

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C.1985, C. c-36, AS AMENDED

AND IN THE MATTER OF SECTION 191 OF THE *CANADA BUSINESS
CORPORATIONS ACT*, R.S.C. 1985, c. C-44, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
AIR CANADA AND THOSE SUBSIDIARIES LISTED ON SCHEDULE "A"

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. c-36, AS AMENDED

**AFFIDAVIT OF KAREN BADGEROW-CROTEAU
(Sworn May 22, 2003)**

I, Karen Badgerow-Croteau of the City of Ottawa, in the Province of Ontario, MAKE
OATH AND SAY AS FOLLOWS:

1. I am the Managing Director of the Financial Institutions Group and Private Pension Plans Division of the Office of the Superintendent of Financial Institutions ("OSFI") and as such have personal knowledge, unless otherwise indicated, of the matters addressed in this affidavit.

2. My responsibilities at OSFI include the management of the Division at OSFI that is responsible for regulating the conduct of employers or plan sponsors and pension plan administrators in respect of pension plans registered under the *Pension Benefits Standards Act, 1985* ("PBSA") and ensuring that the minimum standards set out in the PBSA are met.

Background

3. OSFI was created in 1987 pursuant to the *Office of the Superintendent of Financial Institutions Act*. One of its responsibilities is the administration of the PBSA and the supervision of federally regulated private pension plans ("Plans"). Currently, OSFI regulates approximately 1200 Plans.

4. OSFI is responsible for assuring that the Plans are properly funded and administered with a view to protecting the rights and interests of members, former members and other beneficiaries of pension plans. OSFI may order administrators to deliver various reports in order to allow OSFI to assess the viability of the Plans and may direct administrators to contribute to the Plans in order to assure that the Plans are financially viable and that there are sufficient funds available to meet the commitments under the Plans. In the event that OSFI feels that the administrator of a federally regulated pension plan is not complying with its obligations under the PBSA, OSFI may appoint a replacement administrator for the Plan. In addition to its other functions, OSFI's consent is required before amendments to the existing Plans can be made that reduce or have the effect of reducing accrued pension benefits, pension benefit credits related to accrued benefits or immediate or deferred pension benefits.

5. The Applicants operate airlines and as such, are federal undertakings. Air Canada has ten (10) pension plans with defined benefit provisions and its subsidiary, Jazz, sponsors ten (10) pension plans. Two of the plans sponsored by Jazz contain defined benefit provisions, one of which contains a defined contribution component. The remaining plans that are sponsored by Jazz are exclusively defined contribution pension plans. The terms of a "defined benefit" pension plan define the amount of pension benefit to which a member will become entitled. Generally, these plans also require the employer to fund the plan so that these obligations may be met. However, with respect to the AirBC Pilots Pension Plan, although the pension plan contains defined benefit provisions, the contributions of Jazz, the plan sponsor, are defined through negotiations

with the applicable union. With respect to defined contribution plans or provisions, the pension benefit entitlement is not defined but rather the amount of benefit will depend upon the amount of employee and employer contributions remitted to the pension fund and the investment return of that fund. In respect of defined contribution arrangements, the contributions required to be made by the employer are defined. All of these pension plans are registered and subject to the PBSA.

6. Air Canada is the administrator for each of its 10 pension plans. Jazz is the administrator for 9 of its 10 pension plans. The AirBC Pilots Pension Board is the administrator for the tenth Jazz pension plan known as the AirBC Pilots Pension Plan; however it is Jazz, as the plan sponsor that is obligated to remit employer contributions to this plan.

Contribution Holidays

7. The PBSA, in the prescribed circumstances set out in subsection 9(7.1) of the regulations, permits an employer in respect of a defined benefit plan to take "contribution holidays", that is to reduce all or part of its contributions in respect of the cost of benefits that are to accrue during a plan year. Specifically, subsection 9(7.1) of the Pension Benefits Standards Regulations, 1985 ("PBSR") allows an employer to take a contribution holiday up to the lesser of the surplus in a pension plan valued on a going concern basis and the surplus in a pension plan valued on a solvency or termination basis. In the opinion of OSFI, it is neither acceptable nor prudent to take contribution holidays when a pension fund has a substantial deficit and, in respect of a pension plan, constitutes a course of conduct that is contrary to safe and sound financial or business practices.

8. In January of 2003, OSFI performed an analysis of the financial information the Applicants had provided to OSFI in the valuation reports or actuarial reports covering the various pension plans filed with OSFI in 2001. While these filings disclosed an aggregate surplus in the pension plans of over \$915 million, OSFI's analysis disclosed

that each of Air Canada's pension plans had solvency deficits as at January 2003 although no specific estimate of this amount was derived.

9. I have been informed by Linda Maher, Senior Supervisor, Private Pension Plans Division at OSFI, who is the Manager responsible for the Air Canada and Jazz pension plans, that on February 6, 2003 OSFI approached Air Canada to confirm OSFI's estimates of the plans' ratios and to discuss Air Canada's intentions regarding its contribution holidays. Air Canada confirmed that it had discussed the issue of contribution holidays internally at Air Canada but that no decision had yet been made.

10. During February of 2003 Air Canada provided OSFI with its estimated solvency ratios for nine of its pension plans (excluding the pension plan in place for its Dispatch Employees).

11. Based on these estimated solvency ratios obtained from Air Canada, OSFI estimated the aggregate solvency deficit for all of the pension plans as \$1.3 billion as at January 1, 2003.

12. Having not received confirmation of Air Canada's position concerning contribution holidays from the Applicants, I have been informed by Linda Maher that on February 19, 2003, OSFI again expressed its concerns to Air Canada about the taking of contribution holidays given the estimated solvency deficiencies in the pension plans and the financial difficulties of Air Canada and indicated that, even though Air Canada was not due to file valuation reports in respect of all of its pension plans until 2004, OSFI may require Air Canada to file early valuation reports.

13. On March 6, 2003, representatives of OSFI, including myself, met with representatives of the Applicant, Air Canada, at their offices in Montreal. At this meeting OSFI again expressed its concerns about the Applicant continuing to take contribution holidays despite the deficit in the pension plans. Air Canada indicated that it would raise

the issue of contribution holidays at the meeting of the investment committee for the pension plans scheduled to be held in June or July of 2003. OSFI also informed the Applicant that it was of the view that valuation reports may be required for all the pension plans that they administer. Letters dated March 10, 2003 and March 13, 2003 were sent to Air Canada outlining OSFI's concerns and requesting certain information. Copies of these letters are attached as Exhibits "A" and "B" respectively. OSFI had a conference call on March 14, 2003 with representatives of Air Canada to discuss these letters. Air Canada informed us that OSFI's letter dated March 10, 2003 had been tabled at the Board of Director's meeting held on March 12, 2003. No written response was received from Air Canada addressing these concerns.

14. It is also OSFI's position that the terms of the Air Canada pension plans would not permit the taking of contribution holidays by the employer when the funds of the plans have significant deficits. Attached as Exhibit "C" are excerpts from the ten Air Canada pension plans.

15. March 21, 2003 – Temporary Direction

16. On March 21, 2003, pursuant to section 11 of the PBSA, OSFI issued a Temporary Direction to the Applicant, Air Canada, requiring that they immediately remit to all of its ten pensions plans an amount representing those contribution holidays the Applicant had taken in respect of the 2002 plan year and also directed the Applicant to immediately cease taking contribution holidays in respect of the same pension plans. A copy of the Temporary Direction is attached as Exhibit "D" to this Affidavit.

17. On March 23, 2003, OSFI had a conference call with representatives of Air Canada. At that conference call OSFI confirmed that Air Canada could make representations respecting the Temporary Direction until April 4, 2003. In addition, OSFI confirmed that although the Direction was effective immediately, in the absence of

any intervening events that could adversely affect the members of the Plans and require further regulatory or other legal action, no enforcement proceedings would be commenced to require an immediate payment of the contributions to the Plans prior to the close of business on April 4, 2003. This position was confirmed by OSFI in a letter to Air Canada dated March 23, 2003. A copy of this letter is attached as Exhibit "E" to this Affidavit.

18. The result of this Temporary Direction is that the Applicant became liable to pay to the pension funds approximately \$105 million in respect of contribution holidays taken in 2002 and approximately \$30 million in respect of contribution holidays expected to be taken in the first quarter of 2003. The amount in respect of the 2002 plan year became immediately due and owing to the plans and the contributions holidays taken in respect of the first quarter of 2003 became due and owing on April 30, 2003. The amount in respect of the remainder of the 2003 employer contributions continues to accrue to the pension funds on a quarterly basis and, it is the position of OSFI, will be imposed with a deemed trust in favour the plan members, former members and any other persons entitled to a benefit or refund from the pension plans.

19. On March 26, 2003, OSFI staff met with representatives of Air Canada in Montreal. At that meeting Air Canada stated that it could not make the entire payments but possibly could arrange to begin to remit a specified amount per month. On March 31, 2003 and during the early hours of April 1, 2003, OSFI and Air Canada representatives discussed an arrangement whereby the amounts set out in the Temporary Direction i.e., the aggregate amount of contributions in respect of the 2002 plan year and the entire 2003 plan year, could be paid into the pension funds over a two year period. This arrangement would require Air Canada to fund \$12.5 million per month for 24 months and in the event that Air Canada defaulted on the payment or filed under CCAA, the entire amount would become immediately due and payable. Air Canada also agreed to use its best efforts to prepare valuation or actuarial reports for each of its pension plans

by April 30, 2003. In light of this arrangement, OSFI would then agree to revoke the Temporary Direction. On April 1, 2003, Air Canada filed under CCAA.

20. On April 2, 2003, after due consideration, OSFI, pursuant to subsection 11(5) of the PBSA, notified the Applicants that the Superintendent was not satisfied that there were sufficient grounds for revoking the Direction. However, OSFI indicated that it was open and willing to discuss with Air Canada any proposals for the restructuring of the Plans under the CCAA proceedings. A copy of this letter is attached as Exhibit "F" to this Affidavit.

21. On April 3, 2003 OSFI received a letter from Air Canada informing OSFI that the details of the proposals that had been discussed during the early hours of April 1, 2003 had not been ratified by the Board of Directors and that in light of the CCAA filing the arrangement was not in effect. A copy of this letter is attached as Exhibit "G" to this Affidavit.

22. On April 17, 2003, representatives of OSFI met with representatives of Air Canada and the Monitor at the Applicant's office in Montreal to discuss the CCAA process and OSFI's position on the deemed trust. OSFI reiterated its position that it would entertain a payment schedule over time in order to satisfy the Temporary Direction but that this would have to be presented to all the interested parties including the Court. By letter dated April 25, 2003, OSFI wrote to Air Canada confirming the matters discussed. A copy of this letter is attached as Exhibit "H" to this Affidavit. By letter dated May 6, 2003, Air Canada replied to OSFI's letter of April 25th. A copy of this letter is Attached as Exhibit "T" to this Affidavit.

23. Air Canada has not complied with the Temporary Direction issued on March 21, 2003. Although Air Canada has not made employer contributions to its pension plans, I have been advised by Linda Maher and believe that Air Canada has informed OSFI that it continues to deduct and remit employee contributions to the respective pension funds.

24. It is OSFI's position that pursuant to subsections 8(1) and (2) and section 9 of the PBSA the \$105 million owed for 2002 and the \$30 million owed for 2003 are now due and owing and subject to a deemed trust. The amount in respect of the remainder of the 2003 employer contributions continues to accrue to the pension funds on a quarterly basis. Moreover, it is OSFI's position that until such time as these amounts are paid, they are subject to a statutory "deemed trust" in favour of the plan members, former members, and any other persons entitled to pension benefits or refunds under the pension plans and as such these amounts do not form a part of the assets of the Applicants and are not available to the Applicants to effect the restructuring.

Valuation Reports

25. Pursuant to subsections 12(3) and (4) of the PBSA, by letters dated March 21, 2003 and March 25, 2003, OSFI directed Air Canada, Jazz and the AirBC Pilots Pension Board to file with OSFI valuation reports as at January 1, 2003 or December 31, 2002, depending upon the date as at which the valuation was performed for their last filed valuation or actuarial reports. Pursuant to subsection 12(3) of the PBSA, the administrator of a pension plan is required to file such reports at such time as the Superintendent directs. These reports were required to be filed with OSFI by April 30, 2003. Copies of these letters are attached as Exhibits "J", "K" and "L" to this Affidavit.

26. I have been informed by Linda Maher and believe that on March 20, 2003, with the exception of the request for valuation reports for all of the Air Canada pension plans, Air Canada confirmed that it would comply with OSFI's request for information that was contained in the March 13th letter. OSFI subsequently received the additional information that was requested. I have been informed by Linda Maher that on March 25, 2003, OSFI requested that Jazz provide OSFI with information in addition to that requested in OSFI's letter of March 21st and Jazz confirmed that it would comply with OSFI's request for information. On March 26, 2003 Jazz provided OSFI with copies of

the requested information. A copy of this letter is attached as Exhibit "M" to this Affidavit.

27. I have been informed by Linda Maher and believe that in a telephone conversation with the Chairman of the AirBC Pilots Pension Board held on March 25, 2003, OSFI informed the Board that the valuation or actuarial report that was due at the end of June 2003 should be filed by April 30, 2003. A copy of the letter from OSFI confirming this conversation is attached as Exhibit "L" to this Affidavit.

28. On March 26, 2003, Jazz wrote to Mercers, the pension plans' actuary, instructing them to proceed with an actuarial valuation as at December 31, 2002 to be filed with OSFI by April 30, 2003. A copy of this letter is attached as Exhibit "N" to this Affidavit.

29. On May 2, 2003, OSFI received from Air Canada an "Update on the Financial Position on a Funding Basis as at January 1, 2003" in relation to each of the Air Canada pension plans. These "Updates" confirmed the estimated total deficits for the Air Canada pension plans. By covering letter, Air Canada represented that the submitted "Updates" do not constitute actuarial valuation reports within the meaning of the PBSA and "will not be used for purposes of determining funding requirements for the relevant pension plans." A copy of this letter is attached as Exhibit "O" to this Affidavit. On May 6, 2003, OSFI received an "Update on the Financial Position on a Funding Basis as at January 1, 2003" in respect of the Contributory Defined Benefit Pension Plan for Employees of Air Ontario Inc. from Jazz, the administrator of that pension plan.

30. On May 12, 2003, OSFI held a conference call with representatives of Air Canada to inform them of OSFI's position that the filed Updates were not sufficient in that the required payment schedule was not included in the reports. OSFI informed the Applicant that although a payment schedule was not included with the reports, its obligations under the PBSA still applied, including the funding requirements of the PBSA, and that these amounts continue to accrue and form part of a deemed trust for the plan beneficiaries.

However, OSFI also acknowledged that the payment schedules and deficits in respect of these plans may change as a result of the current processes underway to restructure the plans. In addition, OSFI informed the Applicants that due to the fact that Jazz had stopped remitting contributions to its pension plans, OSFI intended to issue Temporary Directions to Jazz to require that employer contributions be remitted to its pension funds.

31. By letter dated May 16, 2003, OSFI confirmed its May 12th conversation with Air Canada. A copy of this letter is attached as Exhibit "P" to this Affidavit.

32. On May 21, 2003, OSFI wrote to Jazz informing them the information received on May 2, 2003 was not sufficient in that the required payment schedule was not included in the reports. OSFI informed the Applicant that although a payment schedule was not included with the reports, its obligations under the PBSA still applied, including the funding requirements of the PBSA, and that these amounts continue to accrue and form part of a deemed trust for the plan beneficiaries. However, OSFI also acknowledged that the payment schedules and deficits in respect of these plans may change as a result of the current processes underway to restructure the plans. A copy of this letter is attached as Exhibit "Q" to this Affidavit.

33. It is OSFI's position that, with the exception of the deficiencies cited by OSFI in its letters of May 16, 2003 and May 21, 2003, the filed Updates constitute valuation or actuarial reports.

May 16 – Temporary Direction

34. I have been informed by Linda Maher and believe that prior to the issuance of the Initial Order of this Court on April 1, 2003, Jazz had been remitting the employer contributions to its ten pension plans. After April 1, 2003, employer contributions have ceased. I have been informed by Linda Maher and believe that on April 10, 2003 representatives of Jazz confirmed to OSFI that the employer contributions had ceased or

had been suspended but that employee contributions continued to be deducted and remitted to their respective pension plans.

35. I have been informed by Linda Maher and believe that on April 30, 2003 the custodian of the defined contribution pension funds to which Jazz contributed, Sun Life Assurance Company of Canada, informed OSFI that employer contributions up to April 1, 2003 had been remitted to the pension funds and that employee contributions were still being remitted.

36. I am informed by Linda Maher and believe that the AirBC Pension Board was called by OSFI to inform them that OSFI would issue a Temporary Direction in relation to the cessation or suspension of contributions to the pension fund.

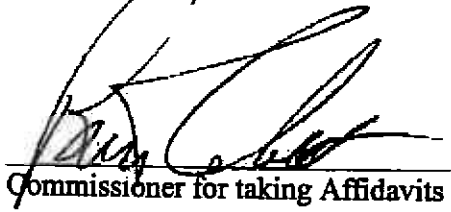
37. On May 16, 2003, OSFI issued a Temporary Direction to Jazz and the AirBC Pilots Association requiring that Jazz immediately cease taking contribution holidays in respect of its pension plans and that the AirBC Pilots Pension Board, as administrator of the AirBC Pilots Pension Plan, take the necessary steps to ensure that Jazz remits its contributions. A copy of these Temporary Directions are attached as Exhibits "R", "S" and "T" to this Affidavit.

38. Although Jazz and the AirBC Pilots Pension Board have until May 26, 2003 to make representations to the Superintendent concerning this Temporary Direction the Temporary Direction came into effect and is enforceable as of May 16, 2003.

39. In light of the provisions in the Initial Order, it is arguable that OSFI is prohibited, without first obtaining leave from the court, from enforcing its Directions as it may deem necessary in order to assure the continued viability of the Plans and prohibited from requiring the Applicants as employers and/or administrators to comply with their obligations under the Plans.

40. I make this affidavit in support of the motion to amend the Initial Order (Amended) and for no improper purpose or delay.

SWORN BEFORE ME at the City of
Ottawa, in the Province of Ontario
This 22nd day of May, 2003



Commissioner for taking Affidavits

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KAREN BADGEROW-CROTEAU