

Case Name:
**Harbert Distressed Investment Fund, L.P. v. General
Chemical Canada Ltd.**

Between
Harbert Distressed Investment Fund, L.P. and Harbert
Distressed Investment Master Fund Ltd., Plaintiffs
(Respondents), and
General Chemical Canada Ltd., Defendant (Respondent)

[2007] O.J. No. 3296

2007 ONCA 600

228 O.A.C. 385

35 C.B.R. (5th) 163

31 C.E.L.R. (3d) 205

61 C.C.P.B. 266

160 A.C.W.S. (3d) 217

2007 CarswellOnt 5497

Dockets: C45784 and C45800

Ontario Court of Appeal
Toronto, Ontario

S.T. Goudge, R.A. Blair and J.L. MacFarland JJ.A.

Heard: March 21 and 22, 2007.

Judgment: September 6, 2007.

(49 paras.)

*Creditors and debtors law -- Creditors -- Priorities -- Appeals by the Minister of the Environment
and the administrator of the respondents' pension funds from a motion judge's decision authorizing
the interim distribution of funds accumulated from the sale of the respondent General Chemical*

Canada's (GCC) operating assets -- Appeals dismissed -- The administrator was not qualified as a secured creditor for the purposes of the Bankruptcy and Insolvency Act -- Ministry was an unsecured creditor -- Ministry did, however, have security against GCC's real property, as provided by the BIA.

Appeals by the Minister of the Environment and the administrator of the respondents' pension funds from a motion judge's decision authorizing the interim distribution of funds accumulated from the sale of the respondent General Chemical Canada's (GCC) operating assets. The respondents, the two Harbert Funds, were a secured creditor of GCC, which was placed into bankruptcy effective November 18, 2005. Its interim receiver had accumulated \$6.5 million from GCC's operating assets and sought the court's authorization to make an interim distribution from those funds to Harbert, as a secured creditor, in the amount of \$3.75 million. The administrator maintained that, pursuant to s. 57(5) of the Pension Benefits Act, it held a lien over GCC's assets in relation to GCC's unpaid pension contributions, and that gave it priority over Harbert's security. The Minister said that GCC had failed to comply with provincial environmental safety requirements, and there would therefore be significant cleanup costs that exceeded GCC's financial assurance given under the Environmental Protection Act. The Minister said that GCC and its interim receiver had an obligation to meet those costs, and that any distribution was premature and might leave no assets for environmental remediation.

HELD: Appeals dismissed. The lien and charge accorded to the administrator under the legislation secured the employer's obligation to pay the unpaid contributions required by the pension plans to the pension funds. It did not secure a debt owed to the administrator. Therefore, s. 57(5) of the Pension Benefits Act did not qualify the administrator as a secured creditor for the purposes of the Bankruptcy and Insolvency Act. With respect to the Minister's appeal, there was no basis to interfere with the interim distribution. Harbert was the only secured creditor against the GCC operating assets that generated the funds for distribution. In that regard, the Ministry was an unsecured creditor. The Ministry did, however, have security against GCC's real property, as provided by the BIA.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Pension Benefits Act, R.S.O. 1990, c. P.8, s. 57(5)

Appeal From:

On appeal from the order of Justice Ruth E. Mesbur of the Superior Court of Justice, dated July 28, 2006, with reasons reported at (2006) 22 C.B.R. (5th) 298.

Counsel:

Mark Zigler, Andrew J. Hatnay, Fred L. Myers and Lawrence J. Swartz, for the appellant Morneau Sobeco Limited. Partnership in its capacity as administrator of General Chemical Canada Ltd.'s pension plans.

Ronald Carr, for the appellant Ministry of the Environment.

Ashley John Taylor, for Pricewaterhouse Coopers Inc., the interim receiver of General Chemical Canada Ltd.

Richard B. Swan, Robert Staley and Linda Visser, for the respondents Harbinger Capital Partners Fund, L.P. and Harbinger Capital Partners Master Fund I, Ltd.

Tycho M.J. Manson, for Honeywell ASCa Inc.

[Editor's note: A corrigendum was released by the Court September 11, 2007; the corrections have been made to the text and the corrigendum is appended to this document.]

The judgment of the Court was delivered by

1 S.T. GOUDGE J.A.:-- The respondents, the two Harbert Funds ("Harbert")¹, are a secured creditor of General Chemical Canada Ltd. ("GCCL"), which was placed in bankruptcy effective November 18, 2005. Its interim receiver has accumulated \$6.5 million from GCCL's operating assets, including cash, accounts receivable and inventory, and seeks the court's authorization to make an interim distribution from these funds to Harbert, as secured creditor, in the amount of \$3.75 million.

2 This proposal is opposed by the administrator of GCCL's two pension plans and by the Ontario Ministry of the Environment ("M.O.E.").

3 The administrator says that, pursuant to s. 57(5) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("P.B.A."), it holds a lien over GCCL's assets in relation to GCCL's unpaid pension contributions, and this gives it priority over Harbert's security.

4 M.O.E. says that GCCL has failed to comply with provincial environmental safety requirements, and there will therefore be significant cleanup costs that exceed GCCL's financial assurance given under the *Environmental Protection Act*, R.S.O. 1990, c. E.19 ("E.P.A."). M.O.E. says that GCCL and its interim receiver have an obligation to meet these costs, and that any distribution at this stage is premature and may leave no assets for environmental remediation.

5 At first instance, the motion judge found against both the administrator and M.O.E., and authorized the interim distribution to Harbert. Both the administrator and M.O.E. have appealed. The appeals were argued together, although they each raise their own issues. I therefore propose to address each separately.

6 In each case, I agree with the result reached by the motion judge, although for somewhat different reasons.

THE ADMINISTRATOR'S APPEAL

7 Until January 2005, when it discontinued operations, GCCL manufactured calcium chloride at its plant in Amherstburg, Ontario. On March 31, 2004, Harbert advanced \$9 million to GCCL, secured against GCCL's operating assets. No one questions that Harbert's security instruments were properly registered under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("P.P.S.A."), and constitute a perfected security interest in GCCL's personal property as of that date.

8 However, GCCL developed financial problems, and on January 19, 2005, it was ordered under the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, ("*C.C.A.A.*").

9 By November 2005, it became clear that GCCL's attempt to restructure while under *C.C.A.A.* protection was unlikely to succeed. Effective November 18, 2005, pursuant to the order of C. Campbell J. of the Superior Court of Justice, GCCL made an assignment in bankruptcy and an interim receiver of certain of its assets was appointed pursuant to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*B.I.A.*").

10 GCCL maintained two pension plans for its employees, one for its salaried employees and one for its unionized employees. Both are defined benefit plans and both are completely employer funded.

11 Until about January 2004, GCCL was making the contributions due under both plans. At that point, it began to fall into arrears, and by March 31, 2004, the date Harbert's security was perfected, that shortfall was \$1,356,230 for the union plan and \$107,499 for the salaried plan.

12 After March 31, 2004, while GCCL made several sporadic payments to both plans, the shortfalls continued to grow. The only exception to this pattern occurred in October and November 2004 when GCCL made payments to both plans in excess of the required contributions for those months. That excess amounted to \$2,164,492 for the union plan and \$113,472 for the salaried plan. Thereafter, the shortfalls continued to grow, although nothing in the *C.C.A.A.* order prohibited GCCL from making the required contributions.

13 The *P.B.A.* requires that every pension plan have an administrator. Up until its bankruptcy on November 18, 2005, GCCL served in that role for both plans. However on December 8, 2005, the Ontario Superintendent of Financial Services, in his capacity as the regulator of Ontario registered pension plans, appointed Morneau Sobeco Limited Partnership (the "Administrator") as the administrator of both plans pursuant to s. 71 of the *P.B.A.*

14 This proceeding arose because the interim receiver has now collected \$6.5 million from GCCL's general operations. These funds do not come from any of GCCL's real estate holdings. Since it views Harbert as the only creditor with security against GCCL's operating assets, the interim proposes to distribute \$3.75 million of those funds to Harbert as secured creditor.

15 The Administrator opposes the motion approving that payment because of the security it says it has under the *P.B.A.* At the same time, the Administrator moved for a declaration that its security pursuant to s. 57(5) of the *P.B.A.* makes it a secured creditor ranking ahead of Harbert's security.

16 The motion judge granted the interim receiver's motion and dismissed that of the Administrator. She found that the lien created by s. 57(5) of the *P.B.A.* was not enforceable under the *B.I.A.* because it was an attempt by the province to do indirectly what it could not do directly, namely to legislate priority under the *B.I.A.* for unpaid pension plan contributions.

17 She drew support for this conclusion from Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2005 (assented to 25 November 2005), which has been passed by the federal Parliament but not proclaimed, and which would create a "pension charge" over a debtor's assets for unpaid pension plan contributions of the kind in issue here. The motion judge concluded that since this amendment must be designed to alter the current state of the law, no such security presently exists.

18 The motion judge went on to find that even if the Administrator held a lien effective for *B.I.A.* purposes, the rule in *Devaynes v. Noble (Clayton's Case)* (1816), 1 Mer. 572, 35 E.R. 781 (C.A.), should be applied, and absent any evident intention at the time of the excess contributions paid by GCCL in October and November 2004 as to which particular deficiencies they were to apply to, they should be applied to reduce the earliest pension indebtedness. This would eliminate all short-falls prior to the effective date of Harbert's security for which the Administrator might have had priority.

ANALYSIS

19 The important section of the *P.B.A.* for the Administrator's appeal is s. 57. Section 57(1) applies to employee contributions required under a pension plan and hence is not relevant here, where both plans are completely employer funded. The same is true of s. 57(4), which applies where a pension plan is wound up, since that has not yet happened in this case.

20 The critical subsections are ss. 57(3) and 57(5). They read as follows:

- (3) An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

...

- (5) The administrator of the pension plan has a lien and charge on the assets of the employer in an amount equal to the amounts deemed to be held in trust under subsections (1), (3) and (4).

21 The *B.I.A.* sets out a scheme of priorities governing payment by creditors in the event of a bankruptcy. Section 67(1)(a) excludes from the bankrupt's property any property held by the bankrupt in trust for another person. Then, in distributing the bankrupt's estate, those meeting the definition of "secured creditor" in s. 2 of the *B.I.A.* are paid first, generally on the basis that the earliest security is paid first. Then, s. 136(1) sets out a list of other creditors who, subject to the rights of secured creditors, are to be preferred and paid in the priority listed in that subsection. Finally, unsecured creditors share *pari passu* in what remains.

22 The critical definition in the *B.I.A.* is that of "secured creditor" defined in s. 2. It reads:

"secured creditor" means a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable, and includes

- (a) a person who has a right of retention or a prior claim constituting a real right, within the meaning of the *Civil Code of Québec* or any other statute of the Province of Quebec, on or against the property of the debtor or any part of that property, or

- (b) any of
 - (i) the vendor or any property sold to the debtor under a conditional or instalment sale,
 - (ii) the purchaser of any property from the debtor subject to a right of redemption, or
 - (iii) the trustee of a trust constituted by the debtor to secure the performance of an obligation,

if the exercise of the person's rights is subject to the provision of Book Six of the *Civil Code of Québec* entitled *Prior Claims and Hypothecs* that deal with the exercise of hypothecary rights; [emphasis added]

23 There is no doubt that once GCCL began to fall short of its required contributions to both pension funds in January 2004, s. 57(3) of the *P.B.A.* applied and GCCL was deemed to hold in trust for the beneficiaries of those plans an amount equal to its unpaid contributions.

24 However, the Administrator concedes that this section does not create a trust as contemplated by s. 67(1)(a) of the *B.I.A.* and excludes nothing from the estate of GCCL for the purposes of distribution under the *B.I.A.* All parties to this appeal agree that that consequence is dictated by *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24. That case held that s. 67(1)(a) of the *B.I.A.* does not apply to statutory deemed trusts that lack the common law attributes of a trust, such as the requirement that the property be kept separate and not commingled with the bankrupt's own property.

25 The Administrator's argument, however, is simply that the lien and charge accorded to it by s. 57(5) of the *P.B.A.* is separate from the deemed trust created by s. 57(3), and is effective for the purposes of the *B.I.A.*, even if the deemed trust is not.

26 For this argument to succeed, however, the first step is that, as holder of a s. 57(5) statutory lien, the Administrator must meet the definition of secured creditor in the *B.I.A.*

27 In my view, it cannot do so. The Administrator does not hold a charge or lien as security for a debt due or accruing due to the Administrator from the debtor GCCL.

28 The *P.B.A.* provides that the Administrator is the person that administers the pension plan. The Administrator is to ensure that the pension plan, and the pension fund maintained to provide benefits under the plan, are administered in accordance with the *P.B.A.* and its regulations (s. 19(1)). In doing so, the Administrator must exercise the care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person (s. 22(1)). Section 56(1) requires the Administrator to ensure that all contributions due under the pension plan are paid to the pension fund when due. To facilitate this, the Administrator is given the right to commence legal proceedings to obtain payment of contributions due under the pension plan (s. 59).

29 Section 55(2) sets out the employer's obligation to make contributions under a pension plan. It reads as follows:

- (2) An employer required to make contributions under a pension plan, or a person or entity required to make contributions under a pension plan on behalf of an employer, shall make the contributions in accordance with the prescribed requirements for funding and shall make the contributions in the prescribed manner and at the prescribed times,
- (a) to the pension fund; or
 - (b) if pension benefits under the pension plan are paid by an insurance company, to the insurance company that is the administrator of the pension plan.

30 None of these provisions suggest that the contributions owed by GCCL are a debt due to the Administrator. Rather, GCCL's legal obligation was to make the contributions to the pension funds that were required under the pension plans. Nor is there even any indication that the contributions are owed to the Administrator to be held in trust for the pension funds. Rather, the legislation contemplates that those contributions are owed to the pension funds pursuant to the pension plans, and are not the property of the Administrator.

31 The Administrator's right to commence legal proceedings simply permits it to seek to compel the employer to pay the contributions to the pension funds due under the pension plans.

32 The consequence of this is that the lien and charge accorded to the Administrator secures the employer's obligation to pay the unpaid contributions required by the pension plans to the pension funds. It does not secure a debt owed to the Administrator. Hence s. 57(5) does not qualify the Administrator as a secured creditor for the purposes of the *B.I.A.*

33 That conclusion is sufficient to dispose of the Administrator's appeal, and makes it unnecessary to decide whether, if s. 57(5) of the *P.B.A.* qualifies the Administrator as a secured creditor for the purposes of the *B.I.A.*, that section is rendered inapplicable because its effect is to reorder the priorities for payment set out in the *B.I.A.*

34 The motion judge found that s. 57(5) has this effect. Relying on *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453, she held that s. 57(5) does not give the Administrator an enforceable lien under the *B.I.A.* As I have indicated, I need not address this issue. Although it was not argued, my reluctance to do so is heightened because it does not appear that a notice of constitutional question was served, even though the issue squarely raises the constitutional applicability of s. 57(5) of the *P.B.A.* in these circumstances.

35 As I have said, the motion judge also decided that even if s. 57(5) of the *P.B.A.* gives the Administrator a lien and charge that is effective for *B.I.A.* purposes, the debt thus secured should be treated as having been fully discharged by the overpayments made in October and November 2004. The motion judge reached that conclusion by applying the general principle in *Clayton's Case* to treat these excess payments as being applied to the earliest arrears in GCCL's required contributions, consequently eliminating the shortfall that existed on March 31, 2004. This would exhaust the effect of any priority the Administrator's secured claim would have over Harbert's secured claim because it arose before Harbert registered its security on March 31, 2004. Any secured claim by the Administrator for GCCL contributions required after that date but not paid would rank after Harbert's secured interest.

36 Given my conclusion that the Administrator is not a secured creditor for *B.I.A.* purposes, I need not address this issue either. In any event, on the assumption she makes of constitutionality, I would not interfere with the motion judge's conclusion. In my view, it was open to her on the facts before her to adopt the evidentiary presumption suggested by the rule in *Clayton's Case*. Since there is no evidence from GCCL, the then administrator, concerning what indebtedness the overpayments in October and November 2004 were intended to apply to, and that the present Administrator was not in place when those overpayments were received or applied, I would conclude that the motion judge could properly resort to the default presumption suggested by the general principle. Nor do I see any equitable basis for not doing so. This is not a case where there is any suggestion that such a conclusion would reflect any attempt by GCCL to adversely affect pension plan members.

37 To summarize, I would dismiss the Administrator's appeal for the reasons I have given.

THE M.O.E. APPEAL

38 At the root of the M.O.E. opposition to the distribution ordered by the motion judge is one simple fact. In manufacturing calcium chloride at its Amherstburg plant, GCCL produced by-products that were deposited in what was called the Soda Ash Settling Basin ("SASB"). It is now a contaminated site and remedial costs could reach \$64 million. The M.O.E. is anxious to see that GCCL assets are available to pay for this clean up.

39 The M.O.E. has a number of regulatory tools to use to protect the environment. In 1997, it issued a Provisional Certificate of Approval to GCCL which *inter alia* required GCCL to provide for the closure of the SASB and assurance that the costs of the closure would be paid for by the company. The latter was provided by a financial assurance that was subject to annual review by the M.O.E. In March 2004, the M.O.E. accepted \$3.4 million as the appropriate amount required of GCCL. Since then, the M.O.E. has vastly increased its estimate of the cost of clean up, to as much as \$64 million.

40 The *C.C.A.A.* order stayed the M.O.E.'s right to review and increase GCCL's financial assurance. In August 2005, the M.O.E. sought the lifting of the stay to permit it to increase that amount, but it was unsuccessful.

41 The November 18, 2005 order appointing the interim receiver did not exempt either the receiver or GCCL from compliance with environmental regulations, nor did it prevent the M.O.E. from issuing orders in respect of the SASB. However, that order expressly excluded the SASB from the property of GCCL over which the interim receiver was appointed.

42 It is uncontested that Harbert's security does not extend to the SASB. Rather, it expressly excludes it. Moreover, the M.O.E. does not assert a security interest in GCCL's operating assets over which Harbert does have security. Section 14.06(7) of the *B.I.A.* does give the M.O.E. a security interest in the bankruptcy in GCCL's contaminated real property and any contiguous property related to the activity that caused the environmental damage. This security ranks above any other security against the same property.

43 However, it is the M.O.E.'s position that the decision to distribute on an interim basis should be guided by what is fair and reasonable having regard to all stakeholders, akin to the considerations applied under the *C.C.A.A.* It argues that the "polluter pays" principle for environmental remediation requires no distribution until there can be an assurance that GCCL's assets are sufficient to clean up the SASB.

44 The motion judge found against the M.O.E. and concluded that, in her discretion, the distribution should proceed. She held that the M.O.E. was an unsecured creditor in relation to the GCCL operating assets that generated the funds to be paid out, that to permit the M.O.E. to effect a delay in distribution would be to give it a *quasi* priority over other unsecured creditors, and in any event it has security over the SASB. She also found no evidence of any imminent environmental effects or any non-compliance by GCCL with any environmental regulations.

45 In this court, the M.O.E. repeats its arguments below and raises, as it did there, the case of *Panamericana De Bienes Y Servicios (Receiver of) v. Northern Badger Oil and Gas Ltd.* (1991), 81 D.L.R. (4th) 280 (Alta. C.A.). In that case, the court found that provincial environmental legislation concerning oilwell clean up costs did not conflict with the scheme of distribution under the *B.I.A.*, and had to be complied with even though that reduced the amounts otherwise available for distribution in the bankruptcy.

46 I agree with the motion judge that the reasoning in that case has been overtaken because of subsequent amendments to the *B.I.A.* Section 14.06(7) now expressly provides for priority to be accorded to environmental clean up costs and s. 14.06(8) now ensures that a claim against the debtor for environmental clean up costs is a provable claim. Neither were in effect at the time of *Panamericana*. To give effect to provincial environmental legislation in the face of these amendments to the *B.I.A.* would impermissibly affect the scheme of priorities in the federal legislation.

47 Beyond that, I see no basis to interfere with the discretion of the motion judge to order the interim distribution. Harbert is the only creditor secured against the GCCL operating assets that generated the funds for distribution. In that regard, the M.O.E. is an unsecured creditor. The M.O.E. does, however, have security against GCCL's real property, as provided by the *B.I.A.* Harbert's security does not extend to the SASB, nor does the interim receiver have possession of that real property. The motion judge found no evidence of non-compliance with environmental orders nor any threat of imminent environmental harm. In these circumstances, I see nothing unreasonable in the interim distribution going forward.

48 I would therefore dismiss the M.O.E. appeal. In the result, both appeals are dismissed.

49 Neither the Administrator nor Harbert sought costs. While the receiver sought costs against the M.O.E., the latter neither sought costs nor invited an adverse costs award. In the circumstances, I would order no costs to any party.

S.T. GOUDGE J.A.

R.A. BLAIR J.A.:-- I agree.

J.L. MacFARLAND J.A.:-- I agree.

* * * * *

Corrigendum

Released: September 11, 2007

Hearing date corrected to "March 21 and 22, 2007".

cp/e/qlfxs/qllkb/qlesm

1 The two Harbert Funds have since changed their names to Harbinger Capital Partners Fund, L.P. and Harbinger Capital Partners Master Fund I, Ltd.