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Financial Services & Banking

DIP LENDING CHARGE: When Super-priority is not so Super

On April 7, 2011, the Ontario Court of Appeal (the "**OCA**") released its decision in *Indalex Limited*, ordering that the reserved sale proceeds of a going-concern sale involving the Canadian Indalex entities ("**Indalex Canada**"), held by the court-appointed monitor, FTI Consulting Inc. (the "**Monitor**"), culminated in the context of cross-border proceedings under both the *Companies' Creditors Arrangement Act* (Canada) (the "**CCAA**") and Chapter 11 of the *US Bankruptcy Code* (the "**US Code**") be utilized to satisfy the deficiencies in respect of Indalex Canada pension plans instead of being paid to the holder of the DIP Charge (as defined below).

On April 3, 2009, Indalex Canada obtained an order of the Ontario Superior Court of Justice (the "**CCAA Court**") which order was later amended (the "**Amended Initial Order**"), granting it protection from creditors under the CCAA (the "**CCAA Proceedings**"). The Amended Initial Order authorized Indalex Canada to borrow funds from JP Morgan Chase Bank, NA (the "**DIP Lender**") and granted a "super-priority" charge on Indalex Canada's property (the "**DIP Charge**"). The US parent of Indalex Canada guaranteed Indalex Canada's obligation to repay the DIP Lender.

On July 20, 2009, Indalex Canada obtained an order from the CCAA Court approving the sale of the Indalex Canada assets. In response to certain claims of Indalex Canada pension beneficiaries, the Monitor retained a reserve fund (the "**Reserve Fund**") from the sale proceeds pending resolution of such claims. Since the sale proceeds in respect of the Indalex Canada assets were insufficient to repay the DIP Lender, it called on the guarantee issued by Indalex US. Upon payment of the shortfall to the DIP Lender, Indalex US became subrogated to the DIP Charge.

At the time of the CCAA Proceedings, Indalex Canada was the administrator of plans in favour of salaried employees (the "**Salaried Plan**") and executives (the "**Executive Plan**" and, together with the Salaried Plan, the "**Plans**"). The CCAA Court dismissed a motion in respect of the Executive Plan on the basis that since the wind-up of the Executive Plan had not yet taken place, there were no deficiency payments owing in respect of such plan as of the closing of the sale transaction. In respect of the Salaried Plan, while the wind-up of such plan had commenced prior to the commencement of the CCAA Proceedings, the CCAA Court indicated that since Indalex Canada was permitted by the regulations to the *Pension Benefits Act* (Ontario) ("**PBA**") to make up the deficiency in the Salaried Plan over a period of years, the payments did not become due until they were required to be paid.

The OCA reversed the decision of the CCAA Court holding that, in the case of the Salaried Plan, the amount of the employer contributions that were required to be made (i.e. accrued but not due) had accrued as of the commencement of the wind-up of such plan and that such wind-up deficiency was subject to a deemed trust pursuant to Section 57(4) of the PBA. The OCA determined that in the absence of a paramountcy argument, the general DIP Charge super-priority language found in the Amended Initial Order was not sufficient to give the DIP Charge priority over the PBA deemed trust claim in respect of the Salaried Plan beneficiaries.

The OCA further held that as the administrator of the Plans, Indalex Canada continued to be charged with the responsibility of an administrator during the CCAA Proceedings and that it had breached its fiduciary duty as administrator of such, a duty which arose both under the PBA and at common law. As such, the OCA held that the appropriate equitable remedy was to impose a constructive trust on the Reserve Fund and pay such money out to the beneficiaries of the Plans in priority to the holder of the DIP Charge.

Because the breach of fiduciary duty finding was sufficient to order the Reserve Fund to be paid, in part, to satisfy the Executive Plan deficiency, the OCA declined to rule on the issue of whether the Executive Plan beneficiaries were also entitled to a secured deemed trust claim ranking above the DIP Charge.

The OCA also indicated that the recent Supreme Court of Canada decision in *Century Services* does not stand for the unqualified proposition that federal priorities under the *Bankruptcy and Insolvency Act* (Canada) apply in CCAA proceedings. A final important point of note is that both the OCA and the CCAA Court expressed the view (without having to rule on the issue) that a debtor should not assign itself into bankruptcy in order to defeat priority claims arising under provincial legislation.

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