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The Supreme Court of Canada's (SCC) decision in Indalex[1] is best known as an insolvency case. What is less well-known, but equally significant, is that the SCC's decision has important implications for pension plan governance. This article focuses on the pension governance aspects of the case and underscores the importance of having the necessary checks and balances in place to effectively resolve conflicts of interest and avoid potential breaches of fiduciary duty by those involved in plan administration.

Very briefly, Indalex involved a dispute over whether the priority of pension plan member claims to the assets of an insolvent employer ranked ahead of the court-ordered super priority charge granted in connection with the debtor-in-possession (DIP) loan advanced by the DIP lender to fund the employer's restructuring efforts during a Companies' Creditors Arrangement Act (CCAA) proceeding. There were three issues before the SCC:

- whether the super-priority charge ranked below the deemed trust imposed by the Pension Benefits Act (Ontario) (PBA) on amounts owed by an employer to a pension plan on plan wind-up – the Ontario Court of Appeal had held in favour of plan members that the deemed trust took priority
- whether the scope of the PBA deemed trust extended to the entire wind-up deficiency of a pension plan or only to the amounts due and not paid under the PBA amortization schedule for wind-up deficit special payments – the Court of Appeal had held in favour of plan members that the scope extended to the entire deficiency
- whether the employer as plan administrator was in breach of its fiduciary duties to the plan members in relation to its obligations under the CCAA proceeding/court-ordered super priority and, if so, whether the remedy of a constructive trust over the employer's assets in the amount of the pension deficiency was appropriate.

On this third point, the Court of Appeal also decided in favour of plan members, holding that while the initial decision to enter into CCAA proceedings was not a breach of fiduciary

duty, the employer was in breach of its common law fiduciary duties throughout the CCAA proceedings. In the Court of Appeal's view, these breaches were sufficiently egregious to warrant the imposition of a constructive trust. Not surprisingly, the Court of Appeal's decision, which represented a departure from prior case law on all three issues, had a chilling effect on Canadian credit markets and a major impact on the terms attached to corporate borrowing in Canada.

At the SCC, the plan members were unsuccessful on the determinative issue of whether the deemed trust took priority over the super-priority charge of the DIP lenders (Issue 1). The plan members were successful on the issue of the scope of the deemed trust (Issue 2) and were also successful on their claim that there had been a breach of fiduciary duties by the employer as plan administrator (Issue 3). However, the SCC disagreed with the Court of Appeal's imposition of a constructive trust to remedy the fiduciary breach. It is the latter issue which is the focus of this article. The SCC had some important things to say about the types of conflicts that can arise in pension plan administration and how those conflicts should be dealt with.

The 'Two Hats' Theory

The possibility of conflicts in pension plan administration is not a novel issue. Potential conflicts arise from the fact that in most Canadian jurisdictions, pension legislation requires single employers in the private sector to serve in two capacities – as plan administrator and, at the same time, as employer/sponsor. To deal with this inherent conflict, tribunals and courts have developed a theory known as the 'two hats' doctrine.

This approach was first articulated in the 1995 decision of the Pension Commission of Ontario (PCO) in Imperial Oil.[2] The issue before the PCO was whether the employer was in breach of its fiduciary duties for amending its plan to (prospectively) eliminate an early retirement benefit. The PCO held that the employer plays two distinct roles vis-a-vis the plan and is not an 'administrator' (and hence subject to fiduciary duties) for all purposes. The PCO stated:

> We do not accept that Imperial Oil was acting in its capacity as administrator when it passed the amendments and, therefore, we do not accept that section 22 applied to its actions ... The Act recognizes that an employer may wear two hats in respect of pension plans ... We are of the view that an employer plays a role in respect of the pension plan that is distinct from its role as administrator. Its role as employer permits it to make the decision to create a pension plan, to amend it, and to wind it up ... The exercise of the power of amendment was an act of Imperial Oil as employer.

The Imperial Oil case thus established the principle that an employer is not wearing its 'fiduciary' hat when it amends its plan or carries out its other employer duties. This principle has been applied many times since the PCO's decision, but virtually all the cases involved a challenge to the exercise of the plan amendment power. Indalex is one of the first cases in which the challenge is to the exercise of a different type of employer decision, the decision to seek CCAA protection and related decisions in support of the court-approved super-priority. The questions before the SCC were whether the employer's actions during the CCAA proceedings resulted in a conflict with its role as plan administrator and, if so, whether the subsequent actions of the employer in its capacity as administrator failed to resolve the conflict, thus putting it in breach of its fiduciary duties to the members.

SCC Decision

The SCC was unanimous in holding that Indalex had breached its fiduciary duties to plan members, but struggled with the question of which conflicts led to the breach of duties, when the conflicts arose, and the steps that could have been taken to avoid or remedy them.

In contrast to the approach taken by the Court of Appeal, a majority of the SCC insisted that the starting-point for the analysis is not common law fiduciary principles generally, but the specific obligations imposed by the applicable pension statute. Cromwell J. (McLachlin C.J.C. and Rothstein J. concurring) identified two requirements in the PBA which were relevant in determining Indalex's obligations in this context: the requirement for an administrator to ensure that payments are made when due and to notify the regulator if they are not and a duty to commence court proceedings when pension payments are not made.

Cromwell rejected the employer's argument that because the decision to seek CCAA protection was a purely corporate decision, all subsequent decisions relating to the CCAA proceedings were also purely corporate decisions. However, he also unequivocally rejected the Court of Appeal's contention that any business decision which could affect the members' interests amounted to a breach of fiduciary duty. At best, such decisions may raise potential conflicts that must be resolved to avoid a fiduciary breach. Cromwell J. adopted a test which limited the employer's fiduciary obligations to functions that are specifically assigned to the administrator under the PBA.

Based on this test, a majority of the SCC held that the conflict in the case arose when Indalex took steps which could have the effect of making it impossible for it to satisfy its obligations under the PBA, when it applied for DIP funding.[3] The SCC concluded that the breach was Indalex's failure to recognize the conflict and ensure that its pension beneficiaries had the opportunity to have their interests effectively represented in the insolvency proceedings, particularly when Indalex sought the DIP financing approval which imposed the super priority charge.[4]

However, the SCC did not agree that a constructive trust was an appropriate remedy for the breach. The SCC concluded that, among other things, imposing a constructive trust would have been disproportionate to the breach (the failure to meaningfully address the conflict of interest during the CCAA proceedings, particularly as the breach ultimately had no impact on the plan members as their interests were fully represented and carefully considered in the subsequent proceedings).

In summary, a majority of the SCC held that Indalex's failure was in not recognizing that it was in a conflict of interest vis-a-vis its role as plan administrator when it sought DIP financing

approval and that it breached its fiduciary duties when it failed to take measures to address the conflict. A key aspect of the SCC decision, however, is that the existence of the unresolved conflict did not give the plan members any more rights than they would have otherwise had, for example, if the conflict had been resolved by the appointment of a replacement administrator. In fact, Cromwell J. tested the available remedies for the plan members by asking the question: if a replacement administrator had been put in place, what would the members have been entitled to? In his view, given the legislative framework, the most they were entitled to receive was notice of the application for DIP financing and the right to be represented in the proceedings. In the view of the SCC majority, plan members would not have been entitled to payment of the pension deficits in priority over the DIP lenders even if the conflict had been adequately resolved.

The SCC decision in Indalex highlights the nature of the conflicts that can arise in the pension context. As mentioned earlier, the issue addressed in Indalex is not new – the courts and tribunals developed the 'two hats' approach to deal with the very issue of pension conflicts. While the SCC was critical of the 'two hats' doctrine, holding that it focused too much on the classification of a particular decision as 'administrator' or 'employer' and not enough on the consequences of the decision,[5] in our view, the basic premise of the 'two hats' approach (that an employer plays distinct roles in respect of its pension plans and that it is not subject to fiduciary duties when performing an 'employer' function) remains intact.

The Indalex decision further refines the 'two hats' approach by articulating the obligation of the employer to be aware of its legal requirements as plan administrator when making corporate decisions and ensuring that it deals with any conflicts which may flow from its statutory obligations.

Practical Implications

In terms of practical implications for employers, first, it is critical for boards of directors, as the guiding mind of the 'employer,' to understand that the type of conflict which arose in Indalex is not a typical corporate conflict of interest. The type of conflict boards are familiar with is where a board member has a personal interest in a decision. This type of conflict is normally dealt with by prohibiting the conflicted board member from voting on the matter.

The type of conflict in Indalex was different – it was a situation of conflicting duties. Indalex owed statutory duties to the pension plan members with respect to the funding of its pension plan which conflicted with its corporate duty to seek DIP financing and take other steps relating to the CCAA proceeding. The SCC decision in Indalex suggests that where this type of conflict arises, it is necessary for the board of directors to test its proposed course of action against the actions a hypothetical arms-length administrator would take.

Second, a board must be able to recognize conflicts of duty situations when they arise so that the conflict can be appropriately addressed. Indalex dealt with a conflict of duties in the context of an insolvency, but employers regularly make corporate decisions such as selling a business or merging pension plans, which could have a negative impact on pension plan members. A critical takeaway from the SCC decision is the importance of building into the plan governance system a process for identifying situations where there is a conflict. This may entail educating board members and others in the company involved in administering the pension plan about the possibility of these types of conflicts.

It may also entail building into the corporate decision-making process a means to determine whether there is a potential for a conflict of duties. Since a board typically delegates most employer and administrator functions to committees, officers, and staff, this process needs to be built into every level of the governance system. While the exact form this process will take depends on the organization, it must involve asking the question: 'does this corporate action give rise to legal obligations under the applicable pension statute and is there a potential conflict?' Since the question of whether a conflict exists may not be straightforward, the process should involve seeking legal advice (whether internally or externally).

In our view, there will be relatively few business decisions where a direct conflict will arise. For the vast majority of corporate decisions, the employer may take a proposed action even if it negatively impacts the employees provided it complies with the procedures laid down in the PBA. However, there are situations, such as the one in Indalex, where there is a direct conflict between the board's duties to its shareholders and its duties as plan administrator. While there may be no easy solutions to a direct conflict, dealing with the problem 'upfront' should give the employer options and more control over the process than if the issue is dealt with through litigation initiated by plan members. BPM

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1. Sun Indalex Finance, LLC v. United Steelworkers, 2013 Canley 77231 (SCC); reversing Indalex Limited (Re), 2011 ONCA 578 (CanLII); reversing Re Indalex, 2010 ONSC 1114 (CanLII) (Indalex)
2. Imperial Oil Ltd. v. Ontario (Superintendent of Pensions) (1995), 18 C.C.P.B. 198 (Ontario Pension Commission) (Imperial Oil)
3. SCC decision, paragraph 214
4. SCC decision, paragraph 222
5. SCC decision, paragraph 65