# Collateral Matters

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# What About Federal Pension Claims?

By Sam Babe

## The Status of *Pension Benefits Standards Act, 1985* and Pooled Registered Pension Plans Act Deemed Trust Claims in Insolvency[1]

The priority of claims against insolvent employers for amounts owing under provincially-regulated pension plans and, in particular, plans governed by the *Pension Benefits Act* (Ontario) (the "***PBA***")[2], has received a great deal of analysis over the past few years. These efforts reached an at least temporary peak upon the release of the decision of the Supreme Court of Canada (the "**S.C.C.**") in *Sun Indalex Finance, LLC v. United Steel Workers* ("***Indalex***")[3], in February 2013. One issue left untouched by *Indalex* and the analysis surrounding it, however, is that of the priority of claims for amounts owing under pension plans governed by the federal *Pension Benefits Standard Act, 1985* (the "***PBSA***")[4] or the new federal *Pooled Registered Pension Plans Act* (the "***PRPPA***")[5]. Despite the deemed trusts created by the *PBSA* and the *PRPPA*, and despite some questionable case law concerning the effect of the *PBSA* deemed trust in particular, in this writer's view the answer is quite simple: in an insolvency proceeding, *PBSA* and *PRPPA* claims do not benefit from any super-priority trust or security apart from the protection explicitly created by the *Bankruptcy and Insolvency Act* (the "***BIA***")[6] and the *Companies' Creditors Arrangement Act* (the "***CCAA***")[7].

1 An expanded version of this article appeared in *National Creditor Debtor Review*, September 2013, Volume 28, Number 3.
2 R.S.O. 1990, c. P.8
3 *Sun Indalex Finance, LLC v. United Steelworkers*, [2013] S.C.J. No. 6 (S.C.C.); reversing *Indalex Ltd. (Re)*, [2011] O.J. No. 1621 (Ont. C.A.); reversing *Indalex Ltd. (Re)*, [2010] O.J. No. 974 (Ont. S.C.J.–Commercial List); and reversing in part *Indalex Ltd. (Re)*, [2011] O.J. No. 3959 (Ont. C.A.). For a discussion of *Indalex*, see the writer's earlier article "After Indalex: Pension Claims under the New *CCAA*," published in *Collateral Matters*, May 2013 (and in *National Creditor Debtor Review*, June 2013, Volume 28, Number 2).
4 R.S.C. 1985, c 32 (2nd Supp)
5 S.C. 2012, c. 16
6 R.S.C. 1985, c. B-3
7 R.S.C. 1985, c. C-36

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## Pension Protections under the *BIA* and *CCAA*

Priority charges in bankruptcy and receivership for a limited set of pension claims (under both *PBSA* plans and provincially-regulated plans) were created in July 2008 with the enactment of sections 81.5 and 81.6 of the *BIA*. Similar protection was added in September 2009 for *BIA* proposals and *CCAA* proceedings. Finally, with the coming into force of the *PRPPA* in December 14, 2012, protections for *PRPPA* amounts were added to the pension provisions in the *BIA* (for bankruptcy, receivership and proposals) and the pension provisions in the *CCAA*.

To take the example of receivership (and focusing on federal pensions), subsections 81.6 (1) and (2) of the *BIA* now read, in part, as follows:

"**Security for unpaid amounts re prescribed pensions plan — receivership**

> 81.6 (1) If a person who is subject to a receivership is an employer who participated or participates in a prescribed pension plan for the benefit of the person's employees, the following amounts that are unpaid immediately before the first day on which there was a receiver in relation

to the person are secured by security on all the person's assets:

a) an amount equal to the sum of all amounts that were deducted from the employees' remuneration for payment to the fund;

b) if the prescribed pension plan is regulated by an Act of Parliament,

i) an amount equal to the normal cost, within the meaning of subsection 2(1) of the *Pension Benefits Standards Regulations, 1985*, that was required to be paid by the employer to the fund, and

ii) an amount equal to the sum of all amounts that were required to be paid by the employer to the fund under a defined contribution provision, within the meaning of subsection 2(1) of the *Pension Benefits Standards Act, 1985*,

iii) an amount equal to the sum of all amounts that were required to be paid by the employer to the administrator of a pooled registered pension plan, as defined in subsection 2(1) of the *Pooled Registered Pension Plans Act*; and

. . .

**Rank of security**

(2) A security under this section ranks above every other claim, right, charge or security against the person's assets, regardless of when that other claim, right, charge or security arose, except rights under sections 81.1 and 81.2 and securities under sections 81.3 and 81.4."

In terms of priority, pursuant to subsection 81.6(2), the pension claims charge ranks subordinate only to the *BIA* super-priorities in favour of unpaid suppliers, farmers (etc.) and employees. In the case of bankruptcies, *BIA* subsections 81.5 (1) and (2) have almost identical language to subsections 81.6 (1) and (2) with the exception that the charge in bankruptcy is also subordinate to statutory deemed trusts in favour of the Crown for source deductions (as preserved by subsection 67(3) of the *BIA*).

In terms of the scope of the charges, subparagraphs 81.5(1)(b)(i) and 81.6(1)(b)(i) refer us to subsection 2(1) of the *Pension Benefits Standards Regulations, 1985*[8], which, in turn, defines "normal cost" as "the cost of benefits, excluding special payments, that are to accrue during a plan year, as determined on the basis of a going concern valuation" (emphasis added). Sections 81.5 and 81.6 of the *BIA* therefore only create super-priorities for any deducted but unremitted employee pension contributions, any unpaid employer defined-plan or pooled-registered-plan contributions and any unpaid normal costs. There is no super-priority under the *BIA* for unfunded pension liabilities (whether they be direct claims or special payments ordered by the Office of the Superintendent of Financial Institutions).

The pension protections in restructurings are found in *BIA* subsection 60(1.5) and *CCAA* subsection 6(6), which prohibit a court from sanctioning any proposal or plan that does not ensure payment of the same pension amounts as are protected by the *BIA* in bankruptcies and receiverships. Pursuant to *BIA* subsection 65.13(8) and *CCAA* subsection 36(7), a court also cannot approve a going-concern sale unless the same pension amounts will be paid out of the sale proceeds (or otherwise)[9].

## The Federal Pension Deemed Trusts

The *PBSA* governs pension plans of employers that are federally regulated including, without limitation, those engaged in maritime shipping, aviation, broadcasting and banking, as well as plans of employers located in the Yukon, the Northwest Territories and Nunavut. Subsections 8(1) and (2) of the *PBSA* set up a deemed trust for amounts owing under a *PBSA* pension plan:

**"Amounts to be held in trust**

8. (1) An employer shall ensure, with respect to its pension plan, that the following amounts are kept separate and apart from the employer's own moneys, and the employer is deemed to hold the amounts referred to in paragraphs (a) to (c) in trust for members of the pension plan, former members, and any other persons entitled to pension benefits under the plan:

(a) the moneys in the pension fund,

(b) an amount equal to the aggregate of the following payments that have accrued to date:

i) the prescribed payments, and

ii) the payments that are required to be made under a workout agreement; and

(c) all of the following amounts that have not been remitted to the pension fund:

i) amounts deducted by the employer from members' remuneration, and

ii) other amounts due to the pension fund from

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9 Strictly speaking, *CCAA* subsection 36(7), as presently drafted, does not give this protection to pension amounts due to the fact that it cross-references the wrong paragraphs of section 6. The writer has, however, argued elsewhere that this is only due to an acknowledged drafting error and the subsection ought to be interpreted and/or corrected to give the pension protection as Parliament intended (see "After Indalex: Pension Claims under the New *CCAA*", note 3 *supra*, at pages 2 to 3).

the employer, including any amounts that are required to be paid under subsection 9.14(2) or 29(6).

**Where bankruptcy, etc., of employer**

(2) In the event of any liquidation, assignment or bankruptcy of an employer, an amount equal to the amount that by subsection (1) is deemed to be held in trust shall be deemed to be separate from and form no part of the estate in liquidation, assignment or bankruptcy, whether or not that amount has in fact been kept separate and apart from the employer's own moneys or from the assets of the estate."

Within the scope of this *PBSA* deemed trust are, among other amounts, any special payments prescribed to meet solvency requirements due on plan termination (pursuant to *PBSA* subsection 29(6)). The *PBSA* deemed trust is therefore more expansive than the protections provided in the *BIA* and the *CCAA*, which, as explained above, exclude special payments.

Pooled registered pension plans are defined-contribution pension plans, administered by financial institutions, for employees and self-employed persons who do not have access to workplace pension plans. The *PRPPA* governs pooled plans in federally-regulated industries and any such plans available to workers or the self-employed in the Yukon, the Northwest Territories and Nunavut. Section 31 of the *PRPPA* creates the deemed trust:

**"Amounts deemed to be held in trust**

31. (1) An employer must ensure that it keeps separate and apart from its own money all of the following amounts that have not been remitted to the administrator:

(a) amounts deducted by the employer from employees' remuneration;

(b) amounts of employer contributions; and

(c) any other amounts required to be remitted to the administrator.

The employer is deemed to hold those amounts in trust for members of the plan.

**If bankruptcy, etc., of employer**

(2) In the event of the winding-up, assignment or bankruptcy of an employer, an amount equal to the amount that by subsection (1) is deemed to be held in trust is deemed to be separate from and form no part of the estate in liquidation, assignment or bankruptcy, whether or not that amount has in fact been kept separate and apart from the employer's own moneys or from the assets of the estate."

Unlike the *PBSA* deemed trust amounts, the amounts subject to the *PRPPA* deemed trust are limited to amounts already protected in the *BIA* and *CCAA*. This can largely be explained by the fact that pooled registered pension plans are, by definition, defined contribution rather than defined benefit plans. If, for example, we compare the *PRPPA* deemed trust to the protections in receivership given by the provisions of *BIA* section 81.6 excerpted above, we see that: the unremitted source deductions covered by *PRPPA* paragraph 31(1)(a) are already covered by *BIA* paragraph 81.6(1)(a); the employer contributions covered by *PRPPA* paragraph 31(1)(b) are covered by *BIA* paragraph 81.6(b)(ii); and the other amounts required to be remitted to the plan administrator, covered by *PRPPA* paragraph 31(1)(c), are covered by the new *BIA* paragraph 81.6(b)(iii).

The important points to note about the deemed trust language in both *PBSA* subsection 8(2) and *PRPPA* subsection 31(2) are: (i) that the deemed trusts only arise upon the occurrence of certain triggering events (bankruptcy, liquidation or winding-up); and (ii) that there is no explicit language giving the deemed trusts priority over other security interests.

## Do the *PBSA* or *PRPPA* Create Protections in Addition to Those in the *BIA* and *CCAA*?

As discussed above, the *PRPPA* deemed trust does not appear to extend to any amounts beyond those already protected under the *BIA* and *CCAA*, but the *PBSA* deemed trust is broader in its scope.

In answering the question of whether the *PBSA* deemed trust creates protections for pension claims beyond those found in the *BIA* and *CCAA*, we should note, first, that the fact that the *PBSA* deemed trust is a creature of statute is not fatal to it in insolvency. Since the *PBSA* deemed trust is not a trust in favour of the Crown, it is not reversed by *BIA* subsection 67(2). And, although there is a long line of case law stating that *BIA* paragraph 67(1)(a) does not exclude property subject to a provincial statutory deemed trust from the estate of a bankrupt, the reasoning of such cases would not apply to property subject to deemed trusts created by federal statute.

The deemed trust language in subsection 8(2) of the *PBSA*, unchanged since the enactment of the *PBSA* in 1986, is largely the same as the former deemed trust language in the *Income Tax Act* (the "***ITA***")[10] that the S.C.C., in *Royal*

10 R.S.C. 1985, c. 1 (5th Supp). The former Subsections 227(4) and (5) read as follows:

"(4) Every person who deducts or withholds any amount under this Act shall be deemed to hold the amount in so deducted or withheld in trust for Her Majesty.

(5) Notwithstanding any provision of the *Bankruptcy and Insolvency Act*, in the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to any amount:

(a) deemed by subsection (4) to be held in trust for Her Majesty, or

*Bank v. Sparrow Electric Corp.* ("***Sparrow Electric***")[11], held did not create a priority over a general security interest properly perfected under provincial personal property security law. As stated by Justice Iacobucci for the majority in *Sparrow Electric*:

> "98 It is open to my colleague to distinguish the fact situation in this appeal from the hypothetical priority contests I have mentioned on the ground that the Crown's interest in the inventory is unlike other charges against inventory in that it depends on the fictional device of deeming. What makes this case different, it might be said, is that the ITA deems to have been done what could have been done. On this understanding, it does not matter that the inventory was not actually sold and the proceeds were not actually remitted to the Receiver General, because ss. 227(4) and 227(5) of the ITA deem these things to have been done. But in my view, this answer cannot succeed because the inventory was not an unencumbered asset at the moment the taxes came due. It was subject to the respondent's security interest and therefore was legally the respondent's and not attachable by the deemed trust. As Gonthier J. himself says:
>
> > ... [subsection 227(4)] does not permit Her Majesty to attach Her beneficial interest to property which, at the time of liquidation, assignment, receivership or bankruptcy, in law belongs to a party other than the tax debtor.
>
> 99 The deeming is thus not a mechanism for undoing an existing security interest, but rather a device for going back in time and seeking out an asset that was not, at the moment the income taxes came due, subject to any competing security interest. In short, the deemed trust provision cannot be effective unless it is first determined that there is some unencumbered asset out of which the trust may be deemed. The deeming follows the answering of the chattel security question; it does not determine the answer."

Amendments to the *ITA* (at subsections 227(4) and (4.1)) were made in 1998 in response to *Sparrow Electric*. These amendments had two main features: first, language was added to the effect that the deemed trust attached notwithstanding any other security interest (other than interests specifically prescribed by the regulations); and, second, the insolvency event trigger for the deemed trust was removed so that the deemed trust arose immediately upon the amounts becoming payable[12]. Similar changes were made at the same time to the deemed trust provisions in section 23 of the *Canada Pension Plan* (the "***CPP***")[13] and section 86 of the 1996 *Employment Insurance Act* (the "***EIA***")[14], and would be made in 2000 to section 222 of the *Excise Tax Act* (the "***ETA***")[15].

In contrast, although there were extensive amendments made to section 8 of the *PBSA* in 1998 and 2010 (as well as amendments made by the *PRPPA* in 2012), none of these touched subsection 8(2). No explicit priority language was ever added and the insolvency event trigger remains to this day. Parliament therefore seems intent not to create any super-priority in the *PBSA* apart from what it created for *PBSA* plans in the 2008 and 2009 amendments to the *BIA* and *CCAA*.

The S.C.C.'s *Sparrow Electric* decision was released on February 27, 1997. Shortly prior, on January 9 of that same year, the Ontario Court of Justice, General Division (Commercial List) released a decision in *Neal v. Toronto Dominion Bank* ("***Neal***")[16] which held that a general security interest ranked subordinate to a deemed trust claim under the *PBSA*. The court in *Neal* followed the S.C.C.'s 1980 decision in *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.* ("***Dauphin Plains***")[17] which held that a general security interest was a floating charge, which only became crystallized upon enforcement, and which, therefore, did not rank ahead of deemed trust claims under the *CPP* or the *Unemployment Insurance Act, 1971*. What was not raised in *Neal*, but had, by that time, already been addressed by the Alberta Court of Appeal in its Sparrow Electric decision, was the fact that

(b) deducted or withheld under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to the province under that Act that is deemed under that Act to be held in trust for Her Majesty in right of the province shall be deemed to be separate and apart from and form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate."

11 *Royal Bank v. Sparrow Electric Corp. (sub nom. R. v. Royal Bank)*, [1997] 1 S.C.R. 411 (S.C.C.); affirming *Royal Bank v. Sparrow Electric Corp.*, [1995] 2 C.T.C. 445 #2, 33 C.B.R. (3d) 34 (Alta C.A.); reversing *Royal Bank v. Sparrow Electric Corp.*, [1994] 9 W.W.R. 338 (Alta Q.B.) and *Royal Bank v. Sparrow Electric Corp.*, (1993) 19 Alta. L.R. (3d) 183, [1995] 1 C.T.C. 101 (Alta. Q.B.).

12 These amendments were made, effective as of June 15, 1994, by the *Income Tax Amendments Act, 1997*, R.S.C. 1998 c.19. The history and intent of these changes as responses to *Sparrow Electric* was summarized by the S.C.C. in *First Vancouver Finance v. Minister of National Revenue*, (2002) 2002 SCC 49, [2002] S.C.R. 720 (S.C.C.) at paragraphs 25 to 29.

13 R.S.C. 1985, c. C-8. As with the 1998 amendments to the *ITA*, these amendments to the *CPP* were made by the *Income Tax Amendments Act, 1997* (see note 12 *supra*).

14 S.C. 1996, c. 23. Like the contemporaneous amendments to the *ITA* and the *CPP*, the changes to the deemed trust language in the *EIA* were made by the *Income Tax Amendments Act, 1997* (see note 12 *supra*).

15 R.S.C. 1985, c. E-15. In June, 1999, the Minister of Finance released explanatory notes to, among other pending statutes, the *Sales Tax and Excise Tax Amendment Act, 1999,* R.S.C. 2000 c. 30, which introduced the changes to, among other provisions, *ETA* Section 222. These notes state that the amendments are a response to *Sparrow Electric* as were similar amendments made previously to Section 227 of the *ITA*, and, specifically, that the changes clarify that the Crown has priority through its trust over any other security interest and that amounts subject to the trust are deemed to be held separately and apart at all times (and not just after a triggering event of liquidation, assignment, receivership or bankruptcy). See http://www.fin.gc.ca/drleg/99-104_2e.pdf at page 101.

16 *Neal v. Toronto Dominion Bank*, (1997) 1997 CarswellOnt 403, 25 O.T.C. 142 (Ont. C.J. Gen. Div. [Commercial List]).

17 *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, [1980] 1 S.C.R. 1182 (S.C.C.)

*Dauphin Plains* was decided prior to the enactment of a *Personal Property Security Act* in the relevant jurisdiction (Manitoba). In its Sparrow Electric decision, the Alberta Court of Appeal held that a security interest properly perfected under the Manitoba *Personal Property Security Act* was a fixed and specific charge. The S.C.C. in *Dauphin Plains* had held that deemed trust claims for pension plan and unemployment insurance deductions did not rank ahead of a fixed and specific charge like it did a floating charge:

> "25 . . . the claim for pension plan and unemployment insurance deductions cannot affect the proceeds of realization of property subject to a fixed and specific charge. From the moment such charge was created, the assets subject thereto, were no longer the property of the debtor except subject to that charge. The claim for the deductions arose subsequently and thus cannot affect this charge in the absence of a statute specifically so providing. However, the floating charge did not crystallize prior to the issue of the writ and the appointment of the receiver. In the present case it makes no difference which of the two dates is selected, both are subsequent to the deductions."

Following this reasoning in *Dauphin Plains*, the Alberta Court of Appeal held that deemed trust claims under the *ITA* did not rank ahead of a general security interest perfected under provincial personal property security law because such a security interest was a fixed and specific charge.

It therefore appears that the pension claims priority aspect of *Neal* was bad law when it was made, since the decision did not take into account the effect of the *Personal Property Security Act* (Ontario) (the "***PPSA***")[18] nor consider, let alone follow, the Alberta Court of Appeal's Sparrow Electric decision. In any event, the S.C.C.'s subsequent decision in *Sparrow Electric* (upholding the Alberta Court of Appeal's ruling) shows conclusively that the pension priority reasoning in *Neal* is fatally flawed.

The above application of the *Sparrow Electric* reasoning to the *PBSA* deemed trust yields the same results as application of common rules of statutory interpretation. Given that the pension provisions of the *BIA* and *CCAA* came into force much later than section 8 of the *PBSA*, normal interpretation would require that the later legislation be deemed to be remedial in nature. Likewise since these provisions of the *BIA* and *CCAA* are the more specific provisions, normal interpretation would take them to have precedence over the general. Finally, the limited scope of the protection given to pension claims in the *BIA* and the *CCAA* would, by application of the doctrine of implied exclusion, suggest that Parliament did not intend there to be any additional protection[19]. In enacting *BIA* subsections 60(1.5) and 65.13(8) and sections 81.5 and 81.6 and *CCAA* subsections 6(6) and 36(7), while not amending subsection 8(2) of the *PBSA* (by adding explicit priority language or by removing the insolvency trigger), Parliament demonstrated the intent that pension claims would have protection in insolvencies and restructurings only to the limited extent set out in the *BIA* and *CCAA*.

There are three additional hurdles for anyone who wishes to assert a *PBSA* deemed trust claim against an insolvent company for amounts not otherwise protected under the *BIA* or *CCAA*. First, in the case of a bankrupt company, *BIA* section 136 contains no spot on the priority scheme for pension claims. Second, by the operation of *BIA* subsection 66(1), the section 136 priority scheme also applies to Division I proposals[20]. Third, as commented on, in *obiter*, by Justice Farley in *United Air Lines Inc.*[21], the insolvency trigger in subsection 8(2) of the *PBSA* refers only to "liquidation, assignment or bankruptcy," but not to restructuring. Thus, even, if the *PBSA* deemed trust was sufficient to otherwise prime secured creditors, there is doubt whether the deemed trust would even arise in a *BIA* proposal or *CCAA* plan.

## Conclusion

Although the *PBSA* deemed trust covers classes of pension claims not protected in the *BIA* or *CCAA*, the archaic language of this deemed trust does not create an interest that can prime a properly perfected contractual security interest. The *PBSA* deemed trust therefore does not provide additional protection or priority for pension claims against an insolvent employer (beyond the protections provided in the *BIA* and *CCAA*). There is thus no parallel between the protection provided by the *PBSA* deemed trust and any protection that *might* be provided by the *PBA* deemed trust (in conjunction with subsection 30(7) of the *PPSA*), as dealt with in *Indalex*[22]. These limits to the *PBSA* protection do not appear to be an oversight by Parliament as the *PBSA* is one of the very few federal deemed trust statutes that was not amended in response to *Sparrow Electric*.

Even though the *PRPPA* subsection 8(2) deemed trust language largely tracks the analogous language in the *PBSA*, the amounts actually covered by the *PRPPA*

18 R.S.O. 1990, c. P.10

19 This writer has argued elsewhere that the doctrine implied exclusion has been consistently applied by the S.C.C. to matters of *CCAA* priorities. See "After Indalex: Pension Claims under the New CCAA", note 3 *supra*, at pages 7 to 8.

20 The *BIA* section 136 priority scheme may or may not also apply in the case of a going-concern sale in a proposal proceeding because subsection 66(1) was not amended to include the new concept of going-concern sale introduced by the 2009 amendments.

21 *United Air Lines Inc., Re*, (2005) 9 C.B.R. (5th) 159 (Ont. S.C.J. [Commercial List]) at para 11.

22 Emphasis on the word "might" is added because it is not clear that the *PBA* deemed trust does provide priority beyond the protections provided in the *BIA* and *CCAA*. As the writer has argued elsewhere, *Indalex* was decided without application of the September, 2009 amendments to the *CCAA* and tells us nothing about the effect of those amendments. In light of those amendments, the writer has argued, the *PBA* deemed trust ought no longer be considered to provide priority in a *CCAA* proceeding. See "After Indalex: Pension Claims under the New *CCAA*", note 3 *supra*.

deemed trust do not appear to extend beyond the amounts already protected in the *BIA* and the *CCAA*, and thus the effect of the *PRPPA* deemed trust in insolvency in relation to secured claims is likely a moot point. That being said, a number of provinces are expected to introduce their own pooled registered pension plan regimes, and, as a result of these and the *PRPPA* regime, a great number of Canadian workers will likely have access to pensions where they never did before. The corollary is that a great number of Canadian employers will become indebted to pension plans where they never were before (especially small and medium enterprises, relatively more prone to insolvency). We can therefore expect the number of super-priority pension claims in insolvencies and restructurings to rise in the future.

# Keeping Fees to a Minimum in a Financing Transaction

By Andrew Biderman and Aaron Collins

## Introduction: The Double-Fee Dilemma

Businesses are always striving to keep costs in check in an effort to increase their bottom line. Legal fees have never been an exception, although more focus seems to be placed on them in the current economic environment. In virtually any material financing transaction, the legal fees are compounded because the borrower is required to pay for the lender's legal fees in addition to its own. Given this, it is not surprising that we have noticed a marked increase in the number of borrowers who are "fee-sensitive" in recent years. Multiple fee quotes, fixed-fee arrangements and alternative payment arrangements are now often requested and becoming more common, as businesses search for ways to keep legal costs in check.

While the "double" costs incurred in most financing transactions are always a sore spot for borrowers, there are some very simple steps that a borrower can take to ensure that legal fees on both sides are minimized. These steps generally fall into three categories: (1) collecting due diligence information and presenting it in a logical, coherent fashion; (2) keeping control of the deal status and closing timeline and being informed of, and involved in, the various aspects of the transaction, and, in particular, (3) managing third parties and chasing down the documents required from those third parties.

We provide further detail on these categories below, but, as you will see, the steps that can be taken typically involve the borrower taking the initiative to assemble information necessary for the lender and being involved in the various negotiations and communications. By doing so, it will help to ensure that all the lawyers involved receive the information and instructions necessary to order and review the required corporate and lien searches and draft and complete documents quickly and efficiently, without spending a lot of time chasing information and reaching out to third parties. This more proactive approach will also help to bring any substantive issues to the forefront, before they become more expensive challenges to deal with later in the process.

## Information is Key: Due Diligence Process

As part of the lender's due diligence process, information relating to corporate structure, assets and various other matters will usually be required for each borrower and guarantor that is party to the transaction. The more of this information that can be assembled and provided by the borrower, the more it will help to reduce costs. Typically, it is helpful for a borrower to have the following information available and up to date prior to starting the process of legal due diligence with the lender:

- An organization (with correct legal names, where possible) and share capital chart. This information is crucial to allow the lender to determine the appropriate structure of the borrower and guarantors and to facilitate the lawyers' completion of documents, including share pledge agreements.
- A detailed list of all locations where the borrower and guarantors have any assets, including municipal address, whether owned or leased, name of landlord (where leased) and the nature of the assets at each location (i.e. inventory, equipment, books and records only, etc.). This information is used to determine required searches and third party documents, and to facilitate completion of draft documents.
- Copies of all material contracts, including major customer/supply agreements, licence agreements, premises leases/warehouse agreements, etc. Typically, the most efficient approach will be to provide a list of material agreements at the outset, and the lender can then decide which of these documents are required to be reviewed. In an asset-based financing, for example, the lender will typically focus on the

impact these agreements may have on realizing on certain assets in an enforcement scenario.

- A list of current litigation where the borrower or any guarantor is a defendant, with a brief summary of status of each proceeding and the maximum potential judgment amount.
- A list of intellectual property that includes jurisdictions where the registration is made, registration numbers, particulars of the trademark, patent, copyright or industrial design in question and the legal name of the entity that owns each piece of intellectual property. The lender will often require their security be registered with the appropriate intellectual property office, and having the information available makes the process much more efficient.
- Copies of any pension-related documents, including the plan itself, as well as the most recent financial statements and actuarial reports for the plan (if applicable). The issues relating to pensions will obviously be more pronounced if the borrower has a defined benefit plan (as opposed to a defined contribution plan).
- Copies of any insurance policies which the lender will review against the insurance certificate that is ultimately delivered.
- A list of local counsel/contacts for each jurisdiction in which the borrower and guarantors do business.
- Contacts for each third party that will likely need to be dealt with, including other creditors (for example, any registered lien holders and any lenders being paid out), landlords, warehousemen and insurance brokers.
- Corporate minute books (which will include, among other things, copies of articles and by-laws and lists of officers, directors and shareholders) will be required to complete the corporate supporting documents required for closing. If the borrower's counsel is required to deliver an opinion, these records will need to be reviewed and any deficiencies corrected.
- Copies of any shareholders' agreements (to the extent not included in the minute books). These documents may have provisions relating to restrictions on the directors' ability to authorize borrowing and the granting of security.

## Keep it Flowing: Deal Status and Timing

When we get a new deal, our first question is generally: "When is the deal scheduled to close?" The typical response is "as soon as possible" or "next week." Of course, there will always be deals that are truly urgent in nature (for example, where the existing facility that is being refinanced has a hard deadline), but a realistic sense of status and timing goes a long way to managing expectations and keeping costs down in situations where there is not a true urgency to close.

Urgent deals mean there needs to be a quick turnaround time for all aspects of the transaction. This usually means more lawyers get involved on both sides, and tasks that could be delegated to more junior lawyers, clerks or even assistants get done by a more senior lawyer, all in order to meet timing demands. As well, we see a number of deals that "have to" close immediately, but are then followed by long gaps of inaction as parties realize the deal that they thought was settled needs to be negotiated further on a business level between the lender and borrower. In such cases, fees are increased because the lawyers involved need to "re-learn" the deal.

In terms of status and timing, the following guidelines will usually help minimize legal fees:

- Require the lender to obtain multiple fee quotes from their proposed counsel and clarify that legal work should not start until the fee estimate has been agreed to. Working through the fee estimate process will also help get both sides on the same page as to exactly what is required and the timing.
- Do not proceed with legal work until you are confident the transaction will proceed. Fees are often driven higher in transactions that stop and start, where there is no real urgency to close because the parties waste time coming back to the file over time.
- Respond as quickly as possible to any requests from the lawyers involved relating to information gathering or document negotiation. They have likely asked the question because they need the requested information to complete a document or deal item.
- Once a deal starts, work as quickly and efficiently as possible to complete it in a realistic timeframe, and ensure that all matters keep moving along. Deals can be completed from start to finish in a couple of weeks, but for a deal of any size, a more realistic (i.e. cheaper) timeframe is about four weeks. If your deal starts dragging much longer than that because lawyers are waiting for responses (or because one lawyer is not responding in a timely manner), chances are that costs are increasing above where they could be.

## Stay in the Game: Be Informed and Involved

As any lawyer will tell you: they would rather work with an informed, involved client. This is not to say that a borrower should be doing all the work. Obviously, the lawyers should be taking the lead in the transaction, making sure everything is moving ahead in a coherent and efficient manner. However, for the borrower, being involved in three key areas can really save a lot of time and cost.

In any financing, there are anywhere from a few to dozens of third parties to deal with. These include lenders being paid out, other lenders with registered security in different collateral, equipment lessors, landlords, licensors and insurance brokers. While there are times when it makes sense for the lawyers to speak directly with third parties, being involved, and taking the lead communicating with third parties to ensure that requests are answered in a timely manner, always helps reduce costs. It is important to keep in mind that, especially with landlords and equipment lessors, third parties generally do not have the same incentives to respond quickly. Keeping the third parties up to date as to the anticipated timing for closing and continuing to follow up with them if they are not responding quickly will minimize fees.

When it comes to documents, lawyers love to negotiate, and they are good at it. The problem is, what matters to lawyers might not matter to a borrower, and those negotiations take time and can be very expensive. It is a more efficient use of resources for a borrower to speak with his or her lawyer about the issues that matter, get a lawyer's take on why something might pose a problem and decide on an effective and simple way to solve it. Fighting over every little issue, whether practical or not, is not only a waste of effort, it often hardens both sides into positions that are not conducive to getting the deal done. The reality is, most typical financing documents give the lenders a lot of discretion (for example, with respect to the eligibility of assets for borrowing base purposes). Where it is clear that a lender in a particular deal will not agree to relinquish this discretion, fighting over every minor detail is often unlikely to yield any real practical benefit to the borrower.

Finally, it pays (the borrower, not the lawyers) for a borrower to give a little thought to the logistics of closing a deal and discuss that with lawyers up front. Are there multiple signatories in multiple jurisdictions, or one signatory down the street? Will a director whose signature is needed be on vacation when a deal is closing? Are there special requirements for any documents to be signed, like notarization? Can everything be executed and scanned for closing? These may seem like almost comical questions to ask, but they all arise from issues that have come up at the last moment when trying to close. Planning the closing logistics well in advance will help avoid a lawyer (or worse for the fees, several lawyers) spending long nights in the office arranging a closing. Your lawyer will thank you for being prepared and you will be happier with the bill at the end of the deal.

### The Bottom Line

To minimize costs, it is crucial that a transaction proceeds quickly and efficiently, without a lot of stops and starts, and with negotiations limited as much as possible to only issues that may have real practical impact. By collecting due diligence information up front, making sure that the deal timing is realistic and efficient and being involved where practical, a borrower's legal fees in a financing transaction will undoubtedly be reduced. While there is no way to avoid the necessity of paying legal fees to both the borrower and lender's counsel, following the guidelines set out above where possible will make for a better experience when it comes time to pay the bills.

# The Untidy Intersection of the *CCCA* and MOE Orders: Recent Clarification by the Court or Appeal in *Re Nortel* and *Re Northstar*

**By James Desjardins and Aaron Baer***

On October 3, 2013, the Court of Appeal for Ontario (the "**Court**") released its rulings in *Nortel Networks Corporation (Re)*[1] ("***Re Nortel***") and *Northstar Aerospace Inc. (Re)*[2] ("***Re Northstar***"), two decisions that help clarify when regulatory orders issued by the Province of Ontario (the "**Province**") become provable claims subject to the restructuring process of the *Companies' Creditors Arrangement Act*[3] (the "***CCAA***"). A provable claim is any valid claim or liability of a creditor that can be compromised under a plan of arrangement in *CCAA* proceedings.

Remedial orders issued by the Minister of the Environment (the "**MOE**") may be reduced to monetary provable claims that can be compromised in *CCAA* proceedings only where (i) the Province has performed the remediation work and advanced a claim for reimbursement; or (ii) the obligation may be considered a contingent or future claim because it is sufficiently certain that the Province will do the work and then seek reimbursement.

### 1. BACKGROUND

The decisions of the Court in both *Re Nortel* and *Re Northstar* were rendered after the decision of the Supreme Court of Canada (the "**SCC**") in *Newfoundland and Labrador v. AbitibiBowater Inc.*[4] ("**AbitibiBowater**"), in which

1 2013 ONCA 599.
2 2013 ONCA 600.
3 RSC 1985, c C-36.
4 2012 SCC 67.

the SCC examined when MOE orders become classified as provable claims under the *CCAA*.

*AbitibiBowater* involved remediation orders issued by the Minister of Environment and Conservation of Newfoundland and Labrador after the applicant, AbitibiBowater Inc. ("**Abitibi**"), was granted protection from its creditors under the *CCAA*. The remediation orders were in respect to multiple sites, many of which had been expropriated by the province of Newfoundland and Labrador.

In reaching its decision, the SCC analyzed subsection 11.8(9) of the *CCAA*, which sets out three requirements for establishing a provable claim:

- there must be a debt, liability or obligation to a creditor;
- a claim must be founded on an obligation that falls within the time limit for claims; and
- it must be possible to attach a monetary value to the obligation.

With regards to the third requirement, the SCC noted at paragraph 30 of *AbitibiBowater* that, "the question is whether orders that are not expressed in monetary terms can be translated into such terms." In making that determination, the SCC held that courts must consider the substance of a remediation order, rather than its form, to determine whether there are sufficient indications that the regulatory body that made the remediation order will ultimately perform the remediation work itself.

In *AbitibiBowater,* the province's Minister of Environment and Conservation had no realistic alternative but to perform the work itself. The province had expropriated most of the properties and remained the owner. As it was sufficiently certain that the province would do the work and then seek reimbursement, the regulatory order was held to be a provable claim subject to the *CCAA* restructuring process.

It is against this backdrop that the Court analyzed *Re Nortel* and *Re Northstar.*

### A) *Re Nortel*

In the late 1990s, Nortel Networks Corporation ("**Nortel**") identified various environmental impacts that arose from its past operations at a number of Ontario sites. On January 14, 2009, Nortel was granted protection from its creditors under the *CCAA*. At that time, Nortel had disposed of its interests in all of its sites (the "**Disposed Sites**"), except for a partial interest in its London site (the "**London Site**").

After Nortel's *CCAA* filing, the MOE issued remediation orders (the "**Orders**") for the Disposed Sites and the London Site that would require further expenditures of approximately $18 million.

On March 9, 2012, Mr. Justice Morawetz of the Ontario Superior Court of Justice (Commercial List) found that the Orders were subject to the stay of proceedings contained in the initial order (the "**Initial Order**") and, therefore, had to be addressed as provable claims in the *CCAA* proceeding.

On June 22, 2012, the MOE was granted leave to appeal the decision to the Court. While the appeal was pending, the SCC released its decision in *AbitibiBowater* which, unfortunately for Mr. Justice Morawetz, was not available when His Honour rendered his decision.

### B) *Re Northstar*

The MOE issued two remediation orders against the respondents (collectively, "**Northstar**") in early 2012. Northstar subsequently sought and obtained protection from their creditors under the *CCAA* in June 2012. A *CCAA* judge approved the agreement for the sale of substantially all of Northstar's assets in July 2012. Northstar's contaminated site in Cambridge was not included in the sale.

Northstar advised the MOE that if the sale of its assets was approved, Northstar would abandon its contaminated site in Cambridge and terminate the remediation work. Not surprisingly, no bidder was interested in purchasing the Cambridge location. After Northstar went bankrupt and the trustee abandoned the Cambridge property, the MOE commenced remediation activities at the Cambridge site.

## 2. COURT OF APPEAL: *Re Nortel* and *Re Northstar*

### A) *Re Nortel*

The ratio of *AbitibiBowater* was set out by Juriansz, J.A., writing for the majority of the Court, at paragraph 31 of *Re Nortel*:

> "As I read [AbitibiBowater], the Supreme Court's decision is clear: ongoing environmental remediation obligations may be reduced to monetary claims that can be compromised in *CCAA* proceedings only where the province has performed the remediation work and advances a claim for reimbursement, or where the obligation may be considered a contingent or future claim because it is "sufficiently certain" that the province will do the work and then seek reimbursement."

With this in mind, the Court bifurcated its analysis to those of Nortel's properties that would satisfy the test in *AbitibiBowater* and become a provable claim and those that would fail.

The Orders regarding the Disposed Sites were directed to the current and former owners of the properties, as well as Nortel. At the Kingston site, the current and former owners named in the Orders were jointly and severally liable with Nortel to carry out the activities required by

the Orders. Section 18 of the *Environmental Protection Act* (Ontario)[5] gave the MOE the power to make orders against the other current and former owners of the Disposed Sites, in addition to Nortel.

As a result, the Court concluded that the MOE Orders in relation to the Disposed Sites were not provable claims subject to the restructuring process under the *CCAA*. Applying the test in *AbitibiBowater,* it was not sufficiently certain that the MOE would perform the remediations ordered.

Conversely, the Court found that Nortel's retained portion of the London Site was worth less than the cost of remediation and that it was probable that the London Site would eventually be abandoned without being sold. The Court considered it sufficiently certain that the MOE would ultimately be forced to undertake Nortel's obligations under the Orders. As a result, the MOE's claim was held to be a provable claim that could be compromised in accordance with the *CCAA* – the effect being that the MOE does not, with respect to the London Site, have priority over Nortel's assets.

The MOE's appeal to the Court was allowed. Mr. Justice Morawetz's declaration that the Orders were stayed by the Initial Order was modified such that the declaration only applies to the London Site. The MOE Orders in relation to the Disposed Sites were not established to be provable claims; such Orders are regulatory orders and are not subject to the insolvency claims process under the *CCAA*.

#### B) *Re Northstar*

In light of its analysis in *Re Nortel*, which was incorporated by reference, the Court held that, in conducting the remediation activities, the MOE made it sufficiently certain that the Province of Ontario would do the work and then seek reimbursement. Therefore, the MOE orders were, in substance, provable claims subject to the *CCAA* restructuring process.

## 3. LOOKING AHEAD

#### A) CCAA

The case law in Ontario appears to be settled: ongoing environmental remediation obligations may be reduced to monetary claims that can be compromised in *CCAA* proceedings only where the Province has already performed the remediation work and then advances a claim for reimbursement, or where it is sufficiently certain that the Province will do the work and then seek reimbursement.

Under the *CCAA*, MOE orders that have become provable claims will be paid in accordance with the priority under the *CCAA* and can be compromised. The MOE does not have priority with respect to the debtors' assets. On the other hand, MOE orders that have not become provable claims are not subject to the rules and requirements of the *CCAA* and, in those circumstances, the MOE enjoys priority over the debtors' assets.

#### B) *BIA*

Under the *Bankruptcy and Insolvency Act*[6] (the "***BIA***"), MOE orders that become provable claims will be paid in accordance with their priority under that statute. Unlike the *CCAA*, however, the *BIA* imposes a timing restriction on claims: subsection 121(1) of the *BIA* requires claims to be founded on an obligation that was incurred before the date of bankruptcy. Given the challenges of identifying the date on which environmental damage occurs, the *BIA* lacks the temporal flexibility of the *CCAA* that is needed to establish environmental claims.

#### C) Directors' Liability

The directors and officers of insolvent companies that contaminate the environment are not immune from liability. The MOE held the former directors and officers of Northstar (the "**Former Directors**") responsible for the environmental damage caused by Northstar, even though much of the contamination occurred prior to the tenure of any of the Former Directors named in the order.

On October 21, 2012, the MOE issued a remediation order against the Former Directors alleging that they had management and control of the Cambridge site and the related remediation systems. After an unsuccessful appeal of the MOE order, immediate liability was imposed on the Former Directors. On October 28, 2013, the Ontario Environmental Review Tribunal accepted the Minutes of Settlement between the MOE and the Former Directors. The Former Directors agreed to pay $4,750,000 to the MOE in exchange for the withdrawal of the MOE order that had imposed liability on the Former Directors for the remediation of the Cambridge site.

The MOE has shown a clear willingness to hold directors and officers liable in cases where a company is unable to finance the remediation costs. Directors and officers may be held liable for environmental contamination, regardless of whether they were directly involved in the contaminating activities. It would be prudent for directors and officers to ensure they are properly insured against such liabilities. Nevertheless, it remains to be seen whether these recent decisions will dissuade talented individuals from serving as directors or officers of organizations.

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5 RSO 1990, c E.19.

6 RSC 1985, c B-3.

# New Requirements For Financial Institution Dispute Resolution

By Brett Kenworthy*

## Introduction

On September 2, 2013, new regulations and commissioner's guidance from the Financial Consumer Agency of Canada (the "**FCAC**") came into effect. These regulatory frameworks impose three overarching changes: (i) guidance with respect to the creation and operation of internal dispute resolution practices and procedures of federally regulated financial institutions ("**FRFIs**"); (ii) enhanced oversight requirements for external complaints bodies that provide services to banks listed in Schedule I and II of the *Bank Act*, as well as authorized foreign banks (which are the subject of an order under subsection 524(1) of the *Bank Act*) (collectively, "**Banks**"); and (iii) additional dispute resolution reporting requirements for Banks. As a result of these amendments, all FRFIs should review internal dispute resolution practices and procedures to ensure compliance, and each Bank should additionally ensure that the external complaints body to which it is a member has been approved by the Minister of Finance.

## (i) Internal Dispute Resolution

The intention under the legislation and new FCAC commissioner's guidance appears to be that the vast majority of complaints made by a person (the "**Complainant**") be handled internally and that external complaints bodies operate only as a last resort. While FRFIs are already required by legislation to have dedicated personnel and procedures in place to attempt to resolve such complaints, the FCAC commissioner's guidance, *CG-12 Internal Dispute Resolution* (the "**IDR**"), provides direction to FRFIs with respect to expectations for compliant internal dispute resolution policies and procedures. The three guiding principles of the IDR are: (1) effectiveness; (2) efficiency; and (3) accountability.

### (1) Effectiveness

FRFIs must demonstrate that internal dispute resolution policies are designed to achieve a successful resolution to customer complaints. In the IDR, the FCAC commissioner indicates that it will evaluate effectiveness upon four criteria: (1) organizational commitment; (2) adequate resources; (3) training for staff and (4) monitoring and reporting systems. These criteria are examined in depth in the IDR. The underlying focus of the FCAC's evaluative metrics appear to emphasize that FRFIs commit to the independence, impartiality and ability of dispute resolution staff to deliver proper resolution to a complaint, while retaining complaint data in an accessible form.

### (2) Efficiency

In the IDR, the FCAC emphasizes that efficiency is the timely resolution of disputes. However, the IDR is equally focused upon the transparency of FRFIs' process and encourages communication at important milestones with respect to the anticipated timeline and progress of the complaints. The IDR also identifies the necessity of educating a Complainant on how to raise a complaint that was not resolved satisfactorily to an external complaints body.

### (3) Accountability

FRFIs can demonstrate accountability by providing accessibility and transparency for a Complainant submitting to the internal dispute resolution process. Legislation requires that FRFIs disclose their complaint-handling procedures: (i) in brochures; (ii) on their website; and (iii) in writing, upon request. Additionally, the FCAC has indicated it will consider written policies and procedures with relation to internal dispute resolution issues to demonstrate an overall commitment to accountability.

## (ii) External Complaints Bodies

Where the internal dispute resolution process fails to resolve the complaint to the satisfaction of the Complainant, it can be brought before an external complaints body for determination. By law, every FRFI must be a member of an external complaints body and this has not changed. It would appear that the intention behind creating such external complaints bodies is to enhance the transparency and efficacy of the complaint process of FRFIs, as well as to enhance a potential Complainant's knowledge of and access to a process designed to be impartial. However, the *Complaints (Banks, Authorized Foreign Banks and External Complaints Bodies) Regulations*, S.O.R./2013-48 (the "**Regulations**") now impose an additional requirement that Banks be members of an external complaints body approved by the Minister of Finance. The Regulations serve two purposes: (1) to increase the requirements of external complaints bodies with member Banks; and (2) to impose additional reporting requirements upon Banks.

The Regulations require that Banks provide a Complainant with the necessary information to submit a complaint, as well as any information necessary to enable the complainant to meet the requirements of its dispute

resolution procedures. The Regulations specifically state that "all information … must be provided in language that is clear, simple and not misleading." The Regulations also require that each Bank displays and makes available to the public (at all locations where business with the public is carried on and where it opens or initiates the opening of retail deposit accounts) copies of a written statement disclosing the name and contact information of the external complaints body of which it is a member. Additionally, once notification of a complaint is provided by a Bank's designated external complaints body, the Bank must cooperate by providing without delay all relevant information in their possession or control.

While outside of the scope of this article, the FCAC commissioner's guidance *CG-13 Application Guide for External Complaint Bodies* serves to clarify how external complaints bodies may submit an application and receive approval from the Minister, upon the recommendation of the commissioner of the FCAC. The FCAC will ensure the compliance of the external complaints bodies.

### (iii) Reporting Requirements

Banks' policies and procedures must demonstrate how it will adhere to the Regulations. An additional requirement imposed by the Regulations includes that Banks must identify the most senior position authorized to resolve such complaints. The Regulations require that Banks disclose: (a) the number of complaints dealt with by the most senior officer or employee designated by the bank for such a purpose; (b) the average length of time spent for the senior officer or employee to address complaints; and (c) the number of complaints that were resolved by the senior officer or employee, in accordance with the Bank's procedures, to the satisfaction of the Complainant. In order to disclose this information, the Regulations require that Banks use an appropriate format to publicly report such information on an annual basis (for example, its inclusion in an Annual Report, Public Accountability Statement, etc.).

## Conclusion

There are a few action points that can be taken from the newly effected changes to the regulatory framework. First, all FRFIs should review internal dispute resolution practices and procedures to ensure compliance with the IDR. Second, each Bank should ensure that the external complaints body to which it is a member applies under subsection 455.01(1) of the *Bank Act* and is approved by the Minister of Finance. Furthermore, it is important that each Bank reviews whether its policies and procedures comply with the disclosure requirements, with respect to: (i) the disclosure and availability of contact information for its external complaints body to its customers; and (ii) the provision of information in its possession or control when requested by the external complaints body. Finally, Banks must update the necessary policies and procedures to comply with the additional annual reporting requirements.

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