Indalex Case Comment

By: Eleonore Morris

Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

____

In Indalex[1] , the Ontario Court of Appeal (the "COA") deviated from recent case law in deciding that pension plan deficiency claims can have priority over security held by Debtor-in-Possession ("DIP") lenders. The decision emphasizes strict adherence to notice requirements, expands deemed trust rights, and examines potential conflicts of interests where a company acts as both employer and administrator of a pension plan. It is an important case affecting companies with defined benefit plans and lenders to such companies.

Indalex obtained protection under the Companies' Creditors Arrangement Act (Canada) ("CCAA") in April 2009. An ongoing sale of its assets, generating $151 million in proceeds, led to Indalex seeking an order for the distribution of such proceeds to its DIP lender, under the DIP priority charge created by an earlier CCAA order.

Representatives of each of the salaried employee plan and the executive pension plan beneficiaries objected to the proposed distribution on the basis that the deemed trust provisions in the Pension Benefits Act ("PBA") applied to the unpaid amounts owing on their plans, and trumped any interest asserted by the DIP lender.

The lower court dismissed this objection, finding that the amounts owing were not subject to the deemed trust provisions: under the salaried employee plan, the amount of the deficiencies were to have been paid over time and did not actually become due until after the date the plan was wound up, and, under the executive plan, the amount of the deficiencies were not due as the plan had not formally been wound up.

By contrast, in respect of the salaried employee plan, the COA concluded that all rights of the beneficiaries accrue as at the date the plan is wound up. The PBA statutory deemed trust applies to the entire deficiency at that date even though the deficit contributions may not yet be due, and the employer was current in all other required contributions.

Regarding the executives' plan, the Court took an equitable approach. The plain wording of the PBA concurred with the lower court's decision. However, the COA held that a decision allowing an insolvent company to avoid pension obligations through inaction (in this case, not winding up the pension plan) was potentially a "triumph of form over substance", and treated the plan as if a wind-up had occurred, triggering the deemed trust.

After establishing the deemed trust claims, the COA then declared that the pension claims took precedence over the DIP lenders' ordered priority claim, based on its findings that: i) Indalex, as administrator of the pension plans, failed to notify the beneficiaries of the motion for a court order to approve a DIP secured loan which would rank in priority to all pension claims; and ii) Indalex failed to disclose to the CCAA court the potential pension deficits. In doing so, the COA rejected arguments that the appeals constituted collateral attacks on the orders granting the priority DIP charge.

The COA criticisms highlight the importance of ensuring compliance with notice requirements for all affected parties. The takeaway from the COA's discussion on this point is that the CCAA regime is designed to allow all matters relating to an insolvency to be dealt with within one overarching proceeding. An initial order and any subsequent orders may be varied or amended on application of an interested party, particularly where such interested party did not receive proper notice.

The decision is a significant step away from the COA's recent decision in Ivaco Inc.[2] and the Supreme Court of Canada decision in Century Services[3]. Under the Bankruptcy and Insolvency Act (Canada) ("BIA"), the priority of many statutory deemed trusts is reversed upon a bankruptcy,

and Ivaco and Century Services provided a straight transition from a sale under the CCAA to a distribution under the BIA following a voluntary filing. Indalex could potentially reopen the argument that insolvent companies acting as pension plan administrators cannot file voluntary proceedings under the BIA without risk of breaching their fiduciary duties.

When considering this, it is important to recognize that Indalex is very fact-driven. The equities before the court appear to have been affected because Indalex's parent company guaranteed the loans provided by the DIP lender subject to the priority charge. Further, Indalex's parent company was actively managing Indalex and therefore implicated in the administration of the pension plans; this was viewed by the court as a severe conflict of interest.

The administrator of a pension plan owes certain fiduciary duties to the plan members. In Indalex, the COA focuses on conflicting duties of an employer assuming the dual role of providing and overseeing a pension plan as part of its business operations, while also administering such plan. The administrative fiduciary duties may be compromised, as the employer may be required to advocate interests of the pension plan which conflict with or oppose the interests of its general business operations, its creditors and other stakeholders. The COA commented that this was an impossible situation, as an employer could never use its administrative power to amend or enforce the plan in a way that was not to its benefit, and only to the benefit of its employees.

Ultimately, the COA found that Indalex had breached its fiduciary obligations to the members of its retirement plans. The practical consequence of this finding is that an employer acting in the dual role should consider appointing an independent pension plan administrator prior to seeking protection and initiating insolvency proceedings, to avoid claims alleging a breach of fiduciary duties. Secured lenders to employers need also be aware of this, and should consider such an appointment as a prerequisite to providing pre-insolvency or DIP financing. Further, where a lender obtains a guarantee of its DIP loans from a non-arm's length party of its debtor, proper consideration must be given to obtaining 'stand alone' security for such guarantee, such as a cash collateral agreement or other pledge of assets to reduce the lender's exposure to priority claims such as pension claims.

Given the step away from recent caselaw, and the uncertainty surrounding the consequences of a voluntary post-CCAA filing in bankruptcy, it is likely the decision will be appealed to the Supreme Court of Canada.

Until such time, or until the legislation is amended to address the inconsistencies in the case law, companies with defined benefit plans and their current or future lenders should consider fully their options.

For companies with defined benefit plans, understanding the current state of the law and effect on any CCAA or BIA proposal or other filing is critical in advance of any insolvency proceedings.

For secured lenders, protective measures, including the appointment of an independent operator of the pension plan and obtaining separate security from non-arm's length guarantors, must be considered prior to a financing and again following commencement of insolvency proceedings.

Eleonore Morris is an associate in our Insolvency and Restructuring practice group. If you have questions or comments about this article or its implications, please contact Eleonore at (416) 369-4168 or emorris@mindengross.com.

---

[1] Indalex Limited (Re), 2011 ONCA 265

[2] Ivaco Inc. (Re) [2006] O.J. No. 4152

[3] Century Services v. Canada [2010] 3 S.C.R. 379