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SUPERIOR COURT REFUSES TO IMPORT INDALEX DECISION INTO QUÉBEC LAW

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ON APRIL 20, 2012, JUSTICE MONGEON OF THE QUÉBEC SUPERIOR COURT RENDERED AN IMPORTANT DECISION IN THE RESTRUCTURING OF THE WHITE BIRCH PAPER COMPANY ("WHITE BIRCH").[1] THE JUDGMENT COULD HAVE A LASTING EFFECT ON CCAA JURISPRUDENCE IN QUÉBEC SINCE IT DEALS WITH ISSUES RELATING TO THE PENSION PLANS OF INSOLVENT COMPANIES AND THE APPLICABILITY OF AN IMPORTANT DECISION OF THE ONTARIO COURT OF APPEAL IN QUÉBEC.

BACKGROUND

White Birch is a manufacturer of newsprint and specialty paper with operations in both Québec and Virginia. In early 2010, the company placed itself under the protection of the *Companies Creditors' Arrangement Act* ("CCAA").[2] At the time the initial order was issued, White Birch's pension plans were in a severe solvency deficit position. The initial order provided, among other things, for the suspension of "special payments" to its pension plans. It also released White Birch from any statutory, fiduciary or "common law" obligations and stated that no trust, whether express, tacit, or deemed, would be recognized. Finally, the initial order created a super-priority charge to secure interim financing ("DIP Financing") in order to enable the company to continue its operations during the restructuring.

Some 21 months after the initial order was granted, the union (CEP), the non-union pension committees, and a group of retirees each petitioned the Court for a declaration that any sums owed by White Birch to the pension plans be declared a claim ranking ahead of the claim of the DIP lender. Furthermore, they alleged that the company had sufficient liquidity to reinstate the special payments to the pension plans and asked for an order to this effect.

PETITIONERS' POSITION

The petitioners sought to persuade the Court to apply the Ontario Court of Appeal's decision in *Re Indalex*[3] in Québec. It was argued that section 49 of the Québec *Supplemental Pension Plans Act* ("SPPA"),[4] similarly to the Ontario *Pension Benefits Act* ("PBA"),[5] created a statutory deemed trust over unpaid contributions by the employer, including special payments. Furthermore, it was alleged, based on *Indalex*, that the onus was on White Birch to show that the provincial legislation must yield to the general objectives of the federal CCAA.

THE *INDALEX* DECISION

The debate between the petitioners and White Birch centred mainly around the application of the *Indalex* decision. In April 2009, Indalex was granted protection under the CCA. It received DIP Financing from a syndicated group of lenders in return for the usual super-priority charge ranking ahead of any secured claim,

[1] 2012 QCCS 1679.

[2] RSC 1985, c C-36.

[3] 2011 ONCA 265 [*Indalex*].

[4] RSQ, c R-15.1, s.49.

[5] 1990, c P.8.

trust, or other statutory and contractual charges. The company was also the administrator of two defined benefit pension plans, one for the employees and the other for the executives, both of which showed significant solvency deficits. Ultimately, Indalex sought authorization to sell its assets and distribute the proceeds to the DIP lenders. The unions, and some of the retirees' representatives, contested the proposed distribution of assets.

The Ontario Court of Appeal unanimously overturned the lower court's decision holding instead, pursuant to section 57(4) of the *Pension Benefits Act*, that the solvency deficit of the employees' retirement plan was subject to a deemed trust and, therefore, that the sum required to offset this deficit had to be carved out of the debtor's estate. According to the Ontario Court of Appeal, the provincial statute continued to apply in matters of insolvency and restructuring absent an express provision in federal legislation to displace it. Ultimately, it was not shown that the PBA and the CCAA were incompatible. As a result, the PBA could be applied even though the debtor had come under the protection of the CCAA. Furthermore, since the initial order did not state that the DIP loan would rank ahead of the deemed trust, the trust had to take priority over the DIP super-priority.

The Ontario Court of Appeal further ruled that the deemed trust provision under the PBA could not apply to the executives' retirement plan because the plan was not wound up at the time the initial order was issued. Rather, the Court held that the company, as administrator of the pension plans, did nothing to protect the interests of the beneficiaries and, consequently, was in breach of its fiduciary duty. The Court resorted to equitable principles to remedy the situation, stating that Indalex had breached its obligations as constructive trustee of the pension plan. According to the Court, the constructive trust in favour of the plan beneficiaries had priority over the charge granted in favour of the DIP lenders.

SPECIAL PAYMENTS UNDER THE SPPA: IS A TRUST CREATED?

Mr. Justice Mongeon of the Québec Superior Court came to a different conclusion than the Ontario Court of Appeal. He held that, as distinct from the PBA in Ontario, the Québec SPPA does not create a trust under Québec law. The relevant provision reads as follows:

> 49. Until contributions and accrued interest are paid into the pension fund or to the insurer, they are deemed to be held in trust by the employer, whether or not the latter has kept them separate from his property.

While the BIA used to contain a presumption which made it unnecessary to create a true trust, both the BIA and the CCAA now only recognize true trusts, with limited exceptions. Therefore, according to Justice Mongeon, under the current regime, the existence of a deemed trust in the statute merely creates a presumption that a trust exists. For a trust to actually exist, all of the constituent elements under the applicable law must be present.

Furthermore, the Court relied on the Supreme Court's decision in *Century Services Inc. v. Canada (Attorney General)*[6] to the effect that, since section 37 does not explicitly protect this deemed trust, it is of no force and effect in the context of an arrangement under the CCAA. In other words, the deemed trust under the SPPA is rendered ineffective against a debtor under the CCAA.

Since no deemed trust existed, a trust would only have been created in favour of the petitioners if it had to satisfy the requirements of a true trust under provincial law. Indeed, the notion of constructive trust, which was fundamental in *Indalex*, is unknown to Québec law. However, in this case, the fact that no funds were transferred or set aside for the special payments led Justice Mongeon to conclude that no true trust was created. White Birch had not transferred anything and had, in fact, maintained complete control over the property supposedly affected by a trust. The sums owed were intermingled with the rest of the company's money and were in no way separated or removed from the company's control.

WAS WHITE BIRCH IN BREACH OF ITS FIDUCIARY OBLIGATIONS?

Justice Mongeon began by drawing an important distinction between the situation in *Indalex* under the PBA and the way in which pensions are administered in Québec. Most notably, unlike the situation in *Indalex* in which the company administered the plans, when a pension plan is registered in Québec, it must be administered by a pension committee. Therefore, once the pension plan has been registered, the employer no longer has any fiduciary obligation to the pension plan. As a result, the Court held that, in contrast to the situation of Indalex, White Birch had not taken up the mantle of an administrator or manager of the pension plans in question and, therefore, could not be found to be in breach of any fiduciary obligation. Moreover, since the constructive trust does not exist under Québec law, White Birch, unlike the situation in *Indalex*, could not be considered a 'constructive trustee'.

[6] 2010 SCC 60.

REJECTION OF *INDALEX*

Mr. Justice Mongeon wrapped up his discussion of *Indalex* by referring to recent cases in Ontario which have refused to find that the deemed trust under the PBA should take priority over CCAA charges. The decision of Justice Morawetz in *Re Timminco*[7] is cited for the principle that ordering a debtor to continue making special payments, where this would have the effect of pushing a viable company into bankruptcy, would frustrate the purpose of the CCAA. Consequently, Mr. Justice Mongeon was of the opinion that even if the Court had come to the conclusion that a trust was created in favour of the petitioners, the SPPA would be rendered inapplicable pursuant to the doctrine of paramountcy.

Ultimately, this rejection not only of the decision in *Indalex*, but also the existence of a trust flowing from section 49 SPPA which could be set up against the debtor, means that the special payments suspended by the initial order rank as mere unsecured claims.

THE "FLOATING CHARGE"

The petitioners argued, in the alternative, that if section 49 SPPA does not create a trust which is effective against the DIP lender, this provision could create a floating charge over the debtor's assets. Justice Mongeon cited the Supreme Court of Canada, which describes the floating charge in the following terms:

> [...] A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize.[8]

The argument here was that the effect of the floating charge would be that the special payments would rank behind the super-priorities granted in the initial order but ahead of other claims, whether secured or not. However, this argument failed because the floating charge theory does not apply under Québec law.

THE *RES JUDICATA* ARGUMENT

In response to the argument that the previous orders of the Court were final and could not be changed or altered, the Court noted that there was a comeback clause which seemed to permit adjustments to be made to the initial order. However, the Court observed that important decisions had been made on the basis of those orders. In this case, the interim lender had agreed to lend tens of millions of dollars to White Birch to keep the company afloat. Furthermore, the initial order was not issued without the petitioners' knowledge. Justice Mongeon concluded that the extended period of time that elapsed between the initial order and the motion before him (21 months) was not due to ignorance of the facts, but rather, to the concerted effort by the petitioners to have the principles of *Indalex* applied in Québec.

While the cash flow of White Birch had clearly improved, Justice Mongeon held that if he ordered White Birch to reinstate the special payments, this would give the pension plans an unfair advantage over White Birch's other creditors whose claims were stayed. Indeed, the increased liquidity of the company was due in large part to the stay obtained under the CCAA because it permitted the company to suspend the payment of roughly $900 million in debt.

CONCLUSION

At this time, it is still unclear what the impact of this decision and the decision in *Indalex* will be. *Indalex* was heard by the Supreme Court of Canada on June 5, 2012 and its judgment is awaited with great anticipation. In addition, on May 9, 2012, the Association of Retired Employees of White Birch - Stadacona applied for leave to appeal Justice Mongeon's decision. While the legacies of both *Indalex* and *White Birch* are yet to be decided, both appeals will be closely followed by members of both the legal and business communities.

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[7] 2012 ONSC 506; 2012 ONSC 948.

[8] *Alberta (Treasury Branches) v. M.R.N.; Toronto Dominion Bank v. MR.N.*, [1996] 1 SCR 963 cited at para 204 of the decision.

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