Timminco Limited: CCAA Court Considers Fiduciary Obligations Post-Indalex

February 23, 2012 by Ian J.F. McSweeney

Timminco Limited is among the first reported cases to be released following the Ontario Court of Appeal's April 7, 2011 decision in *Re Indalex.* There are two *Timminco* decisions – *Timminco 1* and *Timminco 2.*

Indalex Recap

Recall, that in *Indalex*, contrary to widely accepted principles governing pensions under the *Companies' Creditors Arrangement Act* (the CCAA), the Court of Appeal held that the entire amount an employer is required to contribute to fund a pension plan wind-up deficiency under the Ontario *Pension Benefits Act* (PBA) is subject to the deemed trust provisions of the PBA. In this case, such contributions were ordered to be paid in priority to outstanding secured creditor claims, including the super priority charge granted by the CCAA court to the debtor-in-possession (DIP) loan advanced to Indalex to finance its CCAA restructuring. In particular, the Ontario Court of Appeal held that:

- the deemed trust under subsection 57(4) of the PBA extended to all amounts owed by the employer on plan wind-up, regardless of the fact that the regulations under the PBA permit employers to pay the pension shortfall over a period of five years;
- due primarily to certain fact-based procedural deficiencies identified by the Court of Appeal, the DIP charge granted by the CCAA court order, which purports to impose paramountcy over the PBA deemed trust provisions, did not, in the circumstances, have priority over such deemed trust; and
- with respect to one of the affected pension plans that had not been wound up, Indalex was in a conflict of interest position with respect to its co-existing sponsor (non-fiduciary) and administrator (fiduciary) roles (the so-called "two hats" doctrine) in dealing with pension issues under the CCAA proceedings, giving rise to a constructive trust in respect of the plan deficit which also took priority over the DIP charge.

On the first point regarding the scope of the PBA deemed trust provisions relative to pension shortfalls, we may have to wait for insight from the Supreme Court of Canada when it hears the Indalex appeal on June 5, 2012. On the other two points, CCAA courts are already weighing in.

Timminco 1 Decision

In this decision the CCAA court dealt head-on with its jurisdiction to grant super priority to D&O (directors and officers) and other charges which validly prime the PBA deemed trust on pension deficits, as well as the suspension of employer past service contributions (special payments). The court also incorporated into its analysis the concern of the Court of Appeal in Indalex relating to

the potential for conflicts of interest to arise as a result of the dual role ("two hats") of an employer as pension plan sponsor and administrator.

Timminco Limited and Bécancour Silicon Inc. (collectively, the debtors) applied for and obtained relief under the CCAA. The debtors sponsored two defined benefit (DB) plans and a hybrid defined benefit/defined contribution (DC) plan, all of which were underfunded and one of which had already been declared wound up. The debtors applied to Ontario Superior Court for an order (among other things):

- suspending employer special payment obligations to fund DB solvency deficiencies under the pension plans; and
- granting super priority payment of the administration charge (fees of the debtors' CCAA third party service providers) and the D&O (directors and officers) charge out of debtor assets.

The court granted both orders by suspending the debtors' special payment obligations for the duration of the CCAA stay and conferred super priority on both the plan administration charge and D&O charge.

Suspension of Special Payments

The debtors argued that during the CCAA restructuring they could only afford to pay DB normal cost and DC contributions, as well as member contributions deducted through payroll.

The CCAA court found that the debtors were in fact insolvent for purposes of the CCAA and did not have sufficient reserves to continue making special payments during the CCAA stay. The court further held that the affected employees and former employees covered by the pension plans would not be prejudiced by the suspension of special payments since, without the suspension, the CCAA restructuring would not succeed and the debtors' would become bankrupt, which would not produce a better result for them. Based on this lack of prejudice, the court determined that the "two hats" doctrine referred to in Indalex would not be infringed through any conflict of interest because avoiding bankruptcy was in the best interests of both the debtors and pension plan beneficiaries. Therefore the requested relief would not favour the debtors' interests (wearing their employer/plan sponsor "hat") over their fiduciary obligations to pension beneficiaries (wearing their plan administrator "hat").

Super Priority on Administration and D&O Charges

With respect to the super priority request, the CCAA court noted that it was not reasonable to expect essential professional service providers in CCAA restructurings to risk not being paid for their work, nor is it reasonable to expect directors and officers to remain at their posts to provide essential decision making throughout the restructuring process without the requested protection. Again, the court recognized that without such services bankruptcy would result, leaving pensioners and employees worse off. The court agreed with the debtors' submissions that a

CCAA court has the authority under the CCAA to override conflicting provisions of provincial statutes like the PBA deemed trust provisions "where the application of the provincial legislation would frustrate the company's ability to restructure", and that such paramountcy was confirmed by the Ontario Court of Appeal in Indalex.

Timminco 2 **Decision**

Following the relief obtained in Timminco 1 the debtors brought another motion before the CCAA court for an order approving the DIP facility and granting a priority charge on the debtors' current and future assets in favour of the DIP lender. The DIP loan agreement also specified that DIP advances could not be used to make pension plan special payments.
The debtors' motion was opposed by the unions representing affected employees, which argued that when the debtors negotiated the DIP loan agreement they had failed to consider their fiduciary obligations as pension plan administrators, or to consider the best interests of the plan beneficiaries.

In approving the DIP facility and granting the requested DIP loan super priority, the CCAA court rejected the unions' arguments and noted, among other factors, that the Monitor and the secured creditors supported the super priority and "without the approval of the DIP Facility and the granting of the DIP Charge, there simply will be no money available" to proceed with the CCAA restructuring. As a result, the requested priority charge and the terms of the DIP agreement were necessary under the circumstances. The court stated its rationale as follows:

> *"It is unrealistic to expect that any commercially motivated DIP Lender will advance funds without receiving the priority that is being requested on this motion. It is also unrealistic to expect that any commercially motivated party would make advances to the Timminco Entities for the purpose of making special payments or other payments under the pension plans*."

The court went on to find that it was necessary and within its powers to invoke the doctrine of paramountcy such that the provisions of the CCAA override those of Quebec and Ontario pension legislation, thereby granting the DIP lender a super priority over all trusts, liens, charges and encumbrances, statutory or otherwise, including over any deemed trust created under the pension legislation.

Comment

Both Timminco decisions demonstrate that, post-Indalex, there may be an increased focus by the courts in CCAA proceedings on the general issue of potential conflicts of interest under the "two hat" doctrine when it comes to dealing with pension issues. However, the extent to which debtors are actually wearing their administrator "hats" verses their sponsor "hat" (and, as a result, are truly acting as a pension fiduciary) when they take certain pension-related actions during the course of CCAA restructuring requires further judicial scrutiny.

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