MT FINANCIAL SERVICES

Insurance Premiums: Security Interests under PPSA

CAFO Inc. was an insurance premium financer that had a contractual arrangement with Stelco to finance the payment of insurance premiums. Cafo brought a motion as to whether it was entitled to terminate an insurance policy which Stelco had with an insurance carrier, and receive the unearned premiums pursuant to s. 137 of the *Insurance Act (Ontario)*. Cafo also asserted that it was not required to register the security interest it claimed in the unearned insurance premiums on the basis of s. 4(1)(c) of the *PPSA* which provides that the Act does not apply to a transfer of an interest or claim in or under any policy of insurance or contract of annuity. Cafo relied on a number of American cases to support its position.

Cafo's motion was dismissed because the Court determined Section 4(1)(c) of the *PPSA* does not exempt unearned insurance premiums from registration. This decision needs to be recognized by insurers on the requirements for registration under the PPSA to perfect interest in unearned insurance premiums.

Criminal Liability of Organizations: Bill C-45

This statute came into force on March 31, 2004. It is the result of recommendations arising out of the public inquiry into the Westray Mine disaster, and deals with criminal liability for deaths in circumstances arising in the occupational health and safety context. There was a perceived need to impose criminal liability upon business organizations/employers for failure to prevent deaths under their watch.

The statute has been designed to cast a wide net. Unfortunately, this means that all commercial and business organizations that are in the position of directing work or tasks which may involve personal danger to the workers involved must be aware of this new and very broad potential liability.

This includes financial institutions, receivers/receivers and managers, consultants, and other forms of business arrangements including joint ventures and construction contracts. The main issue becomes the degree of care and control exercised over dangerous tasks and operations by various parties involved in a business enterprise. It is desirable for such parties to carefully draft their documents to clearly elicit the actual degree of care and control exercised over the dangerous enterprise. While the imposition of this liability is likely to happen in only the most egregious of circumstances, all commercial documents need to include protective language to clearly define who is in control of the dangerous operation, and who is not.

Pension Law Developments

The recent developments in Canada create two main areas of concern in transactions:

- Firstly, how and under what circumstances can pension plans be merged in an acquisition where one party or the other has a surplus and the other a deficit?

- Secondly, what obligations to distribute a surplus arise if the transaction involves a partial wind-up of the plan?

The first issue arises as a result of the uncertainty arising out of the 2003 case of *Aegon Canada Inc. v. ING Canada Inc.* In that case, and notwithstanding the decision of *Schmidt v. Air Products* SCCR (1994), the Court of Appeal in Ontario determined that the pension surplus in one plan could not be used to offset the obligations relating to a pension deficit in another plan where both plans are administered by the same post-merger employer. The employer kept the assets of both plans separate after a merger of two life insurance companies, but calculated the contribution holidays and paid the contributions due thereunder on the basis that both formed a single fund. The overall effect was to use the surplus of one fund to reduce the employer contributions for the other fund. This has created considerable uncertainty in many deals, and one which may be subject to regulatory change notwithstanding the refusal of the Supreme Court of Canada to grant leave to appeal the decision.

The second issue arose in the recent decision of the Supreme Court of Canada in the *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)* decision released in the summer of 2004. The Supreme Court determined that, in the case of a defined benefit plan (as opposed to a defined contribution plan), a reorganization of a company involving the layoff of employees which requires a partial windup of such plan will result in the requirement that the affected employer pay out surplus benefits to each employee on such partial windup date as if it were a full windup. This has created uncertainty in transactions which contemplate a post-closing rationalization of the employees to realize the synergies contemplated in the deal. The effect of this creates uncertainty in the entitlement of such employees to share in the surplus, and the disposition of such plans on closing where there exist only deficits and not surpluses. It also creates uncertainty about how to deal with beneficiaries who are subject to the laws of different jurisdictions in the case of defined benefit plans.

The solutions to these problems prior to insolvency are no longer clear, and need to be worked out between the parties by negotiation. However, the insolvency context has given rise to some solutions by way of invocation of the court's self-defined "inherent jurisdiction" in CCAA proceedings, giving it broad and sweeping powers to redefine obligations under various contracts and agreements. Applications may be commenced for orders of the Courts to remove uncertainty, and impose practical solutions in situations in which the sponsor of the pension plan is insolvent, but where the plan itself is solvent.

Several recent cases shed some light on how to deal with these circumstances. *Re Ivaco* , was a situation in which past pension plan contributions were in default and were not going to be repaid in the context of the insolvency proceedings. The directors were potentially liable for such deficiencies. The Court issued orders which absolved the directors of liability for such deficiencies, and further absolved the insolvent company itself from the liability to make up the defaulted contributions. It was determined that all claims or liens arising from such defaults were not to be further recognized or dealt with in the insolvency proceedings, and would not have priority over other claims under administration of the insolvency proceedings. Ivaco is now free to restructure without attention to these problems, including the possibility of a sale or liquidation in the course of that reorganization.

In another CCAA proceeding, the Ontario courts ordered that a firm undergoing CCAA proceedings was absolved from its contractual obligation to prepare and submit required actuarial reports. These reports would have triggered default due to disclosure of defaults thereby triggering certain deemed trusts. The resulting reordering of priorities in the CCAA estate would have triggered a problem on the windup and sale, and the court avoided those problems in the issuance of its order.

The courts appear willing to use their “inherent jurisdiction” to amend or forgive covenant violations to preserve the possibility of a sale or restructuring.

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