

PENSIONS AND EMPLOYEE COMPENSATION BULLETIN

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RE GRAPHICSHOPPE: ONTARIO COURT OF APPEAL REJECTS PENSION BENEFICIARIES' TRUST CLAIM IN BANKRUPTCY

The recent decision of the Ontario Court of Appeal in *Re Graphicshoppe*¹ confirms that the deemed trust remedy provided by s. 57 of the *Pension Benefits Act*² (the "PBA") will often be ineffective to protect beneficiaries in case of the insolvency of a plan sponsor. The Court of Appeal held that the PBA deemed trust is not effective in bankruptcy and that the employees will only have a trust claim if the requirements of a common law trust are satisfied. Further, the majority held that the requirement of certainty of subject matter can only be established if the funds in question remain identifiable and traceable.

BACKGROUND

In the months preceding its bankruptcy, Graphicshoppe, the sponsor of a defined benefit pension plan, deducted the required contributions from its employees' pay. Rather than depositing these amounts directly into the pension plan fund or into a segregated account, employee contributions were deposited into its only bank account. Graphicshoppe then used the funds in the account for general corporate purposes. The balance in the account fluctuated and at times dipped below zero. At the time of the bankruptcy, however, there were funds on deposit in excess of the deducted amounts, due to an unrelated transfer from a third party. The employees filed a proof of claim with Graphicshoppe's trustee in bankruptcy (the "Trustee") and asserted a trust claim over the funds on deposit in the bank account, to the extent of the employee contributions that had been deducted but not remitted. The Trustee disallowed the claim on the basis that the employee contributions could not be traced.

LOWER COURT DECISIONS

The employees appealed the Trustee's disallowance of their claim and the Registrar upheld the employees' trust claim. While agreeing with the Trustee that the statutory deemed trust would not be effective in bankruptcy, the Registrar held that the requirements of a common law trust were satisfied in this case. In particular, he held that the requirement of certainty of subject matter was satisfied since the amount of the employee contributions was calculable, whether or not the actual moneys deducted from the employees' pay checks could be traced.

The Trustee appealed to the Superior Court of Justice, where Lax J. agreed that the common law trust was not destroyed when Graphicshoppe intermingled the trust property with other funds. Lax J. confirmed the Registrar's holding that the inclusion in the collective agreement of a defined percentage of employees' wages for pension contributions satisfied the trust requirement of certainty of subject matter.

THE COURT OF APPEAL DECISION

On appeal, majority of the Court of Appeal reinstated the Trustee's disallowance of the trust claim. Justice Moldaver, writing for the majority, confirmed that the statutory deemed trust was not effective in a bankruptcy, but that the employees could have a valid trust claim if the three certainties of a common law trust – certainty of object, intention and subject matter – were established.

Justice Moldaver acknowledged that the moment that Graphicshoppe deducted the employees' contributions, all the elements of a trust were present, but found that through its subsequent actions, Graphicshoppe had destroyed the trust. Justice Moldaver was careful not to state that certainty of subject matter is destroyed when trust funds are

¹ (2005), 78 O.R. (3d) 401

² R.S.O. 1990, c. P. 8

intermingled with other funds, although another recent decision of the Court of Appeal has reached that conclusion. Instead, he held that that a common law trust will be destroyed when the intermingled funds are converted into property that cannot be traced. Specifically, when Graphicshoppe spent the intermingled funds on general corporate purposes, certainty of subject matter was lost and the trust destroyed. New funds deposited into the account from another source could not replenish or resurrect the trust that had been destroyed.

IMPACT ON EMPLOYEES

Clearly, this case is not encouraging for employees of a bankrupt plan sponsor. Not only is the deemed trust provided by the PBA completely ineffective to protect employees in this situation, but it is also extremely difficult for employees to establish a common law trust, given the financial chaos that usually accompanies a bankruptcy. In fact, if the plan sponsor has, as is often the case, used the deducted pension contributions to pay more pressing obligations so that the funds cannot be traced, the employees will only have a general unsecured claim against the bankrupt estate. Given that other recent caselaw has also cast grave doubt on the effectiveness of the statutory lien provided by the PBA, it is questionable whether employees will find any protection under the provisions of section 57 of the PBA.

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The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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