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# Pension *Pulse*

## Pensions and Corporate Insolvency: Ontario Court of Appeal Releases Surprising Decision

The Ontario Court of Appeal released its decision in *Indalex Limited (Re)*, 2011 ONCA 265 on April 7, 2011. The decision comes as a surprise to many pension and insolvency professionals, lenders and pension plan sponsors. The court, essentially, directed that monies held in reserve by the monitor appointed under the federal *Companies Creditors Arrangement Act* should be used to pay off pension fund deficits in preference to secured creditors.

### Background

In 2009, Indalex Limited (a Canadian company) and its U.S. parent sought protection from their creditors under the CCAA and Chapter 11 of the U.S. *Bankruptcy Code* respectively. The court authorized a loan to Indalex under a debtor-in-possession credit agreement and gave the lenders a super-priority charge on Indalex' property, in priority to "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise." Indalex' U.S. parent guaranteed the loan.

Later that year, the court approved a sale of Indalex' assets on a going-concern basis. Indalex and the lender rightly understood the sale proceeds would be used first to pay off the loan, given the super-priority granted to the lender. However, two groups of pension plan members argued that a portion of the proceeds should be reserved for payment of pension fund deficiencies. This amount was ordered withheld, with the result that the loan was not fully repaid from the proceeds of the sale. The U.S. parent guarantor made up the shortfall of \$10.75 million (U.S.).

Indalex sponsored two pension plans, a Salaried Plan, some of whose members were represented by the United Steelworkers, and an Executive Plan. The Salaried Plan was wound up at the end of 2006, however, payments were still being made to the Plan to fund the Plan's wind-up deficiency. The Executive Plan had not been wound up, but was also underfunded at the time of the CCAA proceedings. The deficiency in both pension plans totalled about \$6.75 million.

### Statutory Deemed Trust

Pension legislation in Ontario, and in most other Canadian jurisdictions, creates a deemed trust in favour of the pension fund, equal to employer contributions accrued to the date of a pension plan wind-up but not yet due to be paid under the pension plan or under pension regulations. Typically upon the wind-up of a pension plan, outstanding wind-up deficiencies must be paid over no more than five years. This was the position of the Salaried Plan. The Executive Plan had not yet been wound up.



The deemed trust provision in the Ontario *Pension Benefits Act* is as follows:

*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.*

In addition, the Ontario *Personal Property Security Act* creates a specific priority for deemed trusts under pension legislation over all secured creditors. The combination of provisions under Ontario pension legislation, creating a deemed trust, and the provision under the *PPSA* creating a priority for amounts claimed under deemed trusts, conflicted with the interests of the U.S. parent company of Indalex Limited, that guaranteed the loan to the lender and made up the \$10.75 million (U.S.) shortfall.

For the Salaried Plan that had been wound up prior to the *CCAA* proceedings, the court of appeal held that the deemed trust under the *Pension Benefits Act* was effective as against the guarantor of the debtor-in-possession loan. The court held that all amounts owing under the pension plan had accrued as of the wind-up date, even though they were not due to be paid until as much as five years beyond the wind-up date by virtue of pension regulations.

The Executive Plan, on the other hand, had not been wound up as of the date *CCAA* proceedings had commenced. Given that the deemed trust provision in the *Pension Benefits Act* specifically applies to pension plans that have been wound up, it is difficult to understand how a deemed trust could be imposed in respect of the Executive Plan. However, the court found it unnecessary to decide this point. In addition, in comparing the Salaried Plan with the Executive Plan, the court stated that if the deemed trust were not to apply to the Executive Plan, it would be "a triumph of form over substance."

## Fiduciary Duties

The court found that Indalex, in its role as administrator of the two pension plans, breached its fiduciary duties toward the pension plan members. It is trite law that an administrator of a pension plan owes fiduciary duties toward the plan members. These duties arise both as a function of pension standards legislation and at common law. However, Indalex, as the sponsor of the pension plans, also had obligations as a corporation.

The court acknowledged that Indalex wore two hats, one as pension plan administrator and one as pension plan sponsor or as a corporation. The initial decision to commence *CCAA* proceedings was a corporate decision. Following that initial decision, according to the court, Indalex could not ignore its fiduciary obligations as a pension plan administrator. At the time it was negotiating the debtor-in-possession financing, giving the lenders a super-priority charge, Indalex knew the pension plans were underfunded. The financing decision thereby had a potential effect on the pension plan beneficiaries:

*The decisions that Indalex was unilaterally making had the potential to affect the Plans beneficiaries' rights, at a time when they were particularly vulnerable. The peculiar vulnerability of pension plan beneficiaries was even greater than in the ordinary course because they were given no notice of the CCAA proceedings, had no real knowledge of what was transpiring and had no power to ensure that their interests were even considered – much less protected – during the DIP negotiations.*



The court also held that Indalex put itself into a conflict of interest situation, namely between safeguarding the interests of the corporation and the interests of the pension plan members. The court repeated that Indalex could not resolve the conflict simply by ignoring its role as pension plan administrator. According to the court, it was incumbent upon Indalex to "take steps to address the conflict." The court did not indicate what those steps should be.

Lastly, the court invoked the notion of constructive trust in favour of the pension plan members based on equitable principles and on account of Indalex' breaches of fiduciary duties. The constructive trust would provide extra armour for the plan members in the event of an appeal under which it is decided that there is no deemed trust.

### Implications

This decision has potentially far-reaching implications, well beyond the facts of the case. It is open to question whether the debtor-in-possession would have advanced funds to Indalex had it imagined the result in this case. Also question whether the parent company would have acted as guarantor of the loan. On this last point, the court went out of its way to make it clear that the competing interests over the reserve fund were not the lenders and the plan members, but the parent company guarantor and the plan members. Question whether the decision would have been the same had the loan not been guaranteed.

The decision also raises significant uncertainty as to the extent of an employer's fiduciary obligations in its role as pension plan administrator. There is always a dynamic tension between the roles of employer plan sponsor and plan administrator. However, this decision heightens the responsibilities of plan administrators. The decision makes it pretty clear that there is a fiduciary duty to inform plan members when a loan is being negotiated in the midst of CCAA proceedings. Would this extend to situations outside of the CCAA?

The court made it clear that Indalex placed itself in a conflict situation in its dual roles as a corporation and as a pension plan administrator. The court stated that Indalex was required to take steps - what steps? Indalex could not simply abdicate its responsibilities as pension plan administrator. In many jurisdictions in Canada, the pension regulatory regime in the event of insolvency is not clear. Indalex could have possibly requested the pension regulator to act as plan administrator, however there would have been no obligation upon the regulator to do so.

We understand an application is in process of being prepared to seek leave to appeal this decision to the Supreme Court of Canada. If you have any questions about this decision, please contact any member of our National Pensions and Benefits Practice or our National Restructuring Practice. ■



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