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Does the federal pension deemed trust outrank a perfected security interest in the context of CCAA proceedings? The Superior Court of Québec weighs in

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Author

Brittany Carson

Partner, Lawyer

In the last few years, pension deemed trust issues have been a subject of debate before the courts. The Supreme Court of Canada itself addressed some of these issues in the *Indalex* case.[1] On November 20, 2013, the Honourable Justice Mark Schrager of the Superior Court of Québec rendered an important judgment in *Aveos* addressing whether the federal pension deemed trust outranks a perfected security interest in the context of proceedings under the *Companies' Creditors Arrangement Act* (the "**CCAA**")[2].

THE FACTS
In 2007, the debtor company, Aveos Fleet Performance Inc. ("**Aveos**"), established a defined benefit pension plan in favour of its non-unionized employees (the "**Plan**") which was registered with the Office of the Superintendent of Financial Institutions ("**OSFI**") and governed by the federal *Pension Benefits Standards Act* (the "**PBSA**"). On March 18, 2012, Aveos ceased the operations of its Airframe Division and informed all of its employees not to report to work the following day. On March 19, 2012, Aveos made an application under the CCAA and an Initial Order was issued granting a stay of all proceedings against Aveos. In addition, the Initial Order suspended the making of special payments to the Plan (to amortize the Plan's deficits) but permitted Aveos to make normal cost contributions. The next day, Aveos ceased the operations of its two other divisions and terminated the employment of all but a select few employees.

In April 2012, a divestiture process was approved by the Court. In accordance with this process, virtually all of Aveos' assets were subsequently sold.

In May of 2012, OSFI was informed that accruals would cease with respect to the Plan effective

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The Superintendent of Financial Institutions (the "**Superintendent**") filed a motion before the Superior Court of Québec for declaratory judgment under which it mainly claimed that the deemed trust created by Section 8 of the PBSA required Aveos to pay to the Plan, in priority to Aveos' secured lenders, an amount of $2,804,450 which represented the special payments due the Plan for the period of February to December 2012 (Aveos' last special payment having been made for the month of January 2012).[3] According to the Superintendent, once the Plan was terminated, the balance of the prescribed special payments for 2012 became due pursuant to Section 29(6) of the PBSA and these payments were protected by the PBSA deemed trust and, as such, ranked in priority to Aveos' secured lenders. The Superintendent added that since almost all Aveos's assets had been sold pursuant to the divestiture process, there had been a "liquidation" within the meaning of Section 8(2) of the PBSA which provides for the following:

8(2) In the event of any liquidation, assignment or bankruptcy of an employer, an amount equal to the amount that by subsection (1) is deemed to be held in trust shall be deemed to be separate from and form no part of the estate in liquidation, assignment or bankruptcy, whether or not that amount has in fact been kept separate and apart from the employer's own moneys or from the assets of the estate.

The Superintendent argued that the CCAA is silent on the issue of the PBSA deemed trust and as such, Section 8(2) of the PBSA continues to apply in CCAA proceedings. The Superintendent also argued that the PBSA deemed trust priority exists notwithstanding the date on which it was created or the date of perfection of the security lenders' charges.

Independent of any considerations of rank, the Superintendent also requested that paragraph 19 of the Initial Order, which suspended the making of special payments, be retroactively amended and that Aveos be ordered to make such payments. More specifically, the Superintendent argued that insofar as the underlying rationale of such suspension is to provide an employer with the "breathing room" necessary for it to move forward with its restructuring plans, this underlying rationale was no longer present once Aveos decided to cease its business activities.

Aveos' secured lenders contested the Superintendent's motion. Significant sums of money were owed to them by Aveos and fixed charges on all present and future moveable and personal property had been granted in six provinces and one territory, each one having been perfected in accordance with applicable legislation. Registration dates confirmed that, with the exception of the security interest registered in the Northwest Territories in August 2011, all of the charges were perfected in March 2010.

The secured lenders took the position that the PBSA deemed trust was subordinated to their charges insofar as all of Aveos' property was subject to their security at the time the PBSA deemed trust came into existence and therefore, either the assets were not subject to the PBSA deemed trust or there was a prior charge in their favour. The secured lenders relied, by analogy, on the Supreme Court of Canada's decision in *Royal Bank of Canada v. Sparrow Electric Corp.*[4] in which it was held that property subject to a fixed charge cannot be subsequently impressed with the deemed trust under Sections 227(4) and 227(5) of the *Income Tax Act*. Furthermore, the secured lenders in Aveos argued that the Supreme Court in *Sparrow* had also made it clear that a deemed trust will only be given effect in the context of insolvency proceedings to the extent that the applicable insolvency legislation explicitly provides as such.

As for the Superintendent's argument that the suspension of special payments should be reversed and Aveos should be ordered to retroactively pay the special payments claimed, the secured lenders indicated that it was not open to the Court, at this point, to grant such an order.

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The secured lenders argued that the Superintendent had ample opportunity to request an amendment to the Initial Order and that it failed to do so. Consequently, it would be unfair, at this stage, to retroactively amend the Initial Order in this way. More specifically, the stay of proceedings contained in the Initial Order was extended six (6) times and there have been twelve (12) asset sales and four (4) distributions of funds produced by these asset sales. Despite all of these proceedings, the Superintendent failed to make any application to the Court seeking the amendment of the Initial Order. According to the secured lenders, faced with a timely application to amend the Initial Order, they might have strategized differently and may simply have provoked a bankruptcy.

THE DECISION

THE PRIORITY ISSUE

Justice Mark Schrager begins his analysis by addressing the issue of the priority afforded to the PBSA deemed trust in insolvency proceedings and with a review of the Supreme Court's decision in *Sparrow*. In this judgment, the Supreme Court held that property validly encumbered by a security interest was not subject to the deemed trust under Sections 227(4) and 227(5) of the *Income Tax Act*.

Following the *Sparrow* judgment, these provisions of the *Income Tax Act* were replaced so as to grant priority to the deemed trust in respect of property that is subject to a security interest regardless of whether the security interest was perfected before the deemed trust came into effect. Justice Schrager notes that while similar amendments were made to other statutes, no such amendment was made to Section 8(2) PBSA following the decision in *Sparrow*.

Justice Schrager noted that the fixed charges in this case were created and perfected in 2010 and 2011 while the PBSA deemed trust arose later on. As a result, the Court held that since Aveos' assets were already charged with the secured lenders' security interests, the PBSA deemed trust was, at best, subordinate to such charges.

Justice Schrager also agreed with the secured lenders' position that the PBSA deemed trust is not effective in CCAA proceedings where secured creditors hold prior perfected security interests or charges which are not paid in full. The Court cited the Supreme Court of Canada's decision in *Century Services Inc.* v. *Canada (Attorney General)*[5] in which Justice Deschamps stated that where the intention is to protect the rank of deemed trust claims in insolvency matters, Parliament clearly expresses such intent. In the absence of such explicit statutory basis, no such protection exists in an insolvency context.

Justice Schrager adds that, while *Century Services* dealt specifically with source deductions in favour of the Crown, the Supreme Court's reasoning in that case was not limited to such deemed trusts and Justice Deschamps was clear that there exists a "*general rule that deemed trusts are ineffective in insolvency*."[6]

In response to the Superintendent's question of what exactly would be the use of the deemed trust provided under Section 8(2) of the PBSA, Justice Schrager states that such deemed trust "*is useful for the protection of special payments but only vis-à-vis creditors who do not hold security over the assets of the debtor company which was perfected prior to the deemed trust attaching to the assets*".[7]

Finally, citing the Supreme Court's judgment in *Indalex*, Justice Schrager notes that in Ontario, section 30(7) of the *Personal Property Security Act* subordinates security interests to the deemed trust created by the Ontario *Pension Benefits Act*. There is no similar or equivalent provision in the PBSA or in Quebec provincial law that would give priority to the PBSA deemed trust.

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THE SUSPENSION OF SPECIAL PAYMENTS ISSUE

Justice Schrager stated that judges should be very hesitant to retroactively amend the Initial Order after such a long period of time and after various sales, vesting orders and distributions already occurred. The Court found that given the circumstances, the Superintendent's delay in seeking to retroactively amend the Initial Order was unreasonable and the Superintendent was estopped from seeking such an amendment. The other parties, including the secured lenders, relied in good faith on the Initial Order.

No appeal of Justice Schrager's decision was filed.

CONCLUSION

This decision shows that the question of whether, in a CCAA context, a specific pension deemed trust has priority over a security interest perfected prior in time to the deemed trust's creation must be answered by analysing the language used in the legislative provisions which create the pension deemed trust or which are related thereto. Ultimately, Justice Schrager concluded that neither Section 8(2) nor any other provision of the PBSA or Quebec provincial law contains the language required to grant such priority to the federal pension deemed trust.

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

[2] *Aveos Fleet Performance Inc./Avéos Performance aéronautique inc. (Arrangement relatif à)*, 2013 QCCS 5762.

[3] As for the Plan wind-up deficit of $29,748,200, the Superintendent took the position that it is an unsecured claim which is not protected by the PBSA deemed trust.

[4] [1997] 1 SCR 411.

[5] [2010] 3 SCR 379 (*Century Services*).

[6] *Ibid* at para 45.

[7] *Aveos, supra* note 2 at para 83.

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