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The Supreme Court rules in Indalex: DIP lenders rank ahead of pension beneficiaries in CCAA Restructuring

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On February 1, 2013, the Supreme Court overturned a controversial decision of the Ontario Court of Appeal which granted pension beneficiaries priority over DIP lenders in the context of a restructuring under the *Companies' Creditors Arrangement Act* ("CCAA").[1] The Court of Appeal's decision led many to worry that lenders would be reticent to advance funds to restructuring debtors for fear of not being able to secure charges which would outrank all other claims. However, the Supreme Court's decision would appear to assuage many of those fears although it may raise serious concerns for secured lenders outside an insolvency situation.

FACTS
In 2009, Indalex, a Canadian subsidiary of a US company which manufactured aluminum extrusions, became insolvent. The US company subsequently filed for Chapter 11 bankruptcy protection in the US and the Canadian subsidiary sought, and was granted, a stay under the CCAA. At the relevant time, Indalex was the administrator of two registered pension plans: one for the company's salaried employees (the "Salaried Plan") and one for the company's executives (the "Executive Plan"). At the time the CCAA proceedings were instituted, the Salaried Plan was in the process of being wound up while the Executive Plan had been closed but not yet wound up. At the time the stay was issued, the plans faced funding deficiencies of $1.8 million and $3.0 million respectively.

In April 2009, the CCAA court authorized Indalex to enter into an interim financing agreement with a group of DIP lenders in return for a charge which ranked ahead of all of the company's other creditors. The DIP loan was further guaranteed by Indalex US.

Indalex was successful in selling its assets on a going-concern basis but the accepted bid would not cover the DIP loan in full and the buyer refused to take on the pension plans. On July 20, 2009, both Indalex in Canada and the US applied to their respective courts to obtain an order authorizing the sale of the assets and approving the interim distribution of the proceeds of the sale to the DIP lenders. Members of both pension plans opposed Indalex's motion, arguing that their claims had priority over that of the DIP lenders because the pension liabilities were covered by a statutory deemed trust under the Ontario *Pension Benefits Act* ("PBA"). They further argued that Indalex was in violation of its fiduciary obligations as administrator of the pension plans throughout the insolvency proceedings. The Court approved the sale but ordered the Monitor to hold $6.75 million in reserve leaving the determination of the pension beneficiaries' claims for a later date.

Having covered the DIP lenders' shortfall, Indalex US was subrogated in the DIP lenders' rights and

became the debtor's first ranking creditor by way of the DIP charge.

THE LOWER COURT DECISIONS

Justice Campbell of the Ontario Superior Court dismissed the Plan Members' motions, concluding that the PBA deemed trust did not apply to the wind-up deficiencies as the payments in question were not "due" or "accruing due" as of the date of wind up and the Executive Plan did not have such a deficiency as it had not yet been wound up.[2]

The Court of Appeal allowed the Plan Members' appeals. Reversing the Superior Court, the Court held that s.57(4) of the PBA applies to all amounts due in respect of pension plan wind-up deficiencies. Moreover, it was held that a deemed trust existed for the Salaried Plan and that such deemed trust had priority over the charge granted in favour of the DIP lenders by virtue of s.30(7) of the Ontario *Personal Property Security Act* insofar as the doctrine of federal paramountcy had not been raised at the time the Initial Order which provided for the DIP charge was issued and that there was nothing to suggest that this would frustrate the debtor's ability to restructure. The Court of Appeal also found that Indalex had breached its fiduciary obligations to Plan Members in a number of ways throughout the duration of the CCAA proceedings and that a constructive trust over the reserve fund in favor of Plan Members of the pension plans was an appropriate remedy for these breaches.[3]

THE APPELLANTS' POSITION

Indalex argued before the Supreme Court that the wind-up deficiency costs claimed by the Plan Members could not benefit from the PBA deemed trust as they are not calculated until well after the effective date of wind up. As such, they cannot be said to have accrued, as required by the legislation.[4] Furthermore, they took the position that even if the pensioners benefitted from a deemed trust, the charge in favour of the DIP lenders would outrank any such claim.[5]

With regards to the fiduciary obligations owed by the company, Indalex argued that the company plays two roles, one as administrator of the pension plans and another as employer making decisions in the best interests of the corporation. The argument advanced was that decisions made by an employer in its corporate capacity are not burdened by any fiduciary obligations owed to pension plan members.[6] Moreover, Indalex also asserted that, in the event that the company was found to be in breach of its fiduciary duties as administrator of the pension plans, the constructive trust imposed by the Court of Appeal was not an appropriate remedy.[7]

THE PBA DEEMED TRUST AND WIND-UP DEFICIENCIES

The first question addressed by the Supreme Court involved the application of section 57(4) of the Ontario PBA which reads as follows:

57(4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations [Our emphasis].

The question was whether the deemed trust provided for in this provision applies to the wind-up deficiency payments referred to in s.75(1)(b) of the Act. For the Salaried Plan's wind-up deficiency payments to come under the purview of the statutory deemed trust, they must constitute employer contributions accrued to the date of the wind up but not yet due, as required under s.57(4) PBA.

The majority of the Supreme Court upheld the Ontario Court of Appeal on this point, thus refusing to accept the more restrictive interpretation of the word "accrued" offered up by Indalex. Rather, in the Court's view, the wording, context and purpose of the provision lead to the conclusion that the wind-

up deficiencies set out at s.75(1)(b) are indeed protected by a deemed trust. While the entire Court agreed that the wind-up deficiencies were employer contributions which were not yet due, four of the seven sitting justices also concluded that they had “accrued”. Justice Deschamps, writing for the majority on this point, contrasted her view with that of the dissent, stating:

The distinction between my approach and the one Cromwell J takes is that he requires that it be possible to perform the calculation before the date of the wind up, whereas I am of the view that the time when the calculation is actually made is not relevant as long as the liabilities are assessed as of the date of the wind up [Our Emphasis].[8]

The majority also held that the legislative history of the PBA coupled with the remedial purpose of the deemed trust provision both lead to the conclusion that the exclusion of wind-up deficiency payments from the protection of the deemed trust would run contrary to the Ontario legislature’s intention.[9] However, the entire Court agreed that the deemed trust can only apply with respect to the Salaried Plan and not to the Executive Plan as it had not yet been wound up.[10]

STATUTORY DEEMED TRUSTS AND CCAA SUPERPRIORITY CHARGES: WHICH HAS PRIORITY?

While the Court held that a deemed trust was created in respect of the Salaried Plan payments, this was not enough to dispose of the appeal. The question remains, does the provincial deemed trust created by s.57(4) of the PBA take precedence over the court-ordered charge in favour of the DIP lenders? The Court notes that the PBA provincial deemed trust continues to apply in CCAA proceedings, subject to the application of the doctrine of federal paramountcy which renders inoperative provincial legislation where it enters into conflict with federal law.[11] Furthermore, the Court rejects the Court of Appeal’s refusal to apply this doctrine on the basis that it had not been explicitly raised by the appellants at the time of the Initial Order and the granting of the DIP charge. Rather, the Supreme Court concludes that paramountcy, as a question of law, can be raised regardless of whether it was invoked in an initial proceeding.[12]

The Court concluded that such a conflict did arise in this case insofar as compliance with the provincial law necessarily entails defiance of the CCAA order made in accordance with federal law. As a result, the granting of priority to the DIP lenders had the effect of subordinating the claims of all other stakeholders, including those of the Plan Members. Moreover, the Court held that the court-ordered DIP charge granted in accordance with the CCAA has the same force as a statutory priority. Insofar as the federal and provincial schemes gave rise to conflicting orders of priority, by operation of the doctrine of paramountcy, the DIP charge ranks ahead of the deemed trust.[13]

DID INDALEX BREACH ITS FIDUCIARY OBLIGATIONS?

The Court also held that conflict of interest problems can arise where a company acts as both plan administrator and employer, especially in a restructuring context. More specifically, the company’s corporate interests can come into conflict with its duty as plan administrator to ensure that contributions are made when they are due.[14] An employer cannot disregard its fiduciary obligations to plan members in order to privilege its duties to the corporation.[15]

In the case at hand, the Court found that Indalex was indeed in a position of conflict of interest but the majority did not find that the fiduciary breaches committed by the debtor company were as wide-ranging as the Court of Appeal indicated.[16] While the company was not in breach of its duties by filing for CCAA protection nor by failing to give notice to the Plan Members of its plan to commence CCAA proceedings, it was obligated to provide such notice when it sought the order approving the DIP loan which would outrank the pension claims.[17]

The majority also provided important guidance for employer-administrators who are in a similar situation to that faced by Indalex. More specifically, Justices Deschamps and Cromwell both provided some means by which employer-administrators may address conflicts and thus avoid breaching their fiduciary duties. Justice Deschamps also added that the solution to address a conflict "has to fit the problem, and the same solution may not be appropriate in every case".

While the justices concluded that Indalex did not live up to its fiduciary obligations, the majority, with two justices dissenting, held that a constructive trust was not an appropriate remedy. In the words of Justice Cromwell, four conditions must be present before a remedial constructive trust may be ordered for breach of fiduciary duty, one of which being that the breach of fiduciary duty must have given rise to assets in the hands of the wrongdoer. According to the majority, to satisfy this second condition, it had to be shown that Indalex's breach resulted in assets being placed in Indalex's hands, and not simply, as the Court of Appeal found, that there was a "connection" between the assets and "the process" in which Indalex breached its fiduciary duty. The majority ruled that the failure of Indalex to meaningfully address the conflict of interest that arose in the course of the CCAA proceedings did not give rise to the assets which were retained by the Monitor in the reserve fund (those assets resulted from the sale, not from Indalex's breach of fiduciary duty).

SUMMARY

The Supreme Court could not reach a unanimous decision on all of the issues raised in *Indalex*. Three different sets of reasons were issued by the Court:

Deschamps J. (Moldaver J. concurring)
Cromwell J.(McLachlin C.J. and Rothstein J. concurring)
Le Bel J. (Abella J. concurring)

On the issues, the Court was split as follows:

The PBA deemed trust applies to wind-up deficiencies: 4 to 3;
The DIP charge supersedes the PBA deemed trust because of federal paramountcy: 7 to 0;
Indalex breached its fiduciary obligations as plan administrator: 7 to 0;
A constructive trust was not the appropriate remedy to the breach of fiduciary obligations: 5 to 2.

A QUEBEC PERSPECTIVE

Quebec pension legislation differs from the PBA. Under the Quebec *Supplemental Pension Plans Act* (SPPA), there is no deemed trust for pension deficits on wind up as the SPPA qualifies such deficit as a debt.

Also, in Quebec, pension plans are, under the SPPA, administered by pension committees, unlike the Ontario situation in *Indalex* where the employer was the plan administrator. In cases where the pension committee has not delegated any of its powers and duties to the employer (the SPPA allows a pension committee to delegate all or part of its powers and duties to a third party, including the employer), it would be difficult to find a breach of fiduciary duty by the employer in a situation similar to the one in *Indalex*.

Finally, the *Indalex* matter raised the application of equitable remedies, in particular the constructive trust. This remedy does not exist in the civil law regime of the Province of Quebec.

CONCLUSION

The Court's conclusion that the DIP lenders' charge took priority over the claims of the pension beneficiaries provides an answer to a very live controversy in insolvency law. Moreover, the decision provides restructuring companies with important direction regarding the proper management of conflicts of interest when facing insolvency issues. However, these conclusions may not be easily transported into Quebec law. As we noted above, the role of the employer with a private pension plan in Quebec differs from that of an employer-administrator in Ontario and the legislative

framework is different in Quebec.[18] As such, the Court's conclusions in this respect may not be as relevant to restructuring companies in Quebec.

The Court also made it clear that pension plan members in Ontario benefit from the protection of a provincial deemed trust even in respect of wind-up deficiencies. Perhaps more importantly, while the Supreme Court confirmed that the deemed trust in this case had to yield to the DIP lenders' charge, the expansion of the PBA deemed trust and its continued operation absent any conflict with federal law will certainly raise concerns with secured lenders who may see their first ranking security take a bow before a PBA deemed trust for pension deficits on wind up.

How will lenders react? Will they seek shelter from provincial deemed trusts in the *Bankruptcy and Insolvency Act* where most deemed trusts are inoperative? A perverse effect of this could be that lenders will tend to force bankruptcies instead of restructurings in situations where pension plan deficits are substantial. Lenders may impose additional covenants in their loan agreements to seek better protection from such potential pension plan deficits. The formidable flexibility and capacity to adapt which is a true characteristic of the insolvency and restructuring practice may be a silver lining to what may seem to be gloomy times for secured lenders.

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[1] *Sun Indalex Finance LLC* v. *United Steelworkers*, 2013 SCC 6 [Indalex].

[2] 2010 ONSC 1114.

[3] 2011 ONCA 265.

[4] *Indalex, supra* note 1 at para 33.

[5] Factum of the Appellant, *Sun Indalex Finance*, LLC, Court File No. 34308, at para 101 [Factum].

[6] *Indalex, supra* note 1 at para 63.

[7] *Factum, supra* note 5 at para 89.

[8] *Indalex, supra* note 1 at para 34.

[9] *Ibid* at paras 43-44.

[10] *Ibid* at para 46.

[11] *Ibid* at para 52.

[12] *Ibid* at para 55.

[13]

Ibid at para 60.

[14] *Ibid* at para 182.

[15] *Ibid* at para 65.

[16] *Ibid* at para 74.

[17] *Ibid* at para 73.

[18] *White Birch Paper Holding Company (Arrangement relatif à)*, 2012 QCCS 1679.