



**Insolvency Institute of Canada
L'Institut d'insolvabilité du Canada**

**At the Crossroads of Pension Street
and
Insolvency Road**

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Where are Pension Claims Going?

- Indalex – seeking leave to appeal to Supreme Court of Canada
- BIA – current status of employee/pension claims
- Bills C-501, S-214, S-216, etc. – all proposed amendments have died on the Order paper
- Currently, there are no proposed amendments to the BIA in legislative process
- Next legislative (BIA) review – report by Minister in 2014
- No indication by Conservative Party that legislative amendments to BIA are the preferred route - Pooled Retirement Pension Plan is proposed policy
- NDP prefers increased CPP. Also supported legislative amendments to BIA

Is there a reason for change? Canada vs. G7

Country	Predominant Occupational Pension Arrangement	Status of Pension Claims on Bankruptcy	Pension Fund Guarantee Schemes
Canada	<ul style="list-style-type: none"> • Defined benefit/defined contribution pension plans 	<ul style="list-style-type: none"> • Contributions due but not paid to pension funds have a preferred status • Pension deficit is treated as an unsecured debt 	<ul style="list-style-type: none"> • The Pension Benefit Guarantee Fund (Ontario) guarantees pension benefits in the event of plan sponsor's bankruptcy (only up to certain limits)
France	<ul style="list-style-type: none"> • Limited number of occupational pension plans due to generous state pension schemes • Occupational plans are mainly insured or savings plans 	N/A	<ul style="list-style-type: none"> • No pension fund guarantee scheme
Germany	<ul style="list-style-type: none"> • Defined benefit pension plans 	<ul style="list-style-type: none"> • Pension obligations are treated as unsecured debts 	<p>Upon bankruptcy, the Pension Guarantee Fund ("PSVaG") takes on obligations of plan sponsor (up to a certain level) and purchase annuities</p> <p>About 2/3 of pension liabilities are covered by the PSVaG. The other third is held by insurers and "Pensionskassen" (these funds are being supervised as insurance funds and are subject to stringent solvency standards)</p>

Country	Predominant Occupational Pension Arrangement	Status of Pension Claims on Bankruptcy	Pension Fund Guarantee Schemes
Italy	Defined contribution pension plans	<ul style="list-style-type: none"> Contributions to public pension schemes and other forms of social protection has priority over unsecured debts (theoretically includes contributions to employer-sponsored plans) 	<ul style="list-style-type: none"> Protection Fund for unpaid contributions
Japan	<ul style="list-style-type: none"> Defined benefit pension plans (“employee pension funds” or “EPFs” are large DB plans; there are also other types of DB arrangements) 	<ul style="list-style-type: none"> Employer contributions to EPFs rank behind wages/taxes but ahead of unsecured creditors Contributions to other pension arrangements are unsecured debts 	<ul style="list-style-type: none"> Pension guarantee program covers a portion of the pension benefits accrued by members of EPFs only

Country	Predominant Occupational Pension Arrangement	Status of Pension Claims on Bankruptcy	Pension Fund Guarantee Schemes
United Kingdom	<ul style="list-style-type: none"> Defined benefit pension plans 	<ul style="list-style-type: none"> Preferential status for unpaid contributions (the government ranks as the preferred creditor if it paid those contributions to the pension fund) 	<ul style="list-style-type: none"> National Insurance Fund can pay employee contributions deducted as well as contributions owed by sponsor (up to certain limits) Pension Protection Fund provides compensation to members of eligible defined plans in case of shortfalls
United States	<ul style="list-style-type: none"> A significant number of plans continue to have defined benefit obligations; a strong trend has been observed where employers either replace the DB plan with a DC plan or close the DB plan to new entrants 	<ul style="list-style-type: none"> No priority or preferential status for pension-related claims 	<ul style="list-style-type: none"> Pension Benefit Guarantee Corporation offers some protection of defined benefits if employer is unable to fund the plan

Pension Plan Restructuring

AbitibiBowater – An Example of Negotiated Solutions

- Restructuring of the pension plans was a key pre-condition to implementation of the CCAA Plan
 - The CCAA Plan and Chapter 11 Plan of Reorganization provided for the conversion of approx. \$8 billion of liabilities to equity in the restructured organization (in addition secured debt and DIP financing was to be paid in cash)
 - Approx. \$1.5 billion of post implementation financing was to be raised as a condition to implementing the CCAA Plan and Chapter 11 Plan of Reorganization.

AbitibiBowater (con't)

Ultimately, a business resolution to the funding issues was negotiated between the Company, the unions and the pension regulators

- In addition, Collective Bargaining Agreements were negotiated with virtually all of the Canadian and U.S. union locals.
- Regulator approval was condition on both provinces (Quebec and Ontario) accepting the pension funding deal
- The pension plans were unaffected by the CCAA plan and all pension payments to employees and retirees continued
- Target benefit plans were established for new employees and all active employees for future post-implementation service

AbitibiBowater (cont'd)

- Key elements of the negotiated amendments that were ultimately approved by the pension regulator in Quebec
- Solvency deficiency funding was to be made over a 10 year period, not a 5 year period as contemplated by statute
 - After the 10 years, any remaining solvency deficiency would be funded based on statutory requirements at that time (currently 5 years)
 - Similar to Stelco CCAA pension arrangement with Province of Ontario

AbitibiBowater (cont'd)

- No dividends were to be paid by the Canadian subsidiary until solvency funding reached a level of 80%
- The Company undertook to spend 60% of its capital expansion in the province of Quebec and strategic capex was to be no less than \$75 million over the next 5 years
- The Company's head office was to remain in Quebec
- Lump sum pension payments were to be made in the event that mills were shut down in the Province of Quebec
- Ongoing financial reporting requirements to the Province

AbitibiBowater (cont'd)

- As part of the deal with the Quebec pension regulatory, pension funding was fixed for a period of 10 years.
- A fixed amount of \$50 million per annum is to be contributed
 - Past service costs for pension enhancements, if any, are to be contributed immediately
- Certain other funding is to be made if pension funding falls below a certain threshold (max. \$15 million, but dependant on a free cash flow calculation)
 - Essentially a funding ratio “floor” has been created and is the target minimum funding ratio

AbitibiBowater (cont'd)

- These factors were of particular importance to Abitibi as it granted cost certainty for a significant period of time
 - Essentially pension funding will be \$50 million per annum (which may increase to a maximum of \$65 million per annum, if the funding ratio drops below agreed levels.
 - This formula eliminated the significant actuarial risk with respect to funding for the next 10 years.

The tensions within the CCAA

- Similarities between Indalex and TCT – CCAA Courts creating Orders (using Model orders or otherwise) that grant sweeping powers which can have the effect of ignoring or superseding long established principles of substantive areas of law. In TCT – successor rights in the labour law field or Indalex – trust and pension law.
- Parties need to understand parameters of the CCAA – a fundamental aspect is to ensure that the interests of all stakeholders are protected and a forum is provided to reasonably advance their interests. In all cases where there are pensions, there will be a “two hats” reality unless specific steps are taken to address the conflict. The role of the administrator of the pensions cannot be abandoned without consequences.
- Fiduciary obligations must be accorded the appropriate respect.
- There has to be proper regard to the interests of the affected beneficiaries and the process must recognize that they have a voice.

Indalex - background

- Indalex Canada, the sponsor and administrator of two registered pension plans (the Salaried Plan and the Executive Plan) obtained an Initial Order under the CCAA from the Ontario Superior Court of Justice.
- The Initial Order provided that the DIP lender's charge "shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise".
- Indalex Canada sought an Order approving the sale of its assets on a going-concern basis and an Order to distribute the sale proceeds to the DIP Lenders. The proceeds from the sale of assets were not sufficient to repay the DIP facility in full.

Indalex (con't)

- At the sale approval motion, the Monitor was directed to retain \$6.75 million of the sale proceeds as a “Reserve Fund” to address the estimated deficiencies in the Salaried Plan and the Executive Plan.

Indalex - Court of Appeal Decision

I. Scope of the deemed trust

- The Court of Appeal expanded the scope of the deemed trust established by previous decisions to all amounts owed by the employer to the Plans, including any deficiency claim.

Indalex - Court of Appeal Decision

II. Priority for the DIP charge can be granted

- The Court fully accepted that CCAA judges can make orders granting super-priority charges that have the effect of overriding provincial legislation, including the PBA.
- The Court held that the determination of the super-priority charge for DIP financing must be made on a case-by-case basis.
- The Court indicated that there may well be situations in which paramountcy is invoked and the record satisfies the CCAA judge that the application of the provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy.

Indalex - Court of Appeal Decision

- If the CCAA judge found that recognition of the PBA deemed trust would frustrate the purpose of the CCAA proceeding and paramountcy had been invoked, the CCAA judge would be free to make a super-priority charge that overrode the deemed trust.
- This approach, the Court of Appeal stated, leaves the CCAA Court with greater flexibility and the ability to be “cognizant of the various interests at stake in the reorganization which can extend beyond those of the debtor and creditors to include employees”.
- The Court held that, in this case, there was nothing in the record to suggest that giving the deemed trust priority would have frustrated Indalex’s efforts to sell itself as a going-concern business.

Indalex - Court of Appeal Decision

III. Governance and Fiduciary Obligations

- The court was critical of the debtor companies and their management. The Court found that Indalex Canada had breached its fiduciary obligations under the PBA and at common law as administrator of the Plans.
- The facts cited in support of this conclusion include:
 - (i) Indalex did nothing in the CCAA proceedings to fund the deficit in the underfunded plan;
 - (ii) Indalex Canada took no steps to protect the vested rights of the Plan's beneficiaries to continue to receive their full pension entitlement;

Indalex - Court of Appeal Decision

- (iii) Indalex Canada took active steps which undermined the possibility of additional funding to the Plans;
- (iv) Indalex Canada applied for CCAA protection without notice to the Plan's beneficiaries;
- (v) Indalex Canada obtained a CCAA order to get priority to the DIP Lenders over "statutory trust" without notice to the Plan's beneficiaries; and
- (vi) Indalex Canada sold its assets without making any provision for the Plans.

Indalex - Court of Appeal Decision

IV. The Result

- The Court directed the Monitor to pay funds from the Reserve Fund to satisfy the deficiency in the Salaried Plan.
- With respect to the Executive Plan (which was not in wind-up), after having found a breach of fiduciary duty, the Court concluded that it was not restricted to awarding a money judgment but could, and did, look to equity for a remedy.
- Following the law relating to constructive trusts, the court ordered that a portion of the Reserve Fund (which would otherwise have been paid to the DIP lender) be paid into the Executive Plan.

Priority for the DIP charge in the CCAA

- Limited stay and use of “comeback” hearing on Initial Order.
- Use of a pension stay order (Re Ivaco).
- Address paramountcy in factum/submissions regarding priority to deemed trust and seek specific endorsement.
- Evidentiary record should show need for funding and need for super-priority charge.
- Issue petition for receiving order on first day – stay petition.
- Limit use of comeback clause in Initial Order (i.e. to a period after the order comes to the attention of an affected party).
- Address conflict at outset - take formal steps through the Superintendent, plan amendment, the courts, or some combination thereof, to transfer the administrator’s role to a suitable person.
- Consider striking an independent committee with independent legal advice for the plan administrator’s role.

Conclusions

- **Will it work?**