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Supreme Court of Canada Weighs in on Plan Deficits and the Fiduciary Duty of Pension Plan Administrators in an Insolvency: Sun Indalex Finance, LLC v. United Steelworkers

Date: February 4, 2013

INTRODUCTION

On February 1, 2013, the Supreme Court of Canada issued its highly anticipated decision in *Sun Indalex Finance, LLC v. United Steelworkers*, largely overturning the 2011 Ontario Court of Appeal decision. The Supreme Court upheld an expansive definition of the deemed trust under the Ontario *Pension Benefits Act* ("PBA") and struck down a constructive trust while providing guidance for companies who are both pension plan sponsors and administrators on the scope of their fiduciary duty to plan beneficiaries and on resolving conflicts that can arise between those fiduciary duties and corporate interests in an insolvency situation. Finally, the Court provided some additional guidance on the payment of litigation costs out of a pension fund.

BACKGROUND

Indalex Limited ("Indalex") filed for creditor protection under the *Companies' Creditors Arrangement Act* ("CCAA") on April 3, 2009. FTI Consulting Canada ULC was appointed as monitor ("Monitor"). Indalex's parent company ("Indalex U.S.") sought bankruptcy protection in the United States a few days prior.

On April 8, 2009, the Ontario Superior Court of Justice authorized Indalex to borrow funds pursuant to a debtor-in-possession credit agreement among Indalex, Indalex U.S. and a syndicate of lenders ("DIP lenders"). The Court order contained a "super-priority charge" provision which gave the DIP lenders a super-priority over all other creditors. It specifically granted that the DIP lenders' charge "shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise", other than certain CCAA charges that are not relevant to the decision.

Indalex was the sponsor and administrator of two registered defined benefit pension plans: The Retirement Plan for Salaried Employees of Indalex Limited and the Associated Companies (the "Salaried Plan"), which had been wound up prior to the CCAA filing, and the Retirement Plan for Executive Employees of Indalex Limited and Associated Companies (the "Executive Plan"), which was ongoing (collectively, the "Plans"). Both Plans were underfunded. As of December 31, 2008, the wind up deficiency of the Salaried Plan was approximately $1.8 million and the Executive Plan had an estimated wind up deficiency of approximately $3.2 million as of July 15, 2009.

In July 2009, Indalex sought Court approval of the sale of its assets and the distribution of the sale proceeds to its DIP lenders. The purchaser in the sale assumed no responsibility for the Plans. The proposed distribution of the sale proceeds would result in no funds to cover the deficiencies in the Plans.

The United Steelworkers (the "USW") and a group of retired executives (the "Former Executives"), as beneficiaries of the Salaried Plan and Executive Plan, respectively, objected to the proposed distribution of sale proceeds and asserted a deemed trust claim over the sale proceeds to cover the deficiencies in the Plans. They also claimed that Indalex had breached its fiduciary duty to the Plans' beneficiaries by failing to meet its obligations under the Plans and ignoring its responsibilities as the Plans' administrator once the CCAA proceedings had commenced.

The Court approved the sale of Indalex's assets with the sale proceeds going to the Monitor. As a result of the USW and Former Executives' claims, the Monitor was ordered to retain a reserve fund. When the sale closed at the end of July, the proceeds were insufficient to repay the DIP lenders in full. The Monitor had retained $6.75 million in the reserve fund, representing the approximate value of the Plans' deficiencies.

The USW and Former Executives brought motions to determine their claims in order to have the reserve funds applied to the Plans' deficiencies. Indalex filed a motion seeking a voluntary assignment into bankruptcy. The Court held that the full reserve fund was payable to Indalex U.S., as the guarantor under the DIP loan agreement, and not to the Plans. The USW and the Former Executives appealed.

ONTARIO COURT OF APPEAL DECISION

On April 7, 2011, the Ontario Court of Appeal unanimously ordered the Monitor to pay into each of the Salaried Plan and the Executive Plan an amount sufficient to satisfy the deficiencies in each Plan, finding that the deficiencies should be paid in priority over the guarantor of the DIP loan.

The Court of Appeal declined to find that a section 57(4) deemed trust existed in respect of the Executive Plan because that plan was not wound up at the time Indalex entered into CCAA protection. With respect to the Salaried Plan, the Court of Appeal expanded the scope of the deemed trust provision set out at section 57(4) of the PBA to include the entire wind up deficiency under that Plan. This was a clear departure from earlier decisions which limited the deemed trust to current service costs and special payments accrued to the wind up date.

However, the Court held that Indalex had breached its fiduciary obligations as the administrator of the Plans in the CCAA proceedings. The Court held that the remedy for the breach was to impose a constructive trust over a portion of the reserve fund with the result that the pension deficiency in the Executive Plan was also found to rank ahead of the DIP lenders' super-priority.

The Court of Appeal also issued a costs award and dismissed the USW's motion seeking to have its costs payable from the Salaried Plan. The Court of Appeal declined to award the USW's costs from the Salaried Plan as the USW represented only 7 of 169 plan members and the Salaried Plan was underfunded.

A link to our full summary of the Court of Appeal's April 2011 decision is available here.

THE SUPREME COURT OF CANADA DECISION

The Supreme Court of Canada issued a split decision with written reasons provided by three judges.

First, the Court unanimously found that the super-priority granted to the DIP lenders in the federal CCAA proceedings prevailed over any deemed trust under the provincial PBA on the basis of the legal doctrine that grants paramountcy to federal laws where they conflict with provincial laws.

Second, the Court unanimously found a breach by Indalex of its fiduciary duty to the Plans' beneficiaries but the majority of the Court rejected and overturned the use of a constructive trust as an appropriate remedy for the breach. This finding ultimately resulted in the defeat of the claims by the USW and the Former Executives to have any of the sale proceeds applied to the deficiencies in the Plans.

Nevertheless, for companies that sponsor Ontario-registered defined benefit pension plans, the Court's findings on the extent of the deemed trust in section 57(4) of the PBA are striking. In addition, the Court's findings regarding the acts that constitute a breach of fiduciary duty will be of significant interest to pension plan administrators across Canada.

The Court considered the following issues:

1. Does the deemed trust provided for in s. 57(4) of the PBA apply to wind up deficiencies?
2. If so, does the deemed trust supersede the DIP charge?
3. Did Indalex breach any fiduciary obligations to the Plans' beneficiaries when making decisions in the context of the insolvency proceedings?
4. Did the Court of Appeal properly exercise its discretion in imposing a constructive trust to remedy the breaches of fiduciary duties?
5. Did the Court of Appeal err in not granting costs to the USW from the Salaried Plan?

Three different judges of the Supreme Court provided written decisions, from which the majority judgment for each issue is obtained. The chart below sets out briefly the conclusions in each of these judgments, which are described in greater detail below:

Issue	**Deschamps J. (Moldaver J. concurring) (2)**	**Cromwell J. (McLachlin C.J. and Rothstein J. concurring) (3)**	**LeBel J. (Abella J. concurring) (2)**	**Majority Decision (Justices For/ Against)**
Deemed Trust applies to wind up deficiency	Yes	No	Yes	**Yes (4-3)**
Deemed Trust supersedes DIP charge	No	No	No	**No (7-0)**
Breach of fiduciary duty to Plan beneficiaries resulting from conflict of interest in making decisions within insolvency proceedings	Yes. In this case, breach occurred at point that the motion to grant DIP lenders super-priority was made without notice. Generally, whether a conflict of interest arises depends on nature of the decision.	Yes. In this case, breach occurred at point that the motion to grant DIP lenders super-priority was made without notice. Generally, a conflict of interest arises where representation of beneficiaries would be materially and adversely affected.	Yes	**Yes (7-0)**
Impose constructive trust on sale proceeds as remedy for breach of fiduciary duty	No	No		