MINDEN GROSS LLP

Spring 2011

Topic:

Indalex Case Comment

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

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

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

[2] *Ivaco Inc. (Re) [2006] O.J. No. 4152*
[3] *Century Services v. Canada [2010] 3 S.C.R. 379*

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.

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Uncle Sam Wants Your Money[1]

U.S. persons in Canada (and elsewhere) need to be aware that the financial situation in the U.S. has caused Uncle Sam to hunt for tax dollars wherever they can be found. In this regard, one focus of U.S. lawmakers is reaching into the pockets of U.S. citizens and other persons who are not generally present in the United States. To this end, over the last few years a number of U.S. foreign reporting and compliance initiatives have been instituted, but if the most recent proposals referred to as the "FATCA" rules are implemented on foreign institutions, as is expected to take place beginning on January 1, 2013, non-compliant U.S. taxpayers may have no where left to hide.

The key to the new rules is that they will take the choice of whether or not a taxpayer reports out of the taxpayer's hands and they do this by imposing a 30% withholding tax on U.S. source income earned by foreign financial institutions (for example, any Canadian bank, credit union, etc.) unless the institution enters into an agreement with the IRS to disclose all of their U.S. accountholders. We understand that many banks are already in the process of developing internal programs to track, monitor and report their U.S. account holders – and this means that if you are considered to be a U.S. accountholder, your bank either will have to report you or will ask you to find another place to hold your money – and there may not be an institution willing to take the account.

Although there are, no doubt, many U.S. persons in Canada who are willfully non-compliant there are many others who simply have no idea that they are failing to comply. This is because unlike most tax systems, such as in Canada, where tax is based primarily on residency, the U.S. tax system taxes individuals who are U.S. citizens on their worldwide income regardless of their U.S. residency status. Furthermore, the U.S. citizenship rules are not intuitive and can be complex. For example, a person born outside of the U.S. can be a U.S. citizen simply because one of the person's parents is a U.S. citizen and a person born in the U.S. can be a U.S. citizen even if the person's parents were never U.S. citizens or residents.

Another potential trap for unwary persons is that "former" U.S. Green Card holders who did not renounce their Green Cards in the proper manner continue to be considered to be U.S. persons fully subject to U.S. taxation. Of course, there are many other traps that can trap a person in the U.S. tax system. Even if citizenship is not an issue, determining residency can sometimes be tricky – especially if a person has ties in both the U.S. and another jurisdiction such as Canada.

[1]The rules imposed by IRS Circular 230 require us to state that, unless it is expressly stated any opinions expressed with respect to a significant tax issue are not intended or written by the practitioner to be used, and cannot be used for the purpose of avoiding penalties that may be imposed in connection with U.S. Federal tax matter.

If you think that you might have U.S. filing obligations that you may not be complying with, we strongly advise you to speak with a U.S. taxation specialist lawyer or accountant and to do so as soon as possible.

The reason time is of the essence is that the IRS has recently announced a new Voluntary Disclosure Offshore Initiative, which may provide you with the opportunity to become compliant. The cost of compliance will include tax, interest and possibly penalties but will help you to avoid crippling penalties or worse if you don't comply and are eventually caught. The program expires on August 31 of this year.

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This article was co-authored by Phyllis Guillory of Chamberlain, Hrdlicka, White, Williams & Martin, both members of MERITAS law firms Worldwide.

Welcome

Minden Gross is pleased to announce Boris Zayachkowski has joined the firm as Partner. Boris has an existing practice in Commercial Leasing, Real Estate and Corporate/Commercial law ideally suited to our team. Boris was called to the bar in 1989 and speaks regularly at conferences sponsored by the International Council of Shopping Centers and other organizations on commercial leasing and real estate topics. He is regularly mentioned in the Big Deals – Real Estate section of LEXPERT Magazine.

Firm News

Minden Gross is delighted to have been ranked as one of Ontario's top regional law firms by Canadian Lawyer magazine. It is the continued support and suggestions from our clients that have allowed us to achieve this result. We truly appreciate when clients take time out of their busy days to provide us with open and honest feedback about our services. Thank you again and we look forward to continuing our relationship for years to come.

Minden Gross proudly supports the David Cornfield Melanoma Fund. **Adam L. Perzow**, Partner, Commercial Leasing, is part of the new film A Message to My 16-year-old Self created by the David Cornfield Melanoma Fund to help raise awareness of skin cancer. The film is available on our website.

Minden Gross was pleased to host a special luncheon with Lawyers4Wiesenthal on March 28, 2011 featuring guest speaker Marina Nemat. Marina spoke of her survival in Iran's infamous Evin prison and her new book "Prisoner of Tehran".

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Professional Notes

Stephen Posen presented a paper at the Law Society Six Minute Commercial Leasing Seminar on the topic of "Acting for the Small Tenant on a Small Lease" on February 16, 2011. Stephen also participated in a panel for the Canadian Institute on the topic of Strategically Managing a Party's Default, Insolvency or Bankruptcy on May 18, 2011.

Jerry S. Grafstein, Q.C. participated in The 2011 Grafstein Lecture in Communications hosted at the University of Toronto on March 21, 2011. The lecture was entitled "Boilerplate is Changing Our Legal Universe".

Howard S. Black made his eighth appearance as guest on Business News Network television show MoneyTalk with Patricia Lovett-Reid, speaking on the topic of "Probate Taxes" on March 24, 2011. Howard also co-authored an article with **Jodey Therriault** entitled "Future Estate Planning Considerations: Cryo-Preservation, Cryonics and Cord Blood" published in the Estates, Trusts & Pensions Journal.

Stephen J. Messinger gave a special lecture at the ICSC School for Professional Development in Scottsdale, Arizona. (April 3-7, 2011). He is also an Advisory Board Member and presented at the Georgetown University Law Center Advanced Commercial Leasing Institute in Washington, DC. (April 6-8, 2011).

Steven I. Pearlstein presented a paper entitled "Collateral Mortgages" at the 8th Annual Real Estate Law Summit (Two-Day Program) - April 6 & 7, 2011.

David T. Ullmann was quoted in the article "Pension ruling to complicate insolvency proceedings" in the Globe and Mail on April 8, 2011.

Hartley R. Nathan, Q.C. presented a paper "Calling and Conducting Board Meetings" at The Director's College on April 23, 2011 in Niagara-on-the-Lake. Hartley is also editing the 9th edition of Nathan's Company Meetings and Rules of Procedure to be published in the fall of 2011.

Michael A. Goldberg was interviewed for the article "Ottawa wants piece of capital gains splits" published April 27, 2011 in the National Post. He also wrote an article published in the CCH Estate Planner entitled "Federal Budget "Targets" Planning Involving Minors".

Samantha A. Prasad, **Kenneth L. Kallish, A. Irvin Schein, Brian J. Temins and Glen O. Lewis** attended the Meritas Annual Meeting in Montreal (May 12-13, 2011). Samantha spoke as part of a panel at the Meritas Meeting on the topic of "International Investors in U.S. Real Estate" from the Canadian tax perspective (the other panelists were from Montreal, Boston, Washington and Munich, Germany).

Michael A. Goldberg and **Samantha A. Prasad** were part of the organizing committee of the very successful first ever Meritas Canada-U.S. Cross-Border taxation meeting, involving close to 30 Meritas Canadian and U.S. tax practitioners in Montreal (May 12-13, 2011). Michael spoke and moderated the session.

Minden Gross LLP hosted a breakfast seminar on May 11, 2011 entitled "Putting the Family back in Family Business" featuring guest speakers Ron Prehogan and Dr. Bulka of Equitas Consultants. **David Louis** and **Joan E. Jung** also spoke at this event.

Arnie Herschorn was quoted in the article "Case asks what a seller must reveal" in the National Post on May 18, 2011.

Rachel Moses will be a Licensing Examination Tutor for the Law Society Tutoring and Mentorship Program this Spring.