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SCC Releases its Decision in *Sun Indalex Finance, LLC v. United Steelworkers*

In a much anticipated decision released February 1, 2013, the Supreme Court of Canada set aside the Ontario Court of Appeal's ruling in *Sun Indalex Finance, LLC v. United Steelworkers*. In so doing, the majority of the SCC upheld an order granting priority to charges created in *Companies' Creditors Arrangement Act* ("**CCAA**") proceedings over claims for wind-up funding deficiencies in an insolvent company's pension plans.

In its decision, the SCC addressed the following issues:

- The applicability of the deemed trust provisions in Ontario's *Pension Benefits Act* ("**PBA**") to wind-up deficiencies;
- The conflicting priority between provincial statutory deemed trusts and charges created in a federal insolvency scheme; and
- the extent of a plan administrator's fiduciary duties to the plan members when making decisions in the context of CCAA proceedings and whether a constructive trust is the appropriate remedy for a breach of such duties.

Background

Indalex Limited ("**Indalex Canada**") sponsored and administered two defined benefit pension plans, one for salaried, unionized employees (the "**Salaried Plan**"), and the other for executive employees (the "**Executive Plan**"). In 2009, Indalex Canada obtained protection under the CCAA, following a Chapter 11 filing by its U.S.-based parent company ("**Indalex US**"). At the time of the CCAA filing, the Salaried Plan was being wound up and the Executive Plan was closed but not yet wound-up. Both plans were significantly underfunded.

In the course of the CCAA, Indalex Canada sought and was granted authority for a debtor in possession ("**DIP**") loan in order to continue its operations. The DIP loan was secured by a super-priority charge that, as per the CCAA court order, ranked "in priority to all other … trusts ... statutory or otherwise." Indalex US guaranteed the loan.

In July 2009, Indalex Canada sold its assets on a going-concern basis. The purchaser did not assume the pension plans. The proceeds of the sale were distributed to the DIP lenders thereby resulting in insufficient funds to satisfy the deficiencies in the plans (the proceeds were, in fact, insufficient to repay the DIP loan in full. Indalex US, as guarantor, covered the balance thereby assuming this portion of the DIP lender's claim).

The plan members objected to this distribution claiming that they had a deemed trust pursuant to the PBA which provides that "employer contributions accrued to the date of the wind up [of a pension plan] but not yet due under the plan or regulations," are deemed to be held in trust. The operation of s. 30(7) of the Ontario *Personal Property Security Act* ("**PPSA**") (which gives priority to the interests of a

person who is the beneficiary of a deemed trust arising under the *Employment Standards Act* or under the PBA), would then enable the plan members' claim to rank in priority ahead of all other secured creditors (including the DIP lenders). The plan members also claimed a constructive trust arising from Indalex Canada's alleged breach of its fiduciary duties as administrator of the plans. The CCAA court approved the sale, but ordered that an amount in respect of the plans' funding deficiencies (the "**Reserve Fund**") be retained by the monitor pending the outcome of the plan members' claims.

Shortly after the plan members brought their motion, Indalex Canada moved to lift the CCAA stay of proceedings and assign itself into bankruptcy. Hearing both motions together, the CCAA court found that the DIP claim had priority over the pension claims of former employees and dismissed the plan members' motions on the basis that the deemed trust did not apply to wind-up deficiencies.

The Ontario Court of Appeal reversed this decision and held that the plan wind-up deficiencies were subject to deemed and constructive trusts and that at the end of a CCAA liquidation proceeding, priorities may be determined by the PPSA's scheme rather than the federal scheme set out in the *Bankruptcy and Insolvency Act* ("**BIA**").

Deemed Trust Provisions Apply to Wind-Up Deficits

The majority of the SCC found that the deemed trust provided for in s. 57(4) of the PBA applies to wind-up deficiencies regardless of whether the exact amount of such deficiencies can be calculated at the date of wind up. As the Salaried Plan was wound up, the PBA served to create a deemed trust over its wind-up deficits. The Executive Plan, on the other hand, was not yet wound-up, as such, the deemed trust did not apply to its wind-up deficiencies.

Note: this portion of the decision is based on the Ontario pension legislation. Trust provisions in similar legislation in other provinces can be worded quite differently.

Federal Paramountcy Prevails – DIP Charges Rank in Priority to the Deemed Trust

The SCC unanimously agreed that the DIP charges granted in the CCAA proceedings had priority over the deemed trust.

Priority schemes under the BIA may not necessarily apply in other federal insolvency proceedings (as per Deschamps and Moldaver JJ., though cited with approval by the majority). Stating that Parliament has expressly chosen not to apply all bankruptcy priorities either to CCAA proceedings or to proposals under the BIA, Deschamps J., cautioned that courts may not just simply "read bankruptcy priorities into the CCAA at will"; in certain circumstances, priorities may be determined by provincial schemes even in the context of a federal insolvency proceeding. That being said, however, while the provincial deemed trust under the PBA continues to apply in CCAA proceedings, the SCC held that this application remained subject to the doctrine of federal paramountcy.

Federal paramountcy applies when federal and provincial laws are incompatible, (*i.e.*) when it's either impossible to comply with both laws or when the application of the provincial law would frustrate the purpose of the federal law). In *Indalex*, the deemed trust created under the provincial PBA and PPSA gave rise to different and conflicting orders of priority than those provided in the court-ordered priority based on the CCAA (which the SCC held is of the same effect as a statutory priority): one gave priority to the plan members and the other gave priority to the DIP lenders (and subsequently Indalex US). The SCC held that this conflict between the federal DIP charges and the provincial deemed trust

must be resolved in favour of the charges created under federal legislation. Accordingly, the DIP charge supersedes the deemed trust.

Breach of Fiduciary Duty Occurred but a Constructive Trust was not Appropriate Remedy

The SCC unanimously found that Indalex Canada breached its fiduciary duty as administrator of the pension plans. Although the reasons for judgment differ on the extent of the breaches, the majority of the Court determined that Indalex Canada had breached its fiduciary duty by failing to take steps to ensure that the plan members were informed and had the opportunity to be represented in the CCAA proceedings, particularly in the early DIP financing stages.

Offering some guidance for future CCAA proceedings, the majority of the SCC stated that, in addition to providing sufficient notice to stakeholders, an insolvent corporation which is also a pension plan administrator would do well to bring any conflicts of interest which it may find itself in (as a result of its position as employer and administrator) immediately to the attention of the CCAA court. It is not enough to simply include the beneficiaries in the list of creditors; the judge must be made aware that the debtor, as an administrator of the plan is, or may be, in a conflict of interest. In response, the SCC posited that a CCAA judge may determine it appropriate in the circumstances to do any number of things including appointing an independent administrator, requiring notice directly to the pension beneficiaries, and/or considering limiting draws on DIP loans until notice can be given to the beneficiaries.

Finally, the majority of the SCC found that while there was a breach of fiduciary duty, the imposition of a constructive trust over the funds held in reserve was not the appropriate remedy, as a constructive trust is only appropriate if the breach gave rise to assets which would be unjust for the wrongdoer to retain. Here, the SCC held that Indalex's breach of fiduciary duty gave rise to no such assets and, as such, the remedy was unavailable in the circumstances.

The full decision can be found here.

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