by the company and others charged to the fund, and finally the plan conversion adopted by the Company late in 2000, and issues of plan wind-up.

Your offices have kindly assisted us with our efforts to locate all relevant documents. In this process, your office advised and it became apparent that your historical pension records were seriously deficient. Indeed we were advised that you found it necessary to reconstruct your own files from the Ontario Pension regulators, FISCO. Initially we met with representatives of FISCO and obtained documents from them. Following this, and after identifying deficiencies in their records, we independently contacted Standard Life Assurance Company, CCRA and others to obtain

further documents. In due course, your offices have facilitated production of many documents by arranging for some of these third parties to first provide them to you and in turn you have copied them and provided them to us.

We have thoroughly considered the documents and the issues and now write this letter to explain our opinion and to seek a meeting with the Company to see if the issues can be resolved by a settlement. We propose that such a meeting occur before December 20, 2003. If the matter can not be settled we are instructed to proceed with legal proceedings to resolve these issues and will commence the action immediately.

We will now turn to the legal issues.

Ownership of the Plan Fund
& Right of the Company to make amendments to share in the Fund.

It is our opinion that from the time the pension plan was established the pension fund has belonged entirely to the plan members and the Company has no interest or entitlement to the fund.

Very briefly, the company's pension plan was established prior to July 1959. It was amended in 1959 and again in 1967 and several, if not many, times thereafter. The plan was established as a trust for the members and in the plan documents prior to the amendment in 1967, the fund is reflected as wholly belonging to the members.

Under well established pension law, if at the time the fund is established for the benefit of the members, no express reservation of an interest in the fund is made for the settlor of the trust, in this case the Company, the Company has no right then or later by an amendment to any part of the ownership of the fund. A power of amendment does not amount to an express reservation.

It is our opinion that the pension plan text set out in the pension booklet dated July 1959 makes it clear that it was the intention of the Company to settle the pension fund entirely on the members and not to reserve any interest in that fund for the Company. Section 23. "CHANGE OR DISCONTINUANCE OF THE PLAN" provides that if the plan is discontinued all the benefits secured by the group policy vest with the members and no part of the benefits secured by the group policy shall be retained by the Company. The plan also reflects that there is a trust for the benefit of the members.

Since at least 1959 the plan has continued in existence. In 1967 William M

Mercer Limited, actuaries acting for the Company, advised the Quebec Pension Board, that the pension plan was revised and “improved”. In a letter dated September 14, 1967 Mr. MacDonald stated that he was unsure how to register the changes to the plan, and he had completed a registration “as if it was a new Plan, although, in fact, it is not”. Indeed, the 1967 pension plan text and booklet reflects that the changes to the plan as it was then drafted were amendments to the plan. Earlier in 1965, there were amendments to the plan which were inconsequential to the issues. In 1967 the funding moved from a group annuity basis to a deposit administration basis. Later the funds were put on deposit under the care of trustees.

Certain of the 1967 amendments, and in particular parts of Section XII “Amendment or Termination of the Plan” reflect a restatement of the plan consistent with the original trust settlement provisions. Section 12.1 provides for amendment provided “No such amendment, however, shall have the effect of diminishing the benefits accrued to each member at the time the amendment comes into effect”. Section 12.3 provides for Plan discontinuance but only on the condition that such action “shall render it impossible at any time for any part of the corpus of the trust or income thereon to be used for, or diverted to, purposes other than for the exclusive use of members, retired members or other recipients under the Plan”.

Section 12.4 of the 1967 pension text is inconsistent with the original settlement. In particular, the last sentence of the paragraph provides that any surplus remaining after the provision of benefits may be returned to the Company.

In our opinion, this amendment was not legal and any subsequent structuring of the pension by the Company on the basis that this was a new pension with this right is seriously flawed. The 1995 decision of the British Columbia Court of Appeal in *Hockin v. the Bank of British Columbia* (predicated on earlier decisions of the Ontario Court of Appeal and the Supreme Court of Canada) is authority that the power of amendment does not amount to an express reservation at the time the trust is settled and such a power can not be used to try to take back something already given away.

Following 1967, early actuarial reports accurately recognized that the Plan was restated and thus not a new plan. The words used in such reports are “effective”. Actuarial reports subsequent to 1992 incorrectly set out that the pension plan began January 1, 1967.

CONTRIBUTION HOLIDAYS

Since at least 1959 the Plan has required contributions from the members.

The Plan has been in surplus since 1985 and beginning that date the Company has regularly taken a contribution holiday. The actuarial reports (one missing) reflect between December 31, 1975 and January 1, 2001 the employees contributed \$22,617,000 and the Company only contributed \$4,940,221. Any surplus in the Plan has accordingly been generated largely by the employees' own contributions.

Prior to 2000 the Company regularly enhanced members pensions from surplus, or indeed from extra contributions or commitments.

In our opinion some of the contribution holidays taken by the Company have not been lawful.

EXPENSES

Since 1959 the Company committed to its employees to pay the administrative expenses associated with the pension. Since approximately 1990, this has not been occurring and approximately \$2.5 million has been paid for administrative expenses out of the pension fund.

1991 PARTIAL WIND-UP

In 1990, what I will call the Pitman Division of the Company, ceased to exist. The Company voluntarily recognized that a portion of the plan surplus, as it then existed, was due to the Pitman employees and documents were filed with the Ontario pension regulators which addressed this intention and the transfer of employees and funds from the Wajax Plan.

Such recognition was not given to the employees in 2000.

PLAN CONVERSION & WIND-UP

The history of your actuaries can briefly be summarized as follows. Mercers were the actuaries until December 31, 1984 and beginning in January, 1987 and ending in January, 1996, the actuaries employed were Morneau. Subsequent to 1996 Morneau were replaced by Towers Perrin.

In 1996, it would appear that the pension plan was charged an expense of

approximately \$100,000 to enable the actuaries and perhaps others to contemplate changes to the pension plan. In addition, approximately \$1.8 million to January 1, 2001, was paid out of the fund for the conversion costs.

In a confidential report issued to the Company in 1996, Morneau reported to the Company on possible amendments to the Plan including the conversion from a defined benefit type to a money purchase plan. If the Company was serious about addressing the members' needs, it had three options presented to it by Morneau as follows:

“We have designed three approaches to address the limitations of the current retirement program.

The first approach is based on the assumption that Wajax wishes to provide a retirement program which combines **the best features of DC and DB pension plans**. This type of plan would be perceived to be of high value by all employees but would also carry a high employer cost.

The second approach is based on the assumption that Wajax wishes to offer high value retirement programs but will not decide which type of plan is best for its employees. Instead, employees will have to make the choice themselves. Essentially, **a choice** would be given to each employee to belong in either the “current” DB format or opt for participation in a DC format. Both the DB and DC formula will be provided under the Employees' Plan. This approach would fit well in a “flexible” approach to company benefits.

Finally, the third approach can be seen as a variation of the second approach whereby employees would be given a one-time option to cash out their DB benefits and participate in a DC format from then on. Employees who wish to hold on to their DB format would continue to remain in the DB section of the plan. New employees would have to participate in the DC section. Option 3 presumes that **Wajax wants to maximize the number of employees choosing the DC option**.

A more detailed description of each option is as follows:

OPTION 1

The Employees' Plan would be modified to ...

- change the accrual formula from a CAE formula to a FAE formula (based on best five consecutive years' earnings and last three years YMPE);
- provide a minimum benefit entitlement at all times equal to two times

- employee contributions (with interest); and
- adopt provisions based on 'Ontario or better' legislation to minimize administrative complexities as well as eliminate regional discrimination: (this would affect the vesting rules).

All other aspects of the Employees' Plan would remain intact. Specifically, post-retirement benefit improvements would continue to be provided on an ad-hoc basis.

Essentially, this plan can be described as a DC plan in which the employer not only matches employee contributions but also provides a guaranteed benefit based on final average earnings.

OPTION 2

The Employees' Plan would be modified to:

- change the accrual formula from a CAE formula to a FAE formula (based on best five consecutive years' earnings and last three years YMPE);
- adopt provisions based on 'Ontario or better' legislation to minimize administrative complexities as well as eliminate regional discrimination; and
- introduce a new money purchase section to be offered as an alternative to the DB formula.

Under the money purchase option.

- any benefit accrued under the DB section prior to the individual's switch to the money purchase option would remain payable under the DB format;
- employee contributions would be the same as under the DB section but would attract a 100% match from the company;
- employees would become responsible for making investment selections for their retirement account (within a limited range of investment options); and
- an employee could only switch between DB and DC as at January 1st.

All other aspects of the Employees' Plan would remain intact including ad hoc post retirement indexing under the DB section.

OPTION 3

The Employee Plan would be modified to:

- adopt provisions based on ‘Ontario or better’ legislation to minimize administrative complexities as well as eliminate regional discrimination; and
- introduce a new money purchase section to be offered as an alternative to the DB formula.

The money purchase option would be as follows:

- any benefit accrued under the DB section prior to the individual’s switch to the money purchase option would be converted into a lump sum and deposited in the DC section;
- employee contributions would be the same as under the DB section but would attract a 100% match from the company;
- employees would become responsible for making investment selections for their retirement account (within a limited range of investment options); and
- an employee who opted for the DC portion cannot return to the DB portion and all new entrants must participate in the DC section.

All other aspects of the Employee’s Plan would remain intact. Specifically, under the DB section, the ad-hoc approach to providing increases before and after retirement would continue.”

A fourth option, being a full conversion to a money purchase plan was not an option proposed by Morneau for the following stated reasons:

- “ a large portion of Wajax’s current membership in the Employees’ Plan (ie. approximately 20%) is constituted of employees older than 50. For this large group, a money purchase plan would likely not meet the benefit promise they feel has been made by Wajax under the current plan. Furthermore, the cost to make these employees “whole” (ie. as well off under the DC format as under the DB format) would likely be prohibitive (ie. making them whole in the early retirement subsidy under the plan would provide a windfall to many employees, while making them whole upon retirement at 65 would be perceived as unfair by those wishing to retire early); and (my emphasis added)
- it is a very expensive endeavour to convert a pension plan from defined benefit to money purchase. If the main driving force is to address employee concerns, this could result in substantial work done for the concerns of a vocal group which may not represent all employees. A safer course of action in this case is to offer the second option outlined above and monitor decisions made by employees. Should everyone enrol under

the DC option, then clearly a conversion to money purchase would be appropriate.

Should Wajax wish to eliminate the defined benefit promise, or at least minimize its relevance, due to its desire to avoid investment risk related to the pension plan or because of a desire to make its costs more predictable, then we would suggest adopting option 3 outlined above. This would in effect close the DB section of the plan and, over a few years, we would expect that all employees will either retire or terminate in effect closing the DB section without incurring the conversion costs outlined above.

Also, a full wind-up of the Employees' Plan and its replacement with a Group RRSP or Group RRSP/DPSP combination is not recommended. This is mainly because a full wind-up of the Plan would involve a distribution of the surplus under the plan. In all likelihood, this would involve a portion of the surplus going to the members in exchange for their approval for a refund of the balance to the company. This would likely not constitute a cost efficient way of modifying the retirement program."

The three options of Morneau were obviously rejected and the Company chose to proceed to change the pension plan by adopting the only option not recommended by Morneau. Towers Perrin replaced Morneau. Effective December 31, 2000, the vast majority of the active members were arbitrarily informed that they were being transferred from their present plan to a defined contribution plan. They were given no option of remaining in the defined benefit plan but were given a choice of taking a paid up pension or transferring the commuted value to the defined contribution plan. The only people left in the defined benefit plan were described as "a few employees covered by a union contract and some employees that were on disability leave."

At December 31, 2000, there were 1110 members in the Plan and of that membership over 95% of the employees were forced into the conversion. Of the remaining individuals, approximately 44 were union people in the Waterous Plan and were to be dealt with the next year, and the balance of approximately 51 were disabled individuals.

The following year, as planned, most of the Waterous union employees were forced out of the Plan leaving behind at most 51 individuals. In due course these individuals will either die, or terminate their employment in some other way.

As part of this change, in March of 2001 all the retired and deferred members were notified that their pensions had been sold to Industrial Alliance. In the

Wajax annual report issued in April, 2000, it was stated that this transaction was consummated in 2000 and that the Company had taken into income some \$2.7 million of surplus due to this sale. In the 2001 audited financial statements, the Company took into earnings \$6.1 million of the surplus.

Following the forced changes, the Company is the only party enjoying the benefit of the surplus.

We have not been privy to the current look of the membership in the defined benefit plan but will obtain those documents shortly. We anticipate the membership is dwindling as was expected. In our opinion, it is obvious that the transaction implemented by Towers Perrin was designed to enable the Company to acquire and make use of the surplus for its benefit. The employees have suffered tremendously because of this decision. The Company has not looked after them and this would appear to be a serious breach of fiduciary duty owed to its employees.

The employees were not told that the Company had designed this conversion to enable it to make use of the surplus to the exclusion of the employees.

The employees were never told that the obligations of the Company to the employees to make contributions to the employees defined contribution plan would come from the surplus. Clearly, at present the employees are paying the entire cost of their own pensions but have been misled into believing otherwise.

The issue of wind-up or partial wind-up was taken up with FISCO by the employees and will be advanced as part of any litigation if the matter can not be resolved. The Ontario Courts have recently criticized FISCO for ignoring the requests of members to address changes to a pension and treat it as a partial wind-up and distribute surplus to the members.

OTHER ISSUES

Prior to 2000 the Company transferred Executives from this Pension plan. It is not clear how this was initially funded nor is it clear how the subsequent required contributions were funded. If funded from this plan, the members consider it to be illegal.

SUMMARY

In summary, we have thoroughly investigated this matter and are ready to fully and frankly discuss the matters with you. We are firmly of the view that the advice given to the Company by Towers Perrin was predicated on a misunderstanding of the history of the Plan and without proper consideration of the historical documents. Indeed, based on the comments and correspondence that the pension files were seriously incomplete, no other conclusion can be drawn.

If you are interested in trying to find a settlement please immediately so advise. We would want an actuary to be included in any settlement discussions. Clearly this cost should be paid from the fund. If we can not arrange a meeting to explore settlement options by December 19, 2003, we will then commence the necessary action. We look forward to hearing from you.

Yours truly,

HARBOTTLE & COMPANY

Per:

Dwight C. Harbottle

DCH/ca
Encls.

c.c. Frank C. Sobey
Director, Wajax Limited

Donald J. Taylor
Director, Wajax Limited

Mark L. Cullen
Director, Wajax Limited

Ivan E.H. Duvar
Director, Wajax Limited

Enclosures

- A 1959 Plan/Booklet
- B 1967 Amendment
- C September 14, 1967 letter - Mr. MacDonald
- D select Pitman correspondence, Resolution and report
- E excerpt from the Morneau confidential report
- F excerpts from the 2000 and 2001 Financial Reports