

mcmillan restructuring & insolvency bulletin

re Indalex Limited: new pension deficiency wrinkles for financiers

On April 7, 2011, the Ontario Court of Appeal rendered a decision in the restructuring proceedings involving Indalex Limited (Indalex) under the *Companies' Creditors Arrangement Act* (CCAA) that is inconsistent with prior non-binding comments by the same court relating to the priority of certain pension claims. The decision has material implications for institutional financiers that lend against the inventory, accounts receivable or cash collateral of businesses with Ontario regulated defined benefit pension plans and for the access of those businesses to secured credit.

background

Indalex was the sponsor and administrator of two underfunded defined benefit pension plans. One of the plans (the plan for the benefit of former salaried employees) was in the process of being wound up when Indalex filed for protection from its creditors under the CCAA.

Shortly after the CCAA filing, Indalex obtained DIP financing secured by a super-priority court-ordered charge. The DIP order provided that the charge ranked in priority to all other liens, including statutory trusts. Indalex's U.S. parent guaranteed the obligations of Indalex under the DIP.

Subsequently, the CCAA Court approved a sale of Indalex's assets on a going-concern basis. At the sale approval hearing, representatives of the pension plan beneficiaries obtained an order requiring that \$6.75 million, being the estimated amount of

the underfunding of the pension plans, be held by the court-appointed Monitor pending further order of the CCAA Court.

The proceeds of sale were insufficient to repay the DIP lenders in full and Indalex's U.S. parent paid the shortfall pursuant to its guarantee. The estate of the US parent took the position that the U.S. parent was subrogated to the position of the DIP lenders under the super-priority charge. The court was asked to determine if the reserve funds should be used to cure the pension plan deficiencies or released to the U.S. estate.

Court of Appeal decision

The Court of Appeal held that upon the commencement of the winding up of an Ontario regulated defined benefit pension plan, there is a deemed trust prescribed by Section 57(4) of the *Pension Benefits Act* (Ontario) (PBA) that secures all amounts owed by the employer under Section 75 of the PBA, including future special payments and any wind up deficiency. That holding was inconsistent with non-binding comments made in other decisions. The Court of Appeal also held that the filing by an employer under the CCAA does not trigger bankruptcy priorities and that provincial non-bankruptcy rules continue to apply to the extent that they are not inconsistent with the CCAA.

The Court of Appeal did not discuss amendments to the CCAA made after the commencement of the Indalex case (which have pension related provisions) and therefore did not address whether or not Ontario statutory priorities are now inconsistent with the amended CCAA.

The Court of Appeal also held that, when an employer is also the administrator of a pension plan (which is normal in Ontario), the employer continues to owe a fiduciary duty to the pension plan beneficiaries after it files under the CCAA. The Court of Appeal held that the duty did not prevent the employer from filing under the CCAA. However, it was improper in the Court of Appeal's view for Indalex to do nothing to protect the rights of the pension plan beneficiaries and to fail to put someone else in the position to protect those rights. The Court of Appeal also stated that it was improper for Indalex to seek leave to file for bankruptcy (without any request from arm's length creditors) and to delay

the commencement of the wind up of one of the pension plans in order to reverse the priority of the pension claims.

As a result of the Court of Appeal's ruling that Indalex had breached its fiduciary duties as plan administrator, the Court of Appeal held that it was appropriate to protect the beneficiaries of the second pension plan that was not being wound up at the time of the sale by imposing a constructive trust as a remedy for the breach of the fiduciary duty. In granting the constructive trust remedy, the Court of Appeal emphasized that it was the estate of the U.S. parent of the employer that would have benefitted if the constructive trust was not imposed to protect the pension plan beneficiaries.

The Court of Appeal confirmed that CCAA courts have jurisdiction to grant priority to a DIP lender over pension claims, but in order to do so there has to be adequate notice and disclosure and explicit recognition of such priority in the court record based on the paramountcy of federal bankruptcy law over provincial law. It also accepted the proposition that upon payment under its guarantee the U.S. parent was entitled to recover the balance of the DIP loan on a subrogated basis. However, the Court held that the subrogated claim did not have priority over the statutory or constructive pension trusts for various reasons including that the disclosure and notice given at the time the DIP loan was originally approved by the Court was inadequate.

impact

The primary direct implications of the decision (unless overturned on appeal) are as follows:

- Lenders relying on the security of accounts receivable and inventory are at risk of being subordinate to wind up deficiencies of Ontario regulated defined benefit pension plans;
- Lenders, swap counter-parties, and others relying on cash collateral (in the form of bank deposits) as security may also be subject to that risk;
- Doubt has been cast over the use of bankruptcy proceedings to defeat the priority of provincial statutory liens and trusts for pension and other claims;

- Prior practice with respect to seeking approval of priming DIP loans by the Court will have to be modified by the addition of new procedures to ensure that DIP Lenders are assured priority over provincial statutory liens and trusts; and
- It is possible that constructive trust claims will come to be asserted more frequently in Canadian insolvency proceedings.

further information

Please contact any member of the Restructuring Group at McMillan to discuss steps that can be taken by working capital or DIP lenders in order to mitigate some of the effects of the decision.

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[a cautionary note](#)

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