Court File No. CV-09-8241-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c.C-36 AS AMENDED

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO **FRASER PAPERS INC./PAPIERS FRASER INC.**, FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LIMITED, FRASER PAPERS LIMITED and FRASER N.H. LLC

Applicants

BOOK OF AUTHORITIES OF THE APPLICANTS
(Motion Returnable November 3, 2010)

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TAB 1

1993 CarswellOnt 183, 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275

1993 CarswellOnt 183, 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275

Lehndorff General Partner Ltd., Re

Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; Re Courts of Justice Act, R.S.O. 1990, c. C-43; Re plan of compromise in respect of LEHNDORFF GENERAL PARTNER LTD. (in its own capacity and in its capacity as general partner of LEHNDORFF UNITED PROPERTIES (CANADA), LEHNDORFF PROPERTIES (CANADA) and LEHNDORFF PROPERTIES (CANADA) II) and in respect of certain of their nominees LEHNDORFF UNITED PROPERTIES (CANADA) LTD., LEHNDORFF CANADIAN HOLDINGS LTD., LEHNDORFF CANADIAN HOLDINGS II LTD., BAYTEMP PROPERTIES LIMITED and 102 BLOOR STREET WEST LIMITED and in respect of THG LEHNDORFF VERMÖGENSVERWALTUNG GmbH (in its capacity as limited partner of LEHNDORFF UNITED PROPERTIES (CANADA))

Ontario Court of Justice (General Division — Commercial List)

Farley J.

Heard: December 24, 1992
Judgment: January 6, 1993
Docket: Doc. B366/92

Counsel: *Alfred Apps, Robert Harrison* and *Melissa J. Kennedy* , for applicants.

L. Crozier , for Royal Bank of Canada.

R.C. Heintzman , for Bank of Montreal.

J. Hodgson, Susan Lundy and *James Hilton* , for Canada Trustco Mortgage Corporation.

Jay Schwartz , for Citibank Canada.

Stephen Golick , for Peat Marwick Thorne[FN*] Inc., proposed monitor.

John Teolis , for Fuji Bank Canada.

Robert Thorton , for certain of the advisory boards.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Effect of arrangement — Stay of proceedings.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Stay of proceedings — Stay being granted even where it would affect non-applicants that were not companies within meaning of Act — Business operations of applicants and non-applicants being so intertwined as to make stay appropriate.

The applicant companies were involved in property development and management and sought the protection of the *Companies' Creditors Arrangement Act* ("CCAA") in order that they could present a plan of compromise. They also sought a stay of all proceedings against the individual company applicants either in their own capacities or because of their interest in a larger group of companies. Each of the applicant companies was insolvent and had outstanding debentures issued under trust deeds. They proposed a plan of compromise among themselves and the holders of the debentures as well as those others of their secured and unsecured creditors deemed appropriate in the circumstances.

A question arose as to whether the court had the power to grant a stay of proceedings against non-applicants that were not companies and, therefore, not within the express provisions of the CCAA.

Held:

The application was allowed.

It was appropriate, given the significant financial intertwining of the applicant companies, that a consolidated plan be approved. Further, each of the applicant companies had a realistic possibility of being able to continue operating even though each was currently unable to meet all of its expenses. This was precisely the sort of situation in which all of the creditors would likely benefit from the application of the CCAA and in which it was appropriate to grant an order staying proceedings.

The inherent power of the court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Clearly, the court had the jurisdiction to grant a stay in respect of any of the applicants that were companies fitting the criteria in the CCAA. However, the stay requested also involved limited partnerships where (1) the applicant companies acted on behalf of the limited partnerships, or (2) the stay would be effective against any proceedings taken by any party against the property assets and undertakings of the limited partnerships in which they held a direct interest. The business operations of the applicant companies were so intertwined with the limited partnerships that it would be impossible for a stay to be granted to the applicant companies that would affect their business without affecting the undivided interest of the limited partnerships in the business. As a result, it was just and reasonable to supplement s. 11 and grant the stay.

While the provisions of the CCAA allow for a cramdown of a creditor's claim, as well as the interest of any other person, anyone wishing to start or continue proceedings against the applicant companies could use the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain the stay. In such a motion, the onus would be on the applicant companies to show that it was appropriate in the circumstances to continue the stay.

Cases considered:

Amirault Fish Co., Re, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) — *referred to*

Associated Investors of Canada Ltd., Re, 67 C.B.R. (N.S.) 237 , Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, (sub nom. *Re First Investors Corp.)* 46 D.L.R. (4th) 669 (Q.B.) , reversed (1988), 71 C.B.R.

71, 60 Alta. L.R. (2d) 242, 89 A.R. 344 (C.A.) — *referred to*

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) — *referred to*

Canada Systems Group (EST) v. Allen-Dale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) [affirmed (1983), 41 O.R. (2d) 135, 33 C.P.C. 210, 145 D.L.R. (3d) 266 (C.A.)] — *re-ferred to*

Empire-Universal Films Ltd. v. Rank, [1947] O.R. 775 [H.C.] — *referred to*

Feifer v. Frame Manufacturing Corp., Re, 28 C.B.R. 124, [1947] Que. K.B. 348 (C.A.) — *referred to*

Fine's Flowers Ltd. v. Fine's Flowers (Creditors of) (1992), 10 C.B.R. (3d) 87, 4 B.L.R. (2d) 293, 87 D.L.R. (4th) 391, 7 O.R. (3d) 193 (Gen. Div.) — *referred to*

Gaz Métropolitain v. Wynden Canada Inc. (1982), 44 C.B.R. (N.S.) 285 (Que. S.C.) [affirmed (1982), 45 C.B.R. (N.S.) 11 (Que. C.A.)] — *referred to*

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) — *referred to*

Inducon Development Corp. Re (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) — *referred to*

International Donut Corp. v. 050863 N.B. Ltd. (1992), 127 N.B.R. (2d) 290, 319 A.P.R. 290 (Q.B.) — *considered*

Keppoch Development Ltd., Re (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) — *referred to*

Langley's Ltd., Re, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) — *referred to*

McCordic v. Bosanquet (1974), 5 O.R. (2d) 53 (H.C.) — *referred to*

Meridian Developments Inc. v. Toronto Dominion Bank, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Q.B.) — *referred to*

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 1 (Q.B.) — *referred to*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) — *referred to*

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1 O.R. (3d) 289 (C.A.) — *referred to*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.) , affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. (2d) xxxiii (note), 135 N.R. 317 (note) — *referred to*

Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 — *referred to*

Seven Mile Dam Contractors v. R. (1979), 13 B.C.L.R. 137, 104 D.L.R. (3d) 274 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) — *referred to*

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — *referred to*

Slavik, Re (1992), 12 C.B.R. (3d) 157 (B.C. S.C.) — *considered*

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) — *referred to*

Ultracare Management Inc. v. Zevenberger (Trustee of) (1990), 3 C.B.R. (3d) 151, (sub nom. *Ultracare Management Inc. v. Gammon)* 1 O.R. (3d) 321 (Gen. Div.) — *referred to*

United Maritime Fishermen Co-operative, Re (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.) , varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.) , reversed (1988), 69 C.B.R. (N.S.) 161, 88 N.B.R. (2d) 253, 224 A.P.R. 253, (sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.)* 51 D.L.R. (4th) 618 (C.A.) — *referred to*

Statutes considered:

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 85

s. 142

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 — preamble

s. 2

s. 3

s. 4

s. 5

s. 6

s. 7

s. 8

s. 11

Courts of Justice Act, R.S.O. 1990, c. C.43.

Judicature Act, The, R.S.O. 1937, c. 100.

Limited Partnerships Act, R.S.O. 1990, c. L.16 —

s. 2(2)

s. 3(1)

s. 8

s. 9

s. 11

s. 12(1)

s. 13

s. 15(2)

s. 24

Partnership Act, R.S.A. 1980, c.P-2 — Pt. 2

s. 75

Rules considered:

Ontario, Rules of Civil Procedure —

r. 8.01

r. 8.02

Application under Companies' Creditors Arrangement Act to file consolidated plan of compromise and for stay of proceedings.

***Farley J.*:**

1 These are my written reasons relating to the relief granted the applicants on December 24, 1992 pursuant to their application under the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 ("CCAA") and the *Courts of Justice Act* , R.S.O. 1990, c. C.43 ("CJA"). The relief sought was as follows:

(a) short service of the notice of application;

(b) a declaration that the applicants were companies to which the CCAA applies;

(c) authorization for the applicants to file a consolidated plan of compromise;

(d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;

(e) a stay of all proceedings taken or that might be taken either in respect of the applicants in their own ca-

pacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and

(f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act* , R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act* , R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

3 This process has now evolved to a point where management has developed a consolidated restructuring plan which plan addresses the following issues:

(a) The compromise of existing conventional, term and operating indebtedness, both secured and unsecured.

(b) The restructuring of existing project financing commitments.

(c) New financing, by way of equity or subordinated debt.

(d) Elimination or reduction of certain overhead.

(e) Viability of existing businesses of entities in the Lehndorff Group.

(f) Restructuring of income flows from the limited partnerships.

(g) Disposition of further real property assets aside from those disposed of earlier in the process.

(h) Consolidation of entities in the Group; and

(i) Rationalization of the existing debt and security structure in the continuing entities in the Group.

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and (b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA may be made on an ex parte basis (s. 11 of the CCAA; *Re Langley's Ltd.*, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) ; *Re Keppoch Development Ltd.* (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) . The court will be concerned when major creditors have not been alerted even in the most minimal fashion (*Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.) , at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.) , reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.) , at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or

otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75 ; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.) , at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.) , at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.) .; *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.) , at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

6 The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. see *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra at pp. 297 and 316; *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252 and *Ultracare Management Inc. v. Zevenberger (Trustee of)* , supra, at p. 328 and p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 108-110; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.) , at pp. 315-318 (C.B.R.) and *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252.

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act* , R.S.C. 1985, c. B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.) . It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an or-

derly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.* , supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

8 It strikes me that each of the applicants in this case has a realistic possibility of being able to continue operating, although each is currently unable to meet all of its expenses albeit on a reduced scale. This is precisely the sort of circumstance in which all of the creditors are likely to benefit from the application of the CCAA and in which it is appropriate to grant an order staying proceedings so as to allow the applicant to finalize preparation of and file a plan of compromise and arrangement.

9 Let me now review the aspect of the stay of proceedings. Section 11 of the CCAA provides as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

10 The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* , supra, at pp. 12-17 (C.B.R.) and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 296-298 (B.C. S.C.) and pp. 312-314 (B.C. C.A.) and *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 320 where Gibbs J.A. for the court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it includes a bank holding s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad scope of the C.C.A.A. prevails.

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (Que. S.C.)

at pp. 290-291 and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (Que. C.A.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

> 8. This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 312-314 (B.C.C.A.).

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik* , unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik* situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

> 5. The order provided further that all creditors of Norvik Timber Inc. be enjoined from making demand for payment upon that firm or upon any guarantor of an obligation of the firm until further order of the court.

The CCAA reorganization plan involved an assignment of the claims of the creditors to "Newco" in exchange for cash and shares. However the basis of the stay order originally granted was not set forth in this decision.

13 It appears to me that Dickson J. in *International Donut Corp. v. 050863 N.D. Ltd.* , unreported, [1992] N.B.J. No. 339 (N.B. Q.B.) [now reported at 127 N.B.R. (2d) 290, 319 A.P.R. 290] was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated [at p. 295 N.B.R.]:

> In August 1991 the limited partnership, through its general partner the plaintiff, applied to the Court under the *Companies' Creditors Arrangement Act* , R.S.C., c. C-36 for an order delaying the assertion of claims by creditors until an opportunity could be gained to work out with the numerous and sizable creditors a compromise of their claims. An order was obtained but it in due course expired without success having been achieved in arranging with creditors a compromise. *That effort may have been wasted, because it seems*

> *questionable that the federal Act could have any application to a limited partnership in circumstances such as these* . (Emphasis added.)

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont. Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

The Power to Stay

The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) , and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* , R.S.O. 1990, c. C.43, which provides as follows:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

Recently, Mr. Justice O'Connell has observed that this discre tionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 24127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure* . The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows.

The Power to Stay in the Context of C.C.A.A. Proceedings

By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) , and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

Gibbs J.A. continued with this comment:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s.

> 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period* .
>
> (emphasis added)
>
> I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement. [In this respect, see also *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.) at p. 77.]
>
> I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from *Empire-Universal Films Limited v. Rank*, [1947] O.R. 775 (H.C.) that McRuer C.J.H.C. considered that *The Judicature Act* [R.S.O. 1937, c. 100] then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 (H.C.) and *Canada Systems Group (EST) Ltd. v. Allen-Dale Mutual Insurance Co.* (1982), 29 C.P.C. 60 (H.C.) at pp. 65-66.

15 Montgomery J. in *Canada Systems* , supra, at pp. 65-66 indicated:

> Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, (sub nom. *Lane v. Willis; Lane v. Beach)* [1972] 1 W.L.R. 326 (C.A.) .
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> . . . . .
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> In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 , appeal allowed by consent without costs (sub nom. *Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.)* 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.) , Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
> > The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:

> (1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.

16 Thus it appears to me that the inherent power of this court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Is it appropriate to do so in the circumstances? Clearly there is jurisdiction under s. 11 of the CCAA to grant a stay in respect of any of the applicants which are all companies which fit the criteria of the CCAA. However the stay requested also involved the limited partnerships to some degree either (i) with respect to the applicants acting on behalf of the Limited Partnerships or (ii) the stays being effective vis-à-vis any proceedings taken by any party against the property assets and undertaking of the Limited Partnerships in respect of which they hold a direct interest (collectively the "Property") as set out in the terms of the stay provisions of the order paragraphs 4 through 18 inclusive attached as an appendix to these reasons. [Appendix omitted.] I believe that an analysis of the operations of a limited partnership in this context would be beneficial to an understanding of how there is a close inter-relationship to the applicants involved in this CCAA proceedings and how the Limited Partnerships and their Property are an integral part of the operations previously conducted and the proposed restructuring.

17 A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R. Hepburn, *Limited Partnerships* , (Toronto: De Boo, 1991), at p. 1-2 and p. 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the *Bankruptcy Act* (now the BIA) sections 85 and 142.

18 A general partner is responsible to defend proceedings against the limited partnership in the firm name, so in procedural law and in practical effect, a proceeding against a limited partnership is a proceeding against

the general partner. See Ontario *Rules of Civil Procedure* , O. Reg. 560/84, Rules 8.01 and 8.02.

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership* , 15th ed. (London: Sweet & Maxwell, 1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in *Re Thorne* between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in *Ruzicks* unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section 15 of the *Canada Business Corporation Act* [S.C. 1974-75, c. 33, as am.] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the 'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner — the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test* , (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

21 It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. It seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

22 The order is therefore granted as to the relief requested including the proposed stay provisions.

Application allowed.

FN* As amended by the court.

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TAB 2

Substantive Consolidation in CCAA Restructurings: A Critical Analysis[1]

*Michael B. Rotsztain and Natasha De Cicco**

I. INTRODUCTION

In the increasingly complicated Canadian and global economic environments, it has become more common for business enterprises to operate through complex and often multi-tiered corporate structures, using a number of separate but inter-related corporations. This is driven by a variety of enterprise-specific factors, including operational, financial, and geographic considerations. In many cases, affiliates or subsidiaries are established in order to enjoy the benefits of "tax havens" and thus reduce the taxes paid by the enterprise.

The insolvency of such a corporate group often raises difficult issues of allocation of assets and liabilities among various members of the group which do not need to be addressed while the enterprise is healthy and meeting its obligations. Both common law and statute[2] recognize that corporations and their shareholders and affiliates are separate legal entities with their own separate assets and liabilities and that creditors of one member of a corporate group generally are not entitled to assert their claims against other members of the group unless circumstances exist which permit the "corporate veil" to be pierced or other exceptional grounds exist.

As is so often the case, however, the need to deal with an insolvency in an expeditious and equitable manner can sometimes lead to a somewhat different approach in dealing with the allocation of the assets and liabilities of the members of an affiliated corporate group. In some cases, the courts have per-

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* Torys LLP

2 See, *e.g.*, section 92(1) of the *Business Corporations Act*, R.S.O. 1990, c. B.16, as amended.

mitted the substantive consolidation of all or some members of the group. The primary focus of this paper is substantive consolidation under the *Companies' Creditors Arrangement Act*,[3] although the application of the doctrine under the *Bankruptcy and Insolvency Act*[4] is also reviewed.

Initially developed under United States bankruptcy law, the doctrine of substantive consolidation has been adopted and implemented by Canadian courts in a number of bankruptcies and restructurings, even though neither the CCAA nor (except in very limited circumstances, discussed below) the BIA expressly permits substantive consolidation. In a substantive consolidation in the insolvency context, a number of affiliated legal entities, typically corporations, are treated as if they were one entity. This generally results in assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied. This paper does not deal with the doctrine of procedural consolidation, under which estates of related debtors are jointly administered, but the assets and liabilities of each estate are dealt with separately.

As substantive consolidation involves the pooling of affiliated debtors' assets and liabilities, it can have a significant impact on creditors' claims. Some investors may benefit by the application of the doctrine, while others may have their recoveries diluted. Moreover, substantive consolidation extinguishes inter-company obligations, which can also have an impact on creditors' recoveries, as well as making it impossible to attack inter-company transactions under the various available remedies.

Despite its significant ramifications and its *ad hoc* application over the past 15 years, the doctrine of substantive consolidation under Canadian insolvency law is still in its relative infancy. Although numerous consolidated CCAA plans of reorganization have been approved and implemented, and there have been several consolidated bankruptcies, there are only a handful of reported cases on the issue and still fewer that specifically analyze the basis for the application of the doctrine.

A combination of several factors, including the absence of express statutory authority to permit substantive consolidation, the relatively undeveloped body of Canadian case law, the state of flux of U.S. jurisprudence, and the potential significant impact substantive consolidation may have on creditors highlights the need to clarify the law and practice on the issue and to apply the doctrine of substantive consolidation consistently and fairly. It is within this context that this paper will provide a critical analysis of the application of the doctrine of substantive consolidation under existing Canadian law and, in particular, under the CCAA, as well as a discussion of possible different approaches.

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3 R.S.C. 1985, c. C-36, as amended [hereinafter CCAA].

4 R.S.C. 1985, c. B-3, as amended [hereinafter BIA].

For the purpose of such analysis, this paper is divided into the following parts: Section II provides an overview of the development of the law of substantive consolidation in Canada in bankruptcies and BIA and CCAA restructurings. Section III contains a listing of some notable consolidated plans of reorganization filed under the CCAA with respect to which no reasons for judgment in respect of the consolidation are available. Section IV provides a brief summary of the law of substantive consolidation in the United States and a discussion of recent legal developments there. Finally, in Section V, the authors discuss the merits of the current Canadian approach and possible different approaches. The paper concludes with the authors expressing their views on the appropriate test for substantive consolidation and the procedures which should be used in applying the test.

II. THE DEVELOPMENT OF THE LAW OF SUBSTANTIVE CONSOLIDATION IN CANADIAN BANKRUPTCIES AND RESTRUCTURINGS

The doctrine of substantive consolidation has evolved somewhat differently under the BIA than it has under the CCAA, perhaps because the BIA deals with liquidations and restructurings, while the CCAA deals, at least explicitly, only with restructurings. Accordingly, in this section, the leading Canadian decisions on substantive consolidation have been grouped on the basis of the type of proceeding ((a) BIA bankruptcies and liquidations, (b) BIA proposals, and (c) CCAA restructurings) and summarized, in an attempt to highlight the relatively undeveloped state of Canadian jurisprudence.

1. *Bankruptcy and Insolvency Act* — Bankruptcies and Liquidations

The BIA does not expressly authorize the substantive consolidation of two or more estates except in very limited circumstances, which do not apply to corporations. Sections 66.12(1.1) and 155(f) effectively permit substantive consolidation in Division II consumer proposals and summary administration of estates, respectively, in "such circumstances as are specified in directives of the Superintendent" of Bankruptcy.[5]

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5 Directive No. 2R entitled "Joint Filing" issued by the Superintendent of Bankruptcy on December 19, 1997, specifies the circumstances in which an assignment in bankruptcy or a consumer proposal of two or more individuals may be dealt with jointly. It provides that "[a]ssignments filed under the provisions relating to summary administrations may be dealt with as one estate where the debts of the individuals making

Section 183 of the BIA, which vests the bankruptcy courts with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings" may be considered and, as discussed below, has been relied upon by courts as a general source of the court's authority to consolidate two or more estates under the BIA.

A. & F. Baillargeon Express Inc., Re[6] is the leading case on substantive consolidation under the BIA and resolved any controversy regarding the availability of substantive consolidation under that statute.[7] On an appeal by the trustee from an order of the Registrar, the court allowed the appeal and ordered the substantive consolidation of the estates of five bankrupt companies. The court acknowledged that the BIA was silent on the issue. However, following the approach adopted by U.S. bankruptcy courts, the court exercised its equitable jurisdiction under Section 183 of the BIA and ordered the substantive consolidation of the five bankrupt companies. Although the court did not establish a legal test for substantive consolidation under the BIA, it considered the following factors in rendering its decision: (i) the operational intermingling of the affiliated companies indistinctly to suppliers, customers, and assets; (ii) the "total disregard for the niceties of corporate identity and separate judicial personalities"; and (iii) the fact that substantive consolidation would promote cost efficiency.[8]

It should be noted that, in its reasons, the court expressed the concern that there were some creditors who stood to receive a larger dividend on an individual, rather than a consolidated, basis, while several creditors stood to receive a higher dividend as a result of substantive consolidation, thus obtaining

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the joint assignment are substantially the same and the administrator of consumer proposals is of the opinion that it is in the best interest of the debtors and creditors". Regarding Division II consumer proposals, the directive provides that "[c]onsumer proposals may be dealt with as one consumer proposal where the debts of the individuals making the joint consumer proposal are substantially the same and the administrator of consumer proposals is of the opinion that it is in the best interest of the debtors and creditors".

6 *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (Qué. S.C.) [hereinafter *A. & F. Baillargeon*].

7 In *Pateman, Re* (1991), 5 C.B.R. (3d) 115 (Man. Q.B.) [hereinafter *Pateman*], the court, *in dicta*, questioned whether substantive consolidation was available at all under the BIA.

8 In this case, the evidence suggested that it was highly unlikely that there would be any dividend for ordinary creditors. Greenberg J. explained the cost efficiency argument as follows: "to oblige the Trustee to perform a separate body of work in respect of each of these five companies, thereby increasing the expenses of the bankruptcy and reducing the realisation by the secured creditors, that would only further diminish the already faint hope of any dividend to the ordinary creditors". *A. & F. Baillargeon*, *supra*, note 6 at para. 17.

a benefit to the detriment of others.[9] However, notwithstanding these concerns, the court was satisfied that the likelihood of realization was remote and, thus, requiring the trustee to administer the five estates on an individual basis would result in the incurring of unnecessary costs and expenses to the detriment of all creditors.[10] Moreover, the court noted that:

> There is also the consideration that in Bankruptcy matters the Court exercises an equitable as well as a legal jurisdiction, and that practicality is always the order of the day. It is frequently said in the jurisprudence that the Act is a "businessman's law" and that practical business considerations should not be disregarded, as they sometimes are in other domains where a strict interpretation of the law must be followed and observed.[11]

In *J.P. Capital Corp., Re*,[12] the court dismissed, without prejudice, an application by the trustee for an order consolidating the estates of two bankrupt companies and one bankrupt individual. The court indicated the trustee could renew its application once there had been "a clearer identification of the corporate structure, the assets, and the effect of a *pari passu* distribution" of assets on unsecured creditors.[13]

Although the court accepted that substantive consolidation would make the administration of the estates easier and save administrative fees in the long run,[14] and acknowledged that the majority of creditors consented to consolidation, it was concerned with the effect of substantive consolidation on all creditors. It stated that, "[a]lthough expediency is an appropriate consideration it should not be done at the possible prejudice or expense of any particular creditor".[15] The court noted that, unlike in *A. & F. Baillargeon*, the two bankrupt companies in this case maintained separate and distinct bank accounts and acted and operated as separate legal entities. Moreover, the court considered the different position the individual bankrupt might be in relating to his discharge compared to the two bankrupt companies. For all these reasons, the court concluded that the application for substantive consolidation was premature.

In *Associated Freezers of Canada Inc., Re*,[16] the trustee brought a motion for an order approving a proposed "*en bloc*" sale of assets of five bankrupt companies. In the event that the "*en bloc*" sale proceeded, the trustee requested

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9 *A. & F. Baillargeon*, *supra*, note 6 at para. 18.

10 *A. & F. Baillargeon*, *ibid.*, at para. 19.

11 *A. & F. Baillargeon*, *ibid.*, at para. 23.

12 *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Gen. Div.) [hereinafter *J.P. Capital*].

13 *J.P. Capital*, *ibid.*, at para. 19.

14 *J.P. Capital*, *ibid.*, at para. 16.

15 *J.P. Capital*, *ibid.*, at para. 18.

16 *Associated Freezers of Canada Inc., Re* (1995), 36 C.B.R. (3d) 227 (Ont. Gen. Div.) [hereinafter *Associated Freezers*].

the substantive consolidation of the five bankrupt companies. The principal secured creditor supported the proposal. In allowing the motion, the court noted "[t]he way in which the assets of the five bankrupt companies are organized and intertwined would appear to me to reasonably require that they be dealt with en bloc by the trustee to realize the greatest value for all interested parties both secured and unsecured".[17]

Thus, although there is limited jurisprudence on substantive consolidation under the BIA, there is little doubt that it has been recognized as a remedy available to the courts to apply in proper cases.

2. *Bankruptcy and Insolvency Act* — Proposals

The jurisprudence on the doctrine of substantive consolidation in proposals under the BIA is scarce. There are only two reported cases, and these deal with the issue of substantive consolidation in the context of a joint proposal by two natural persons. It appears that there are no reported cases allowing a group of insolvent corporations to file a joint proposal under the BIA, although the better view is that this would be permitted on the basis of the case law discussed in the immediately preceding section of this paper.[18]

In *Pateman*, an application to approve a joint proposal by two natural persons under the BIA was dismissed because the court determined that one of the applicants was not "insolvent" within the meaning of the Act. In its reasons, the court questioned whether a joint proposal could be made under the BIA. It stated that it had "serious reservations as to whether a joint proposal can be made save and except in the case of partners" but left the issue unresolved, since it did not need to determine it.[19]

The issue was subsequently addressed by the court in *Nitsopoulos, Re*,[20] where it was held that the BIA does not prohibit the filing of a joint Division I proposal by two or more natural persons.[21] In reaching its decision, the court was swayed by the practice permitting a BIA proposal to be jointly made by a partnership and its individual partners and by the requirement that Division I proposals be reviewed by the court as to their fairness and reasonableness, an effective check against potential abuse of the right to file a joint proposal. The court observed that in considering the fairness and reasonableness of a Division

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17 *Associated Freezers, ibid.*, at para. 1.

18 Of note in this regard is section 66(1) of the BIA, which provides that "[a]ll the provisions of this Act, except Division II of this Part, in so far as they are applicable, apply, with such modifications as the circumstances require, to proposals made under this Division".

19 *Pateman, supra*, note 7 at para. 45.

20 *Nitsopoulos, Re* (2001), 25 C.B.R. (4th) 305 (Ont. S.C.J.) [hereinafter *Nitsopoulos*].

21 *Nitsopoulos, ibid.*, at para. 7.

I proposal, its review "would encompass a consideration equivalent to s. 66.12(1.1) and further that the court would be able to see if the voting class(es) was fair and reasonable in the circumstances".[22] While not entirely clear from the court's endorsement, it appears that the court implicitly approved as relevant to the "fairness and reasonableness" test for Division I joint proposals the policy statement set out in the Superintendent of Bankruptcy's Directive No. 2R on joint filing of Division II consumer proposals.[23]

3. *Bankruptcy and Insolvency Act* — Summary

In summary, while the limited reported case law on the doctrine of substantive consolidation under the BIA, whether in the context of bankruptcies and liquidations or proposals, suggests that substantive consolidation is available under the BIA, the cases do not establish a clear and comprehensive test as to when substantive consolidation will be permitted. Rather, the courts have identified a number of relevant factors to be considered in determining whether or not to allow substantive consolidation. Similar to their approach under the CCAA, discussed below, the courts have considered the following factors to be relevant: (i) the extent of financial and operational integration of the debtors; (ii) the degree to which the separate corporate personalities are recognized; (iii) the cost implications of separate versus joint estates; and (iv) the effect of substantive consolidation on creditors generally and, in particular, any resulting prejudice.

4. *Companies' Creditors Arrangement Act* — Restructurings

As is the case under the BIA (with the limited exceptions noted above), there is no express statutory provision authorizing substantive consolidation under the CCAA.[24] Rather, courts have relied on their equitable jurisdiction and

22 *Nitsopoulos*, *ibid.*, at para. 9.

23 See *supra*, note 5.

24 In *Nitsopoulos*, *supra*, note 20 at para. 4, in discussing the authority to consolidate a joint proposal under the BIA, the court observed that, pursuant to section 3, "[t]he *Companies' Creditors Arrangement Act* contemplates dealing with a proposal of an affiliated group of companies". It is not clear whether the court was implying that section 3 authorizes substantive consolidation under the CCAA. The authors submit that any such interpretation of section 3 would be unjustified in that section 3 simply permits the claims against a debtor company and affiliated debtor companies to be aggregated for the purposes of the $5 million in total claims CCAA qualification test.

discretionary powers to make such orders. It is difficult to determine with any degree of certainty how many consolidated CCAA plans of arrangement have been filed and approved by Canadian courts. However, what is certain is the dearth of jurisprudence on the topic and the relatively small number of attempts to articulate a clear test as to when substantive consolidation will be permitted. This and the following subsection of this paper will review the jurisprudence under the CCAA. Section III contains a listing of a number of other notable CCAA cases in which substantive consolidation has been permitted, but no judicial reasons are available.

Northland Properties Ltd., Re[25] is the leading case on substantive consolidation in the context of the CCAA. The debtor companies collectively owned and operated various real estate, including hotels and office buildings. Although the debtor companies were separate legal entities, they were managed and operated as a single entity. No distinction was made based on the legal ownership of the property and assets comprising each of the hotel and office divisions; creditors and tenants dealt with the major divisions as a whole and not the separate corporations owning the properties; the companies maintained a single operating account with a bank; with the exception of one company, audited financial statements were prepared on a consolidated basis; the companies were beneficially owned by the same persons; and expenses and revenues were allocated to each of the companies for the sole purpose of filing separate tax returns.

The debtor companies brought a motion for an order, *inter alia*, merging and consolidating their reorganizations. Effectively, the debtor companies attempted to obtain advance approval to present an as yet unprepared consolidated plan to creditors. The court dismissed the motion on the basis that it was premature. However, the court noted that the debtor companies were not barred from seeking creditor approval of a consolidated plan and returning to court for approval.[26]

In rendering its decision, the court considered various U.S. cases and legal tests adopted by U.S. bankruptcy courts regarding substantive consolidation. First, the court considered the "economic prejudice test" enunciated in *Baker & Getty Financial Services Inc., Re*[27] as follows:

> The propriety of ordering substantive consolidation is determined by a balancing of interest. The relevant enquiry asks whether "the creditors will suffer greater

25 *Northland Properties Ltd., Re* (1988), 69 C.B.R. (N.S.) 266 (B.C. S.C.) [hereinafter *Northland Properties*].

26 The debtor companies ultimately filed a consolidated plan which was approved by the creditors and sanctioned by the court. See discussion below of the British Columbia Court of Appeal's decision.

27 *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S.B.R. D. Ohio, 1987) [hereinafter *Baker*].

> prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".[28]

Second, the court considered the U.S. "elements of consolidation" test identified in *Vecco Const. Indust. Inc., Re*[29] Under this test, the following factors are considered to assist in the balancing of interests in an application for substantive consolidation:

(i) Difficulty in segregating assets;
(ii) Presence of consolidated financial statements;
(iii) Profitability of consolidation at a single location;
(iv) Commingling of assets and business functions;
(v) Unity of interest in ownership;
(vi) Existence of intercorporate loan guarantees; and
(vii) Transfer of assets without observance of corporate formalities.[30]

Finally, the court in *Northland Properties* accepted the caveat of the U.S. Bankruptcy Court in *Snider Brothers Inc., Re*[31] that it must be clearly shown that not only the "elements of consolidation" are present, but also that the court's permitting substantive consolidation is necessary to prevent harm or prejudice or to effect a benefit generally. This would suggest that, in the court's view, substantive consolidation is an extraordinary remedy to be resorted to only sparingly.

Some commentators[32] have noted that the court seems to have adopted a two-step test (i.e., (a) the need for consolidation and (b) the equities must favour consolidation) or, perhaps, commingled the approaches adopted by the U.S. bankruptcy court. However, the court in *Northland Properties* ultimately focused on the "economic prejudice test" articulated in *Baker* and *Snider Bros.* to conclude that substantive consolidation is permissible under the CCAA at the appropriate stage of the case.[33]

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28 *Baker, ibid.*, at 142.

29 4 B.R. 407 (U.S. Bankr. E.D. Va., 1980) [hereinafter *Vecco*].

30 *Northland Properties, supra*, note 25 at 279.

31 *Snider Brothers Inc., Re*, 18 B.R. 230 (U.S. Bankr. D. Mass., 1982) [hereinafter *Snider Bros.*].

32 E. Hayes, "Substantive Consolidation under the *Companies' Creditors Arrangement Act* and the *Bankruptcy and Insolvency Act*", (1994) 23 Can. Bus. L.J. 444 at 448; D. Knowles & A. Zimmerman, "Further Developments and Trends in the *Companies' Creditors Arrangement Act: 1992*" Insolvency Institute of Canada, Practising Law Institute, October 1992 at para. 112, online: WL (CANINSOLV-COM).

33 *Northland Properties, supra*, note 25 at 280.

This approach was subsequently confirmed by the British Columbia Court of Appeal as the correct test for substantive consolidation.[34] The Court of Appeal described the *Snider Bros.* test as "the test between economic prejudice of continued debtor separateness versus the economic prejudice of consolidation" and noted that *Snider Bros.* "holds that consolidation is preferable if its economic prejudice is less than separateness prejudice".[35] In addition, the Court of Appeal observed that denying substantive consolidation could result in the CCAA plans becoming seriously fragmented.[36] The Court of Appeal, therefore, specifically approved the lower court's conclusion in *Northland Properties* that the court has the authority in a CCAA case to approve a consolidated plan.[37]

Though decided well more than a decade ago, the *Northland Properties* decisions contain the most extensive analysis and remain the pre-eminent cases on the doctrine of substantive consolidation under the CCAA. Subsequent case law has been scarce, and the decisions that have been reported have been fact-specific and, thus, have not resulted in the development of significant additional jurisprudence. In both *Fairview Industries Ltd., Re*[38] and *Lehndorff General Partner Ltd., Re*,[39] the court held that substantive consolidation is permitted under the CCAA in appropriate circumstances. More recently, in *Global Light Telecommunications Inc., Re*,[40] the court sanctioned a consolidated plan of arrangement despite opposition from one creditor. However, the court did not, in any of these cases, review the test for substantive consolidation adopted in *Northland Properties*.

In *Fairview Industries*, the court made an initial order consolidating the proceedings of six debtor companies. The determinative factors considered were: (i) the debtor companies' finances were intertwined; and (ii) there would be no prejudice suffered, as no inter-company payments were being made nor were fees to flow to the parent companies in the interim period before the presentation of the plan.[41]

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34 *Northland Properties Ltd., Re* (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195 (B.C. C.A.), which was an appeal from the British Columbia Supreme Court's order sanctioning the consolidated plan.

35 *Ibid.*, at 202.

36 *Ibid.*

37 *Ibid.*

38 *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43 (N.S. T.D.) [herinafter *Fairview Industries*].

39 *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) [hereinafter *Lehndorff*].

40 *Global Light Telecommunications Inc., Re* (2004), [2004] B.C.J. No. 1153, 2004 CarswellBC 1249 (B.C. S.C.) [hereinafter *Global Light*].

41 *Fairview Industries, supra*, note 38 at para. 53.

Subsequently, two secured creditors brought a motion to amend or rescind the initial order to require two of the six debtor corporations to file separate plans of compromise or arrangement. The court granted the motion partly on the basis that, as the creditors held security on virtually all of the assets and property of the debtor companies and had categorically stated they would oppose any fully consolidated plan, the prospect of securing acceptance of a consolidated plan was extremely low, thereby jeopardizing the reorganization.

In *Lehndorff*, on the initial CCAA application, the court authorized a group of companies to file a consolidated plan of compromise or arrangement, since it was satisfied that their businesses were significantly intertwined, and, thus, a consolidated plan was appropriate.[42] The court noted that there were multiple instances of inter-company debt, cross-default provisions, and guarantees, and that the companies operated a centralized cash-management system. The court took a fact-specific approach and did not cite any authority or expressly articulate the test that was applied over and above the debtor companies being "intertwined". It is interesting to note that, unlike in *Northland Properties*, the court expressed no reservations about permitting substantive consolidation prior to the filing of a plan.

In *Global Light*, the court sanctioned a consolidated plan, notwithstanding opposition from a creditor that it was not fair and reasonable in the circumstances. In its reasons, the court referred to the following factors in support of its decision: (i) at the hearing of the application to add subsidiaries of the original petitioner company as petitioners in the proceedings, the creditor had not opposed the proposal by the debtor companies to file a consolidated plan in the future, nor had it appealed from the order adding the subsidiaries as petitioners; (ii) the consolidated plan had been approved by a significant majority of the creditors who voted; (iii) all creditors had dealt with the parent company (the original petitioner) and its subsidiaries knowing they were dealing with the original petitioner as parent; and (iv) there was no evidence suggesting that the opposing creditor had accommodated the group of companies in such a way that it should be the sole beneficiary of the sale proceeds from one of the subsidiaries' investment, which would apparently have been the case had consolidation not been permitted.

5. *Companies' Creditors Arrangement Act* — Liquidations

PSINET Ltd., Re[43] appears to be the only reported decision addressing the doctrine of substantive consolidation in the context of, in effect, a liquidation

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42 *Lehndorff, supra*, note 39 at para. 4.

43 *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) [hereinafter *PSINet*].

under the CCAA.[44] As was the case in *Fairview Industries*, *Lehndorff* and *Global Light*, the court's decision was largely fact-specific without an in-depth analysis of the doctrine itself. On an unopposed motion to sanction a consolidated CCAA plan of four affiliated debtor companies, the court considered the following factors in approving and sanctioning the plan: (i) the consolidated plan avoided the complex and potentially litigious issues surrounding the allocation of the proceeds of the sale of substantially all of the companies' assets; (ii) the plan reflected the intertwined nature of the debtor companies and their business operations, which businesses essentially operated as one entity; (iii) the companies' records were incomplete and deficient; (iv) the plan was fair and reasonable; (v) the creditors had had sufficient time and information to make a reasoned decision and had voted in favour of the plan by a significant margin; and (vi) concessions made by the major creditor ameliorated any prejudice resulting from the consolidation.

In its findings, the court acknowledged that, by its very nature, a consolidated plan will benefit some creditors but be to the detriment of others. However, the court stated that it is appropriate to consider the "overall general effect" of a consolidated plan. Moreover, the court noted that if consolidation is appropriate in the circumstances, then it would not be appropriate to segregate creditors into classes by corporation, "absent very unusual circumstances".[45] The court minimized the significance to the case at bar of the decisions in *Pateman* and *J.P. Capital*, which considered prejudice to one creditor as sufficient grounds for disallowing a consolidated plan, on the basis that these cases were decided under the BIA and not the CCAA.[46] The court referred to *Northland Properties* as the authority for substantive consolidation under the CCAA but did not specifically review the reasoning in that case or in the U.S. authorities considered in the case.

6. *Companies' Creditors Arrangement Act* — Summary

The *Northland Properties* cases remain the leading authorities on the doctrine of substantive consolidation under the CCAA. In subsequent cases, the courts have been content to base their rulings largely on the specific facts of the case, without analyzing or, in most cases, ever referring to the reasoning in the *Northland Properties* cases or attempting to formulate a comprehensive substantive consolidation test under the CCAA. Thus, until a court approaches a CCAA consolidation case differently, the principles reviewed in *Northland*

44 The case report notes that substantially all the assets of the debtor companies had been sold to a third party. See *PSINet*, *ibid.*, at para. 2.

45 *PSINet*, *ibid.*, at para. 11.

46 *PSINet*, *ibid.*

Properties will continue to provide the best available guidance on the doctrine of substantive consolidation under the CCAA.

In addition to reviewing case law, examining "the facts on the ground", or how the courts have dealt with substantive consolidation in cases where reasons have not been given, provides useful information on CCAA law and practice in the area.

III. CONSOLIDATED PLANS OF ARRANGEMENT OR COMPROMISE UNDER THE CCAA

Despite the scarcity of case law on the doctrine of substantive consolidation under the BIA or the CCAA, numerous consolidated plans of arrangement have been approved and sanctioned by courts under the CCAA without reasons for judgment on the issue. The following is a listing of some of the more prominent cases where this has occurred.

Year	Lead Company	Province	Court File No.	Number of Companies Consolidated
1992	Olympia & York Developments Limited	Ontario	B125/92	26
1993	Bramalea Limited	Ontario	RE2166/92	At least 34
2000	Bluestar Systems Canada Corp.	Ontario	00-CL-3860	2
2000	Canadian Airlines Corporation	Alberta	0001-05071	2
2002	360networks inc.	British Columbia	L011792	8
2002	GT Group Telecom	Ontario	02-CL-4580 Court of Appeal File No. M29418	3
2002	Cineplex Odeon Corporation	Ontario	01-CL-4024 M27138	6
2003	AT&T Canada Inc.	Ontario	02-CL-4715 03-CL-4874	7
2004	Doman Industries Limited	British Columbia	L023489	14
2004	Air Canada	Ontario	03-CL-4932	8

Although no jurisprudence has resulted from these permitted consolidations, they are evidence that the practice has evolved to the point that, at least in Ontario and British Columbia, CCAA plans involving substantive consolidation are not unusual. A disproportionate number of the cases listed above originate from Ontario. While it is impossible to state with certainty why this is the case, the authors speculate it results from both the relative complexity of the enterprises initiating CCAA cases in Ontario and the activist approach taken generally by the Ontario Superior Court of Justice in applying the CCAA.

Once a CCAA practice becomes well-established, it acquires significant precedential value. Thus, it becomes important to be aware of notable consolidations, even those where no judicial reasons are available.

IV. SUBSTANTIVE CONSOLIDATION UNDER U.S. LAW[47]

Much like Canadian law, U.S. law on substantive consolidation has developed on a case-by-case basis. There is, however, far more U.S. jurisprudence.

The power to substantively consolidate derives from the general equitable powers of a U.S. bankruptcy court.[48] There is no express statutory basis for substantive consolidation other than section 105 of the *Bankruptcy Code*,[49] which merely gives the U.S. bankruptcy court the power to enter an order to implement its equitable powers, and section 1123(a)(5)(C), which is discussed below. Section 105(a) provides that:

> [t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.[50]

Part 4 of this section contains a further discussion of the U.S. bankruptcy courts' jurisdiction to substantively consolidate estates.

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47 The authors gratefully acknowledge the contribution to this section of the members of the Restructuring and Insolvency Group of the New York office of Torys LLP.

48 *Tureaud, Re*, 59 B.R. 973 (U.S. N.D. Okla., 1986) at 975 [hereinafter *Tureaud*]; *Stone v. Eacho*, 127 F.2d 284 (U.S. 4th Cir., 1941), cert. denied 317 U.S. 635 (1942) at 289 [F.2d] [hereinafter *Stone v. Eacho*].

49 11 U.S.C. (2003).

50 *Ibid.*

Therefore, the U.S. bankruptcy courts have developed a variety of standards and considerations to be applied in any given case. The approaches of various courts can be categorized into two broad rubrics: (i) the objective factors test; and (ii) the subjective balancing tests. U.S. courts generally apply a combination of these two approaches in reaching a final determination as to the appropriateness of substantive consolidation.

1. The Factors Test: Piercing the "Corporate Veil" and "Alter Ego"

The original cases invoked the "alter ego" or "corporate veil" analysis.[51] These corporate concepts provided U.S. bankruptcy courts with "nonbankruptcy" standards for the consolidation of legally separate entities; i.e., standards applied in cases other than bankruptcies, often collectively described as "piercing the corporate veil". Under these approaches, the U.S. bankruptcy courts found that "where a corporation is a mere instrumentality or alter ego of the bankrupt corporation, with no independent existence of its own, equity would favor disregarding the separate corporate entities".[52]

Generally, the "alter ego" and "corporate veil" analyses rely on certain objective criteria to determine whether one entity should be substantively consolidated with another entity. Although U.S. bankruptcy courts have used differing sets of factors, most courts employ one of two basic sets of factors. The first list, from *Vecco*,[53] which, as discussed above, was referred to in the *Northland Properties* lower court decision, is set out in Section II(4) of this paper. It focuses on the degree of "separateness" between the two entities.

The second set of factors, which is rooted in the "alter ego" analysis, includes the following factors:

(i) the parent corporation owns all or a majority of the capital stock of the subsidiary;
(ii) the parent and the subsidiary have common officers and directors;
(iii) the parent finances the subsidiary;
(iv) the parent is responsible for incorporation of the subsidiary;
(v) the subsidiary has grossly inadequate capital;
(vi) the parent pays salaries, expenses or losses of the subsidiary;

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51 See, *e.g.*, *Gulfco Inv. Corp., Re*, 593 F.2d 921 (U.S. 10th Cir., 1979) [hereinafter *Gulfco*]; *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. 2nd Cir. N.Y., 1966) [hereinafter *Kheel*]; *Stone v. Eacho*, *supra*, note 48 at 284.

52 *Gulfco*, *ibid.*, at 928.

53 *Supra*, note 29.

(vii) the subsidiary has substantially no business except with the parent;
(viii) the subsidiary has essentially no assets except for those conveyed by the parent;
(ix) the parent refers to the subsidiary as a department or division of the parent;
(x) the directors or officers of the subsidiary do not act in the interest of the subsidiary, but take directions from the parent; and
(xi) the formal legal requirements of the subsidiary as a separate and independent corporation are not observed.[54]

In addition, U.S. courts have relied on other independent considerations to determine whether to consolidate substantively affiliated entities, including: (i) whether the creation of the affiliate was for the purpose of defrauding, hindering, or delaying creditors;[55] and (ii) whether a substantive consolidation order would facilitate in the debtor's reorganization plan under Chapter 11.[56]

These factors do not, in and of themselves, create a mechanical test. Establishing any or all of them in a given case is not dispositive.[57]

2. The Balancing Tests

The second approach consists of a subjective balancing test.[58] While U.S. bankruptcy courts have employed a number of variations of this balancing test, their analyses can be grouped into three broad areas of inquiry: (i) the harm or benefit to the debtor or its estate; (ii) the harm or benefit to creditors of the entity and its affiliates; and (iii) the continued relevance of the factors test.

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54 *Tureaud, supra*, note 48 at 975, citing *Fish v. East*, 114 F.2d 177 (U.S. 10th Cir., 1940), and *Gulfco, supra*, note 51.

55 *Tureaud, supra*, note 48 at 976.

56 See *F.A. Potts & Co., Inc., Re*, 23 B.R. 569 (U.S. Bankr. E.D. Pa., 1982) at 573 [hereinafter *F.A. Potts & Co.*].

57 *Snider Bros., supra*, note 31 at 234, "[t]here is no one set of elements, which, if established, will mandate consolidation in every instance"; *Donut Queen, Ltd., Re*, 41 B.R. 706 (U.S. Bankr. E.D. N.Y., 1984) at 709-10 [hereinafter *Donut Queen*]; *cf., ORFA Corp. of Philadelphia, Inc., Re*, 129 B.R. 404 (U.S. Bankr. E.D. Pa., 1991) at 415, "the absence of one or more factors will not necessarily defeat a request for consolidation" (citations omitted).

58 *Murray Indus., Inc., Re*, 119 B.R. 820 (U.S. Bankr. M.D. Pa., 1990) at 828.

(a) Harm or Benefit to Debtor or its Estate

U.S. bankruptcy courts most frequently evaluate the "benefit" or "prejudice" that substantive consolidation would impose on the debtor and its estate by analyzing: (i) whether the affairs of the debtor and its affiliates are so entangled as to make it impractical to separate them (i.e., the degree of "separateness");[59] or (ii) whether consolidation will increase the debtor's opportunity to reorganize.[60]

The first aspect, "separateness", has two components: (a) whether the entities are so commingled that separation is impossible;[61] and (b) whether creditors relied on the credit of the individual entities.[62]

U.S. bankruptcy courts focus on the degree to which an entity's affairs are "entangled" to evaluate the "separateness" of the entity from its affiliates.[63] As a general rule, even when the affairs between the debtor and its affiliate are "entangled", U.S. bankruptcy courts are reluctant to order substantive consolidation unless severe accounting difficulties exist and creditors stand to benefit.[64]

The second component of the evaluation of debtor separateness is whether creditors relied on the separate existence of the entities before the bankruptcy proceedings. The U.S. bankruptcy court will attempt to discern the expectations of creditors, with respect to their access to the assets of the debtor and its affiliates, when structuring a transaction.[65]

(b) Harm or Benefit to Creditors

Some U.S. bankruptcy courts have held that substantive consolidation is appropriate if the result is a more equitable distribution of rights among the

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59 *Augie/Restivo Banking Co. Ltd., Re*, 860 F.2d 515 (U.S. 2nd Cir., 1998) at 517 [hereinafter *Augie/Restivo*]; *Kheel, supra*, note 51 at 847; *Munford, Re*, 115 B.R. 390 (U.S. Bankr. N.D. Ga., 1990) at 396.

60 *F.A. Potts & Co., supra*, note 56 at 573; *Manzey Land & Cattle Co., Re*, 17 B.R. 332 (U.S. Bankr. S.D., 1982) at 338; *Vecco, supra*, note 29 at 411.

61 See, *e.g.*, *Kheel, supra*, note 51 at 847.

62 See, *e.g.*, *Augie/Restivo, supra*, note 59 at 518.

63 *Augie/Restivo, supra*, note 59 at 519, where the U.S. court held that the assets had not been commingled and, therefore, no debtor entanglement existed; *Kheel, supra*, note 51 at 847, where the U.S. court held that the transferring of funds between related corporations in an extremely complex pattern in effect pooled the corporations together.

64 *Augie/Restivo, supra*, note 59 at 519; *Kheel, supra*, note 51 at 847.

65 *Augie/Restivo, supra*, note 59 at 518-19; see also *Flora Mir Candy Corp., Re*, 432 F.2d 1060 (U.S. 2nd Cir., 1970) at 1063 (entities separateness prevents consolidation in spite of accounting difficulties); *Ford, Re*, 54 B.R. 145 (U.S. Bankr. W.D. Mo., 1984) at 147-48.

various creditors.[66] Other courts oppose reallocating creditors' rights, requiring instead a collective benefit to all creditors.[67] Still other U.S. courts have even interpreted "benefits to creditors" so as to allow some creditors to be harmed, as long as consolidation produces a net gain.[68]

(c) Continued Relevance of "Piercing the Corporate Veil" and "Alter Ego" Factor Tests

The U.S. bankruptcy courts continue to employ the *Vecco* and *Tureaud* "factor" tests in conjunction with the balancing of the equities approach. Some courts treat the factors together as a single element of the balancing approach.[69] Other courts treat the result derived from the balancing approach to be another factor to be added to the *Vecco* or *Tureaud* lists.[70] Still other courts have created their own singular combinations of factor analysis and equitable balancing.[71]

3. Substantive Consolidation is an Extraordinary Remedy

Regardless of the approach used by a U.S. bankruptcy court, substantive consolidation, if applied, is a drastic remedy in that as a result of its application the legal separateness of different corporations and in some cases, the expectations of third parties dealing with these corporations are ignored and instead a group of corporations are treated as if they were one legal entity. Due to the harm that substantive consolidation may inflict on certain creditors, U.S. bankruptcy courts have historically expressed a reluctance to employ the remedy.[72] Because substantive consolidation is such an extraordinary remedy, upon a

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66 See, *e.g.*, *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (U.S. 11th Cir., 1981) at 250 [hereinafter *Eastgroup Properties*]; *Baker*, *supra*, note 27.

67 See, *e.g.*, *Augie/Restivo*, *supra*, note 59 at 518, "[t]he sole purpose of substantive consolidation is to ensure the equitable treatment of *all* creditors" (emphasis added); *I.R.C.C. Inc., Re*, 105 B.R. 237 (U.S. Bankr. S.D.N.Y., 1989) at 242 (substantive consolidation should benefit all creditors collectively).

68 See, *e.g.*, *Kheel*, *supra*, note 51 at 847, "equity is not helpless to reach a rough approximation of justice to some rather than deny it to all".

69 See *e.g.*, *Snider Bros.*, *supra*, note 31 at 234; *Donut Queen*, *supra*, note 57 at 709-10.

70 See, *e.g.*, *Luth, Re*, 28 B.R. 564 (U.S. Bankr. D. Ohio, 1983) at 568.

71 See, *e.g.*, *Augie/Restivo*, *supra*, note 59 at 518 (reducing elements to single factor of financial entanglement); *Eastgroup Properties*, *supra*, note 66 at 249-50 (examines factors for evidence of substantial identity between entities and the necessity for substantive consolidation).

72 See, *e.g.*, *Kheel*, *supra*, note 51 at 847, "[t]he power to consolidate should be used sparingly"; *Lewellyn, Re*, 26 B.R. 246 (U.S. Bankr. S.D. Iowa, 1982) at 251.

review of all the factors, if all or most of the factors are not present and the companies have not held themselves out to creditors to be one company, then a court generally will not order substantive consolidation.

4. Challenge to the U.S. Court's Jurisdiction

In *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*,[73] institutional investors commenced an action against Grupo Mexicano de Desarrollo (GMD) alleging that GMD defaulted on its obligations under certain guaranteed notes. The investors sought, and the district court granted, a preliminary injunction restraining GMD from dissipating, transferring, conveying, or otherwise encumbering the notes. On appeal, the Second Circuit court affirmed the district court's decision. On further appeal, the United States Supreme Court reversed and held that a federal district court lacks jurisdiction to enjoin a defendant's transfer of assets prior to judgment, regardless how egregious the risk of irreparable harm. The court held that a federal court sitting as a "court of equity" is limited to such equitable remedies as existed in the English Court of Chancery in 1789.

Although *Grupo Mexicano* did not directly address the doctrine of substantive consolidation, some commentators believed that it was merely a matter of time before the court's jurisdiction to order substantive consolidation was challenged.[74] Following the reasoning in *Grupo Mexicano*, it could be argued that the bankruptcy court does not have jurisdiction to order substantive consolidation since it is neither specifically authorized by statute[75] nor was it available in 1789.

The *Grupo Mexicano* decision, and its effect on the doctrine of substantive consolidation, was subsequently addressed in *Re Stone & Webster, Inc.*[76] Stone & Webster, Inc., and 72 of its direct and indirect subsidiaries, filed for Chapter 11 relief. Two plans were prepared by the respective creditor committees. One plan consolidated substantively all of the companies into one estate, and the other did not. On a motion for summary judgment in response to a motion for substantive consolidation, the court held that *Grupo Mexicano* was

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73 *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), reversing 143 F.3d 688 (U.S. 2nd Cir., 1998) [hereinafter *Grupo Mexicano*].

74 See, *e.g.*, B.H. White & W.L. Medford, "Substantive Consolidation of Non-debtor Entities: Tag, You're in Bankruptcy" 2003 ABI JNL Lexis 235; J.M. Tucker, "*Grupo Mexicano* and the Death of Substantive Consolidation" (2000) 8:2 Amer. Bank. Inst. L.R. 1.

75 For a detailed discussion on the scope of section 105(a) of the *Bankruptcy Code* and the reasons why it does not vest an independent equity power in the bankruptcy court, see J.M. Tucker, *ibid.*

76 286 B.R. 532 (U.S. Bankr. Del., 2002) [hereinafter *Stone & Webster*].

not controlling on the issue of substantive consolidation or the authority of the U.S. bankruptcy court to grant the remedy of substantive consolidation. The court provided two broad reasons in support of its finding. First, the court noted that "in *Grupo Mexicano*, the majority opinion strongly suggests that bankruptcy law provides a court with authority to grant remedies not administered by the courts of equity at the time of the enactment of the *Judiciary Act*". Second, the court found "clear statutory authority in the *Bankruptcy Code* for substantive consolidation in Chapter 11 cases" in section 1123(a)(5)(C) of the *Bankruptcy Code*, which states that a Chapter 11 plan shall provide adequate means for the plan's implementation, such as "merger or consolidation of the debtor with one or more persons". The court noted that "one or more persons" includes a debtor and concluded that the statutory language is indicative of Congress's intent to allow a Chapter 11 debtor to merge or consolidate with debtors or entities during the reorganization process.[77] The court's approach in *Stone & Webster* has been subsequently adopted in *Re American Homepatient, Inc.*[78] and *Re Worldcom, Inc.*[79]

In summary, given that a number of courts have rejected the application of the U.S. Supreme Court's decision in *Grupo Mexicano* to the equitable powers of the bankruptcy court respecting substantive consolidation, it is safe to conclude that substantive consolidation is alive in the United States, at least for the moment.

V. MERITS OF THE CURRENT CCAA APPROACH AND POSSIBLE DIFFERENT APPROACHES

As set out above, neither under the BIA nor under the CCAA have the courts completely filled the statutory vacuum by articulating a clear and comprehensive test for substantive consolidation. The small number of reported cases are largely fact-specific, with the courts considering the following principal factors: (i) the extent of financial and operational integration among the debtor companies; (ii) the blurring of corporate identities; (iii) administrative efficiencies and cost savings; and (iv) the balancing of the interests of and prejudice to the debtors and the affected creditors. Thus, under current Canadian law and practice, considerable discretion as to whether to permit substantive consolidation resides with the presiding judge.

Such discretion is, of course, one of the hallmarks of the CCAA. The Act is a skeletal piece of legislation in the Canadian and British traditions, with an inherent flexibility to meet the challenges posed by specific cases, rather

77 D.B. Stratton, "Equitable Remedies in Bankruptcy Court: Grupo Mexicano, Substantive Consolidation and Beyond" 2003 ABI JNL. LEXIS 39 at 14.

78 298 B.R. 152 (U.S. Bankr. M.D. Tenn., 2003).

79 2003 Bankr. Lexis 1401 (U.S. Bankr. S.D. N.Y., 2003), Case No. 02-13533.

than a comprehensive code along the lines of the U.S. *Bankruptcy Code*. There continues to be a debate on a number of CCAA issues on the relative merits between the current skeletal legislative framework and a more rule-based system. On the one hand, the CCAA approach can lead to uncertainty as to what rules will be applied in any particular situation and, thus, create confusion and unpredictability in the marketplace, if not loss of confidence in the integrity of the process. On the other hand, the flexibility of the current CCAA approach permits the court to apply equitable principles to meet the needs of specific restructurings, and to "fill in the gaps" in the legislation when required.[80] This might not be possible if the legislation attempted to codify the law.

As is the case with other important CCAA issues, the real question, which is impossible to answer definitively, is: are users of the CCAA (i.e., debtor companies, creditors, and other stakeholders) being well-served by the current flexible, *ad hoc* approach to substantive consolidation, or would their interests be better protected if there were a clear and comprehensive test added to the legislation? Regardless of the answer to this question, should more procedural rigour be applied to actual determinations of whether substantive consolidation ought to be permitted so that fair hearings, on adequate notice to the affected parties and on the basis of proper materials, are held when consolidation is being advocated?

In attempting to address these questions, it is, of course, important to be mindful that, while typically not so explicitly characterized in the Canadian jurisprudence, substantive consolidation is an extraordinary remedy, in that it significantly affects existing rights. Yet it also must be recognized that, when dealing with the exigencies and pressures of a complex restructuring, the courts are not particularly well-equipped to consider the actual effect of consolidation on a scientific basis and often have to deal with the issue in an expeditious and pragmatic manner. Consistent with restructuring practice on so many other issues, a fair balance has to be achieved between the existing rights of the parties and the need to complete the restructuring quickly, effectively, and fairly.

Despite the fact that Canadian jurisprudence on substantive consolidation is relatively undeveloped, legislating a CCAA substantive consolidation test is not necessary or desirable. Not even the more rule-based BIA or the U.S. *Bankruptcy Code* contains such a test. In its recent report on possible BIA and CCAA amendments, the Senate of Canada has made no recommendation for the adoption of a statutory substantive consolidation test.[81] Thus, there appears to be general recognition that it is the judges who preside over complex restructurings who should be left with the flexibility to develop and apply the law

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80 See, *e.g.*, *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. S.C.J. [Commercial List]) at para. 4.

81 Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies Creditors' Arrangement Act* (Report of the Standing Senate Committee on Banking, Trade and Commerce, November 2003).

of substantive consolidation on a commercial and pragmatic basis, taking into account the unique circumstances of each case.

Attempting to codify the rules governing substantive consolidation could well result in an overly mechanical approach being taken, ill-suited to deal with the "seeds of chaos, unpredictability and instability" associated with insolvencies.[82] This would be of particular concern in restructurings, where there are "rough-and-tumble" negotiations among the stakeholders over an acceptable plan to keep the debtors afloat, not a mechanical dismemberment of the carcass.[83]

The current approach taken by the courts is to consider both the specific factors in a case which might necessitate substantive consolidation and the prejudice or "overall general effect" which might result from consolidation.[84] This is generally the same approach applied by U.S. bankruptcy courts in the more extensive U.S. jurisprudence. It is, therefore, difficult to argue that there is anything fundamentally wrong with the substantive consolidation tests being applied by Canadian courts on the few occasions where judicial reasons have been rendered, though it would be beneficial if more precision were brought to the exercise.

Where, however, a change of approach would be desirable, however, is in connection with the second question posed above; i.e., the procedural aspects of dealing with substantive consolidation. We believe that the current approach does not give sufficient weight to the extraordinary nature of substantive consolidation. It appears that orders permitting substantive consolidation are often made as part of applications for other orders (*e.g.*, the initial CCAA order or the meetings order) without a separate hearing on the issue or detailed evidence relevant to the issue being filed. On other occasions, the ruling on substantive consolidation is not made until the sanction hearing at the conclusion of the proceedings. At the sanction hearing, there is usually overwhelming momentum to have the plan approved since, by that time, there has already been creditor approval, often by a substantial majority, and significant time, cost and effort have been invested in the proceedings. Thus, it is usually very difficult at that stage of the case for an objecting creditor to successfully oppose substantive consolidation.

Accordingly, legislation should be enacted, or the courts should adopt the practice of, requiring the proponent of substantive consolidation (typically the debtor companies) to specifically apply, wherever possible, for a substantive consolidation order on adequate notice and with proper materials and mandating a hearing to rule on the application. It should be a requirement that such an application be made no later than the time of filing of the CCAA plan to ensure

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82 *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]) at para. 16.

83 *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.) at para. 48.

84 *PSINet*, *supra*, note 44.

that the issue is adequately addressed prior to the debtors going to the expense of distributing the plan and convening creditors' meetings to vote on the plan, and at a time when there is no intense pressure to have the court approve the plan and permit its implementation.

Imposing these requirements would create procedural fairness in the process. In addition, as a result of these requirements, the courts would need to deal with substantive consolidation on a more rigourous basis than is currently the case, and any appearance that the issue is not being adjudicated on fairly would likely disappear. There would also likely be the additional benefit of an increased number of reasons for judgment on the issue, which could accelerate the development of more extensive jurisprudence on the substantive consolidation test. In other words, procedural rigour would lead to analytical rigour in the application of the doctrine of substantive consolidation which, in the authors' view, would be of great benefit to the users of the CCAA.

TAB 3

Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis

*Michael MacNaughton and Mary Arzoumanidis**

Introduction

Large corporations are increasingly structured as corporate groups[1] to accommodate the complexities of operating in the modern business environment. In fact, the corporate group is the most typical corporate structure of a large enterprise.[2] Although each member of the corporate group retains a separate legal personality, the affairs of the corporate group are often conducted as if it were a single commercial entity. This may be evidenced through the use of extensive inter-company loans, commingling of assets, overlap in personnel, and a failure to keep proper financial records for each individual member of the group.

In the context of insolvency, the complex structure of corporate groups creates unique problems. Corporate groups test the limits of the separate legal personality principle since the insolvency no longer concerns a single debtor,

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1 There is no formal definition of a corporate group, but generally it is understood to mean a family of related companies or businesses in which one company (the parent or holding company) effectively maintains control over the others through shareholding and managerial controls. See generally, Vanessa Finch, *Corporate Insolvency Law: Principles and Perspectives* (Cambridge: Cambridge University Press, 2002) at 406.

2 Jacob S. Ziegel, "Corporate Groups and Cross-border Insolvencies: A Canada-United States Perspective" (2002) 7 Fordham J. Corp. & Fin. L. 367 at 369 [hereinafter Ziegel].

but rather a bundle of related companies. The insolvency of a group of companies also raises the fundamental problem of ascertaining which assets within the corporate group belong to which company, and which creditor claims exist against each related company. Consequently, these difficulties necessitate a closer look into the interrelationship of the component parent, subsidiary and related companies in order to determine the extent of integration between the separate legal entities constituting the group. This considerably increases the complexity of the insolvency proceedings and poses new demands on the legal system to yield novel doctrines that address the inherently difficult problems associated with the insolvency of a corporate group.

In a liquidation or reorganization of a corporate group, the doctrine of substantive consolidation has emerged in order to provide a mechanism whereby the court may treat the separate legal entities belonging to the corporate group as one. In particular, substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied. In effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity.

The legal framework dealing with substantive consolidation is different across the jurisdictions of Canada, the U.S. and Australia. In Canada, for example, neither the *Companies Creditors' Arrangement Act*[3] nor the *Bankruptcy and Insolvency Act*[4] contain express provisions authorizing substantive consolidation. Similarly, the U.S. *Bankruptcy Code* does not explicitly permit substantive consolidation. However, courts in both jurisdictions have rendered consolidating orders on the basis of their equitable jurisdiction. In contrast, Australia has recently enacted legislative reforms that expressly grant a statutory power to effect a pooling arrangement, at least in the context of liquidations.

This paper provides a comparative analysis of the application of the doctrine of substantive consolidation in Canada and the United States and reviews the statutory pooling mechanism in Australia. Section I discusses the nature of substantive consolidation through a brief comparison to other related doctrines, while Section II examines the effects of substantive consolidation. Section III examines the evolution of the doctrine in the United States. Section V reviews the development of substantive consolidation in Canada under the CCAA and CCAA. Section VI focuses on the pooling mechanism in Australia. Finally, Section VII concludes.

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3 *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36, as amended [hereinafter CCAA].

4 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended [hereinafter BIA].

I. DISTINGUISHING THE DOCTRINE OF SUBSTANTIVE CONSOLIDATION

At the outset, substantive consolidation should be distinguished from procedural consolidation; the latter is a distinct device permitting the joint administration of the estates of related companies. In Canada, as in the United States, an order for procedural consolidation is almost *de rigueur* in insolvency proceedings under the CCAA and the BIA.[5] Procedural consolidation merely promotes administrative convenience and cost efficiency since a single court has jurisdiction over multiple related debtors. Unlike substantive consolidation however, procedural consolidation does not have substantive consequences. It does not alter the substantive rights and liabilities of creditors and debtors, nor does it affect the allocation of assets or the *pro rata* satisfaction of claims.[6] Further, since procedural consolidation does not eliminate inter-company claims, the possibility to attack inter-company transfers as fraudulent or preferential transactions still exists. Accordingly, procedural consolidation results in each debtor remaining separate and distinct, with the substantive rights of all concerned intact.

Further, substantive consolidation differs from related, yet distinct, remedies which one commentator has described as the doctrines of "corporate disregard".[7] These remedies include piercing the corporate veil and equitable subordination.[8] While these doctrines attempt to remedy the misuse of and impose respect for the corporate form, each of these remedies has subtle differences.

The doctrine of piercing the corporate veil provides that in certain circumstances, courts will ignore the principle of limited liability and lift the corporate veil to hold directors, shareholders or other related entities liable for corporate wrongs committed by their corporation. In the context of corporate groups, veil piercing effectively involves making the parent company's shareholders liable for the harmful corporate acts it commits by permitting creditors of the subsidiary to reach the assets of the parent company. In other words, the direction of claims by the subsidiary's creditors moves up towards the shareholders of the parent. In contrast, the aim of substantive consolidation is not to hold shareholders liable for damaging corporate acts. Rather, the goal of substantive consolidation is to ensure the equitable treatment of all creditors in

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5 Ziegel, *supra*, note 2 at 376.

6 *Ibid.*

7 Mary Elisabeth Kors, "Altered Egos: Deciphering Substantive Consolidation" (1998) 59 U. Pitt. L. Rev. 381 at 383 [hereinafter Kors].

8 In *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), the Supreme Court of Canada has left open the question of whether equitable subordination exists in Canada. In the United States, the doctrine of equitable subordination is codified in Section § 105(c) of the U.S. *Bankruptcy Code*.

cases where the affairs of two or more corporations are so intertwined that each lacks corporate independence. Thus, the direction of claims asserted by creditors does not matter. Creditors may seek claims moving up towards the parent company, or down towards the subsidiary, or even laterally between related subsidiaries.[9]

As with substantive consolidation, equitable subordination aims to achieve the fair treatment of all creditors. Generally, the doctrine of equitable subordination holds that in cases where a creditor has engaged in some type of inequitable conduct which results in injury to other creditors, the court may exercise its equitable jurisdiction to allocate that creditor's claim to a junior position. Effectively, equitable subordination changes the priority that a creditor may have against the assets of its debtor by placing all or part of its claim behind that of a similarly ranked creditor. However, the value of that creditor's claim is preserved. For example, where a parent corporation is also a creditor of a subsidiary but dominates the affairs of the subsidiary to the extent that it prejudices other creditors, the imposition of equitable subordination will affect the ranking of the parent's claim but not its value. In contrast, substantive consolidation not only eliminates inter-company claims entirely, but also reconstructs the value of *all* creditor claims and requires that *all* creditors share the pooled assets on a *pro rata* basis.

While the doctrines of piercing the corporate veil, equitable subordination and substantive consolidation generally attempt to respond to corporate improprieties and affect creditor claims in some manner, it is the effect of substantive consolidation on creditor claims which is most profound. Veil piercing allows the creditor of one company to recover its claim from another related company. Equitable subordination places the claim of a related company behind the claim of an unrelated company. In both cases, the value of the claim is preserved. In substantive consolidation, however, the value of all creditor claims is reconfigured.

II. EFFECTS OF THE DOCTRINE OF SUBSTANTIVE CONSOLIDATION

The primary aim of substantive consolidation is to ensure the equitable treatment of all creditors. Even though substantive consolidation should not effectively benefit one group of creditors to the detriment of another group, its effects can be quite dramatic on creditor recoveries. Substantive consolidation effectively redistributes wealth among creditors of the related entities and in-

9 Andrew Brasher, "Substantive Consolidation: A Critical Examination", online: The Harvard Law School <http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/Brudney2006_Brasher.pdf>.

dividual creditors will invariably realize asymmetric losses or gains. Separate debtors forming part of a corporate group will have differing ratios of assets-to-liabilities, varying levels of solvency or disparities in encumbered assets. In substantive consolidation, creditors of entities with lower ratios of assets-to-liabilities will benefit from the higher asset-to-liability ratio of the consolidated group. Creditors of entities with higher asset-to-liability ratios will receive a proportionately smaller satisfaction of their claims as a result of consolidation.

The effects of substantive consolidation on creditor recoveries may be illustrated by the following example. Assume Company A has $6 million in liabilities and $1 million in assets. Assume further that Company B is a related company and has $4 million in liabilities and $2 million in assets. Outside substantive consolidation, creditors of Company A would receive 17 cents on the dollar for their claims, while creditors of Company B would receive 50 cents on the dollar. In substantive consolidation, all creditors will receive 30 cents on the dollar for their claims.

III. SUBSTANTIVE CONSOLIDATION IN THE UNITED STATES

The recent decision of the Third Circuit Court of Appeals in *In re Owens Corning*,[10] is perhaps the most significant decision on substantive consolidation to date in the United States. Prior to *Owens Corning*, the increased use of interrelated corporate structures for tax and other business purposes prompted courts to increasingly allow the remedy of substantive consolidation, despite the fact that several appellate courts cautioned that it is an extraordinary remedy and should be used sparingly.[11] The *Owens Corning* decision provides much needed guidance on when it is appropriate to order consolidation and restores certainty and predictability in an area of law that has otherwise been plagued by inconsistent tests and approaches. However, the test articulated by the Third Circuit limits the circumstances in which substantive consolidation will be allowed. Before turning to a more detailed discussion of *Owens Corning*, the following section provides an overview of the historical development of the doctrine in the United States, highlighting important cases and trends.

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10 *In re Owens Corning*, 419 F.3d 195 (3rd Cir. (Del), 2005), reversing 316 B.R. 168 (Bkrtcy. D. Del., 2004) [hereinafter *Owens Corning*].

11 See *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. 2nd Cir. N.Y., 1966) at 847 [hereinafter *Kheel*]. See also Timothy Graulich, "Substantive Consolidation — A Post-Modern Trend" (2006) 14 Am. Bankr. Inst. L.R. 527. [hereinafter Graulich].

(a) Historical Development of the Doctrine of Substantive Consolidation[12]

The U.S. *Bankruptcy Code* contains no express provision authorizing substantive consolidation, yet substantive consolidation has been accepted in the United States as early as 1941.[13] Traditionally, the courts in the United States have permitted substantive consolidation under their general equitable powers derived from s. 105(a) of the U.S. *Bankruptcy Code*.[14] Further, in the context of reorganizations, s. 1123(a)(5)(C) of the U.S. *Bankruptcy Code* is often relied on as support for the "merger or consolidation of the debtor with one or more persons".[15]

The foundation for substantive consolidation as a distinct doctrine stems from the decision of the U.S. Supreme Court in *Sampsell v. Imperial Paper & Color Corp.*,[16] where a simple fraudulent conveyance case was tacitly turned into the seminal substantive consolidation case. In *Sampsell*, an individual debtor transferred assets to a corporation he formed specifically to avoid his personal creditors. At the bankruptcy hearing, the trustee successfully obtained an order for turnover of the corporation's assets so that they could be administered by the trustee for the benefit of the individual bankrupt's creditors. The decision in favour of the trustee included findings that the corporation was the alter ego of the bankrupt and that the transfer of the assets was fraudulent in that the purpose of the transfer was to place those assets beyond the reach of creditors. A creditor of the corporation subsequently filed a claim seeking distribution priority over the funds realized from the turned over assets. In deciding that the creditor should not be afforded priority and could only share *pari passu* in the pooled assets, the U.S. Supreme Court indirectly approved substantive consolidation.

Subsequent jurisprudence on substantive consolidation veered away from invoking principles based on fraudulent conveyance law and instead shaped the consolidation inquiry by applying "nonbankruptcy" standards rooted in corporate law and the power to pierce the corporate veil. Beginning with

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12 For an insightful discussion on the development of substantive consolidation in the U.S., see Douglas G. Baird, "Substantive Consolidation Today" (2005) 47 B.C. L. Rev. 5 at 15.

13 *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (U.S., 1941) [hereinafter *Sampsell*].

14 11 U.S.C. § 105(a) provides in part that the court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title".

15 11 U.S.C. § 1123(a)(5)(C) which provides in part that, "[n]otwithstanding any otherwise applicable nonbankruptcy law, a plan shall. . .provide adequate means for the plan's implementation, such as . . .merger or consolidation of the debtor with one or more persons".

16 *Sampsell, supra*, note 13.

Soviero v. Franklin Nat. Bank of Long Island,[17] the Second Circuit rendered a series of decisions which focused the inquiry on the corporate form and, in particular, whether there was an abuse of that corporate form or structure. These decisions continue to guide the current case law in this area.

In *Soviero*, the Court authorized the consolidation of a group of fourteen affiliated companies upon finding extensive commingling of assets and functions. Among the factors which the Court considered in making its decision were that the affiliated companies, one of which had become bankrupt, operated a single business, had the same directors, shareholders and staff, and shared accounting records. Further, the affiliated companies had no working capital and the debtor provided all funds required by them and recorded the payments in its books as "loans and exchanges". Inventories were arbitrarily assigned to each of the affiliates at the end of the year where they were reflected in the consolidated financial statement and relied upon for tax purposes. Suppliers shipped merchandise directly to the affiliates but billed the debtor. The debtor paid for, among other things, the affiliates' advertising charges, union dues, insurance and accounting charges, and at the end of the year charged each affiliate with an arbitrary portion thereof by bookkeeping entries.

The Court held that the affiliates were, "but instrumentalities of the bankrupt with no separate existence of their own. Consequently, there existed a unity of interest and ownership common to all corporations, and that to adhere to the separate corporate entities theory would result in an injustice to the bankrupt's creditors".[18] Noting that it would be difficult to imagine a better example of commingling of assets and functions, the Court appeared to be especially offended by the debtor's flagrant disregard of the corporate form and found that the debtor "held up the veils of the fourteen collateral corporations, primarily, if not solely, for the benefit of the tax gatherer, but otherwise completely disregarded them".[19]

In *Chemical Bank New York Trust Co. v. Kheel*,[20] eight debtor shipping companies were all owned and controlled by the same individual and were operated as a single unit, with little or no attention paid to corporate formalities. The bankruptcy referee obtained a consolidating order based on its recommendation that "auditing of the corporations' financial condition and especially the intercompany relationships would entail great expenditure of time and expense without assurance that a fair reflection of the conditions of the debtor corporations would in the end be possible".[21] However, a creditor objected on the

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17 *Soviero v. Franklin Nat. Bank of Long Island*, 328 F.2d 446 (C.A. N.Y., 2d Cir., 1964) [hereinafter *Soviero*].

18 *Ibid.*, at 448.

19 *Ibid.*

20 *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. 2nd Cir. N.Y., 1966).

21 *Ibid.*, at 846.

ground that consolidation was appropriate only on a "showing that it knowingly dealt with the group as a unit and relied on the group for payment".[22]

The Second Circuit rejected the notion that substantive consolidation requires proof that creditors knowingly relied on the debtors as a single unit. The Court stated that, "[w]hile the record in the *Soviero* case indicates that there was evidence that the Bank had dealt with the bankrupt and its affiliates as one, the opinion does not make this a necessary foundation for the result".[23] Rather, the Court in *Kheel* approved consolidation on the basis that the interrelationship of the group was hopelessly obscured such that the time and expense necessary to attempt to unscramble them was so substantial so as to threaten the realization of any net assets for all the creditors.[24] Therefore, the Court found that substantive consolidation can be authorized where the finances of the entities are hopelessly entangled, despite a creditor's reliance on the separate credit of the debtor companies. The significance of the *Kheel* decision is that it added excessive time and expense of disentangling the financial affairs of the debtors as an additional factor to consider in determining whether consolidation is appropriate.

In a concurring opinion, Justice Friendly criticized the majority's reasoning as focusing too much on the complexities of the accounting at the expense of the rights of individual creditors who might have dealt separately with certain of the corporations. However, in *In re Flora Mir Candy Corp.*,[25] the theme of deferring to creditor reliance on the separate credit of one of the debtors prevailed.

Flora Mir involved a debtor, Meadors Inc., which had issued debentures six years before it was bought and sold by a number of parties and ultimately acquired by the parent Flora Mir. Shortly thereafter, Meadors Inc. became defunct and ceased operating and the Meadors debenture holders subsequently sued the parties to the purchases and Flora Mir for misappropriation of Meadors's assets. A year later, Flora Mir, Meadors and ten other subsidiaries filed for bankruptcy and sought consolidation of their estates. The Meadors debenture holders opposed consolidation as it would dilute their recoveries since they would have to share the proceeds of the misappropriation claim with the creditors of the other debtors. Despite the objection of the Meadors debenture holders, the bankruptcy referee approved consolidation The district court set aside the consolidation order insofar as it concerned Meadors, but upheld it as to the other subsidiaries.

On appeal, the Court of Appeals affirmed the decision not to consolidate on the basis that the debenture holders clearly relied on the separate credit of

22 *Kheel, supra*, note 20 at 847.

23 *Ibid.*

24 *Ibid.*

25 *In re Flora Mir Candy Corp.*, 432 F.2d 1060 (C.A. N.Y. 2d Cir., 1970) [hereinafter *Flora Mir*].

Meadors since they had purchased the debentures at a time when Meadors had no affiliation with the other debtors. Furthermore, the Court found that the debenture holders would have been significantly prejudiced by consolidation. Not only would they have to share Meadors' assets with the creditors of other debtors, but consolidation would wipe out Meadors' misappropriation claim against Flora Mir and the debenture holders would also have to share any recovery from the misappropriation claim with other creditors. Thus, *Flora Mir* focused on the reliance placed by the objecting creditors on the separate credit of one of the debtors and the prejudice that would have resulted to those creditors from consolidation.

In *In re Continental Vending Mach. Corp.*,[26] the Second Circuit affirmed a reorganization plan of a parent and its subsidiary which provided that unsecured claims may be consolidated while secured claims would remain unconsolidated. More importantly, the Court reaffirmed the main substantive consolidation principles expounded by the Second Circuit:

> The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach the assets for the satisfaction of debts of a related corporation. While it does not require that the creditors knowingly deal with the corporations as a unit, *Chemical Bank New York Co. v. Kheel*. . .it should nevertheless be "used sparingly" because of the possibility of unfair treatment of creditors who have dealt solely with the corporation having a surplus as opposed to those who have dealt with the related entities with deficiencies.[27]

Equally important was the Court's recognition that a balancing test was to be applied in determining whether to grant substantive consolidation. The Court stated that "because consolidation in bankruptcy is "a measure vitally affecting substantive rights," the inequities it involves must be heavily outweighed by practical considerations such as the accounting difficulties (and expense) which may occur where the interrelationships of the corporate group are highly complex, or perhaps untraceable".[28]

The significance of the Second Circuit decisions is that they demonstrate the development of the fundamental issues in substantive consolidation that are still relevant today: the difficulties of disentangling the financial affairs of the separate entities and the desire to protect creditors' reliance on the separate credit of one entity.[29]

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26 *In re Continental Vending Mach. Corp.*, 517 F.2d 997 (C.A.N.Y. 2d Cir., 1975), certiorari denied (sub nom. *James Talcott, Inc. v. Wharton*) 424 U.S. 913 (U.S., 1976) [hereinafter *Continental Vending*].

27 *Ibid.*, at 1000-01

28 *Continental Vending, supra*, note 26 at 1001.

29 Kors, *supra*, note 7 at 395.

Since the doctrine was originally conceived, the U.S. bankruptcy courts have developed a variety of tests and standards to determine the propriety of substantive consolidation. These tests include the alter-ego/factors test derived from traditional veil piercing case law, the balancing tests articulated in *In re Auto-Train Corp., Inc.*,[30]and *In re Augie/Restivo Baking Co., Ltd.*,[31] and more recently the *Owens Corning* test.

The Alter-Ego/Factors Tests

The "alter ego" analysis follows the themes articulated in the *Soviero* line of cases where the court will consolidate upon finding evidence that the separate entities were excessively unified by failing to observe corporate formalities. The purpose of the inquiry under the alter-ego/factors test is to determine whether legally separate entities are actually the "mere instrumentality" or "alter ego" of the bankrupt or parent corporation. The courts will deem the entities "alter egos" and find consolidation appropriate if certain objective factors are found to exist. While several checklists of factors have been developed, the courts most commonly cite the factors identified by the Court in *Fish v. East*,[32] and *In re Vecco Const. Industries, Inc.*[33]

In *Fish v. East*, the Court identified the following factors as being relevant to the inquiry:

(1) the parent corporation owns all or majority of the capital stock of the subsidiary;

(2) the parent and the subsidiary have common directors or officers;

(3) the parent corporation finances the subsidiary;

(4) the parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation;

(5) the subsidiary has grossly inadequate capital;

(6) the parent pays the salaries or expenses or losses of the subsidiary;

(7) the subsidiary has substantially no independent business except

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30 *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. 2d Cir., 1987) [hereinafter *Auto-Train*].

31 *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515 (2d Cir. (N.Y.), 1988) [hereinafter *Augie/Restivo*].

32 *Fish v. East*, 114 F.2d 177 (10th Cir., 1940) at 191 [hereinafter *Fish*].

33 *In re Vecco Const. Industries, Inc.*, 4 B.R. 407 (Bankr. E.D. Va., 1980) at 410 [hereinafter *Vecco*].

with the parent corporation or no assets except those conveyed to it by the parent corporation;

(8) the subsidiary is commonly referred to as a subsidiary or a department or division of the parent;

(9) the directors or officers of the subsidiary do not act independently but take direction from the parent; and

(10) the formal legal requirements of the subsidiary as a separate and independent corporation are not observed.[34]

In *Vecco*, the Court set out the following seven factors to guide the determination of whether substantive consolidation is appropriate:

(1) the degree of difficulty in segregating and ascertaining individual assets and liability;

(2) the presence or absence of consolidated financial statements;

(3) the profitability of consolidation at a single physical location;

(4) the commingling of assets and business functions;

(5) the unity of interests and ownership between various corporate entities;

(6) the existence of parent and inter-corporate guarantees on loans; and

(7) the transfer of assets without formal observance of corporate formalities.[35]

Many courts simply employ the alter-ego/factors test as an independent test for substantive consolidation. Other courts use the alter-ego/factors test as one element of the balancing tests. In either case, the presence or absence of any or all factors does not necessarily mean that the court will grant consolidation.[36]

The Balancing Tests

The decisions in *In re Auto-Train Corp, Inc.*,[37] and *In re Augie/Restivo Baking Co., Ltd.*,[38] mark a significant departure in the doctrinal development

34 *Fish*, *supra*, note 32 at 191.
35 *Vecco*, *supra*, note 33 at 410.
36 *Kors*, *supra*, note 7 at 402.
37 *Auto-Train*, *supra*, note 30.
38 *Augie/Restivo*, *supra*, note 31.

of substantive consolidation. Instead of relying on a laundry list of factors to determine whether there has been an abuse of the corporate form, these decisions balance the benefits and harms of consolidation.

The Court in *Auto-Train* noted that, "[b]efore ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties".[39] Under the Auto-Train test, the proponent of substantive consolidation must show:

> (1) there is substantial identity between the entities to be consolidated; and
>
> (2) consolidation is necessary to avoid some harm or to realize some benefit.[40]

The first prong of the test is essentially a classic "alter ego" inquiry where the *Vecco* factors are usually employed to determine whether there is substantial identity.[41] The second prong weighs creditor reliance on the unity of the corporate group with the difficulties of disentanglement and other administrative benefits.[42]

Once this *prima facie* case is made, a presumption arises that the creditor objecting to substantive consolidation has not relied solely on the credit of one of the entities involved. The burden then shifts to the objecting creditor to show that it relied on the separate credit of one of the debtor companies and would be prejudiced by consolidation. This part of the test imports the theme of creditor reliance first identified in *Kheel*. However, the Court went on to state that even if the objecting creditor establishes such reliance, consolidation may still be ordered where the benefits of consolidation "heavily outweigh the harm".[43]

In *Augie/Restivo*, the Second Circuit reviewed the various decisions addressing substantive consolidation and concluded that the factual elements considered by the courts involved "variants of two critical factors": (i) whether creditors dealt with the entities as a single economic unit and did not rely upon their separate identity in extending credit, or (ii) whether the affairs of the debtor are so entangled that consolidation will benefit all creditors.[44] Substantive consolidation is proper under this test where either factor is present.

The first factor under the *Augie/Restivo* test is consistent with the earlier Second Circuit decisions in *Kheel* and *Flora Mir* and focuses on creditor expectations at the time they extend credit. Thus, under the first prong of the

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39 *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. 2d Cir., 1987) at 276.

40 *Ibid.*

41 *Eastgroup Properties v. Southern Motel Ass'n, Ltd.*, 935 F.2d 245 (11th Cir. (Fla.), 1991) at 249.

42 Kors, *supra*, note 7 at 405.

43 *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. 2d Cir., 1987) at 276.

44 *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515 (2d Cir. (N.Y.), 1988) at 518-19.

Augie/Restivo test, consolidation is appropriate where the creditor dealt with the entities as a single unit, and is inappropriate where it would prejudice a creditor that relied on corporate separateness. Under the second factor, the test for substantive consolidation requires that the finances of the entities be "hopelessly entangled". Although the test aims to ensure that no creditor will be harmed, since "substantive consolidation should be used only after it has been determined that all creditors will benefit because untangling is either impossible or so costly as to consume the assets,"[45] the degree of entanglement (i.e., hopeless entanglement) effectively guarantees that substantive consolidation will rarely be justified.

The Owens Corning Decision

Before considering the test articulated by the Third Circuit in *Owens Corning*, a brief review of the decision itself is necessary.

Owens Corning and its subsidiaries comprised a multinational corporate group that produced and sold asbestos-containing products. Each subsidiary existed as a separate legal entity for a specific reason such as for limited liability, tax benefits or regulatory reasons. Further, each subsidiary maintained separate books and records where inter-company transactions were regularly documented. In 1997, Owens Corning and certain of its subsidiaries entered into a $2 billion credit agreement with a lending syndicate. Due to Owens Corning increasing liabilities on asbestos-related claims, the bank syndicate insisted on some form of "credit enhancement" and obtained unsecured "net worth" guarantees from subsidiaries having a book value of $30 million or more.

In 2000, Owens Corning and seventeen of its subsidiaries filed for protection under Chapter 11 of the U.S. *Bankruptcy Code*. The Plan of Reorganization provided for substantive consolidation. The lower court found consolidation was "a virtual necessity" in the circumstances and granted the order. It should be noted that the Court granted a deemed consolidation, a special type of substantive consolidation where the separate entities are not actually combined but distributions to creditors are made "as if" there has been a consolidation.

In determining whether substantive consolidation was warranted, the lower court applied the *Auto-Train* standard. First, the Court had no difficulty in finding "a substantial identity between the [parent] and its wholly-owned subsidiaries".[46] In particular, the factors that supported this finding included: management on a product-line basis, rather than on an entity basis, lack of separate business plans or budgets, dependence on the parent company for funding, centralized cash management and establishment of subsidiaries for the

45 *Ibid.*, at 519.

46 *In re Owens Corning*, 316 B.R. 168 (Bkrtcy. D. Del., 2004) at 171.

convenience of the parent.[47] Second, the Court found that substantive consolidation would simplify the proceedings since it was difficult to separate the financial affairs of the group. Finally, the Court further found that the bank syndicate had relied on the overall credit of the corporate group and not on the credit of any of the subsidiary guarantors.

The Third Circuit reversed. It found no evidence of pre-petition disregard of corporate separateness between Owens Corning and its subsidiaries. The loan negotiations were premised on the separateness of the of all the Owens Corning entities, no allegations of bad faith were made by anyone concerning the loan and testimony presented by both sides evidenced the intention to treat the entities as separate.

Further, the Court found there was "no meaningful evidence post-petition of hopeless commingling" of assets and liabilities of the corporate group to justify consolidation. Further, there was "no question which entity owns which principal assets and which has material liabilities".[48] The Court explained that "commingling justifies consolidation only when separately accounting for the assets and liabilities of the distinct entities will reduce the recovery of every creditor - that is, when every creditor will benefit from the consolidation".[49]

Furthermore, the Court found that any potential harm caused by substantive consolidation to the bank syndicate could not be remedied at a later stage through the possibility of giving priority to their claims. Finally, the Court outright rejected the possibility of a deemed consolidation and found that the attempts of the plan proponents sought to remake substantive consolidation remedy to strip the bank syndicate of their rights under the Bankruptcy Code, favour other creditors and trump possible objections to the plan.[50]

The Owens Corning Test

In *Owens Corning*, the Third Circuit expressly adopted the *Augie/Restivo* test for consolidation which requires either creditor reliance on the unity of the corporate group or a showing of excessive cost in unscrambling the commingled affairs of the individual entities. In doing so, the Court specifically rejected the *Auto-Train* test on the basis that it failed to capture the few cases where substantive consolidation may be considered and "allows a threshold not sufficiently egregious and too imprecise for easy measure".[51] The Court also disapproved of using a checklist of factors to determine whether legally separate entities should be consolidated. The Court stated that it, "often results in rote

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47 *Ibid.*

48 *Owens Corning*, *supra*, note 10 at 214.

49 *Ibid.*

50 *Ibid.*

51 *Owens Corning*, *supra*, note 10 at 210.

following of a form containing factors where courts tally up and spit out a score without an eye on the principles that give the rationale for substantive consolidation".[52] The Court identified these principles to be:

1. The general expectation of state law, bankruptcy and of commercial markets is that courts will respect entity separateness absent compelling circumstances that call equity into play;
2. Substantive consolidation addresses harms caused by debtors in disregarding corporate separateness, not the harm resulting from the actions of creditors. Harms caused by creditors are better addressed by the avoidance provisions of the Bankruptcy Code;
3. Mere benefit to the administration of the case is not a harm justifying substantive consolidation;
4. Substantive consolidation is extreme and imprecise and should be considered a remedy of last resort after other available remedies are considered and rejected; and
5. Substantive consolidation may be used defensively to remedy identifiable harms, it may not be used offensively as a tactic to disadvantage creditors or to alter creditor rights.[53]

Guided by these principles, the Court articulated a new test for substantive consolidation. The *Owens Corning* test requires a proponent of consolidation to establish that the entities:

(1) pre-petition, disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or

(2) post-petition, their assets and liabilities were so scrambled that separating them is prohibitive and hurts all creditors.[54]

The Court went on to state under the first prong of the test, a *prima facie* case exists when, "based on the parties' pre-petition dealings, a proponent proves corporate disregard creating contractual expectations of creditors that they were dealing with debtors as one indistinguishable entity".[55] Additionally, proponents who are creditors must show that they actually and reasonably relied on the debtors' supposed unity. Further, assuming that a *prima facie* case can

52 *Ibid.*

53 *Owens Corning*, *supra*, note 10 at 211.

54 *Ibid.*

55 *Owens Corning*, *supra*, note 10 at 212.

be made, creditor opponents of consolidation can still defeat a motion for consolidation if they can prove that they are adversely affected and that they actually relied on debtors' separate existence.[56]

The *Owens Corning* test narrows the circumstances in which substantive consolidation may be ordered and thus makes it much more difficult for a proponent of substantive consolidation to succeed. First, the test places the burden of proof on the proponent of consolidation to establish a *prima facie* case on the issue of whether creditors relied on corporate separateness. Although this makes the test easier to apply, it also raises an insurmountable obstacle to obtaining consolidation. Secondly, the applicability of the remedy in the pre-petition period is limited to creditors whose claims are based on contractual rights. Therefore, involuntary creditors, such as tort and statutory claimants are excluded because such creditors do not rely on entity separateness or entity unity. Third, post-petition, the remedy will be granted only if it would increase *every* creditor's recovery. This test will only be satisfied where the cost of disentangling the assets and liabilities of the various entities is so high that benefit of not doing so would increase every creditor's recovery.

IV. SUBSTANTIVE CONSOLIDATION IN CANADA

(a) Substantive Consolidation under the CCAA[57]

The CCAA does not expressly authorize the substantive consolidation of the estates of two or more debtors. Consequently, the courts have relied upon their general equitable and discretionary powers to authorize substantive consolidation pursuant to s. 183 of the CCAA which vests the bankruptcy court with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and other proceedings".[58]

Despite the absence of statutory authorization for substantive consolidation under the CCAA, the decision of the Québec Superior Court in *Re A. & F. Baillargeon Express Inc.*,[59] solidified that the remedy is available under the court's equitable jurisdiction. It remains the leading case. In this case, the trustee

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56 *Ibid.*

57 For an insightful discussion on substantive consolidation in Canada see M. Rotzstain and N. De Cicco, *Substantive Consolidation in* CCAA *Restructurings: A Critical Analysis*, (2004) Annual Review of Insolvency Law 331, and E. Hayes, *Substantive Consolidation under the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act*, (1994) 23 Can. Bus. L.J. 444.

58 BIA, s.183.

59 *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (Que. S.C.) [hereinafter *A. & F. Baillargeon*].

of five related bankrupt companies appealed an order of the register in bankruptcy dismissing its motion for the consolidation of the estates. Persuaded by U.S. jurisprudence that, "bankruptcy proceedings of affiliated corporations should be consolidated wherever it is impractical to separate their financial affairs,"[60] the Court exercised its equitable jurisdiction under s. 183 of the CCAA to grant the consolidation order.

In rendering its decision, the Court unfortunately did not articulate a legal test for substantive consolidation under the CCAA, but rather based its decision on the presence of two factors. First, the Court found that the five bankrupt companies operated as one company with an intermingling of customer lists, bank accounts and assets. Second, the Court found that consolidating the estates in this case would be most expedient and cost effective. However, the Court expressed concerns that consolidation could have a prejudicial dilutive effect on the recoveries of some creditors who stood to gain a larger dividend on an individual basis, while benefiting other creditors stood to receiver a higher dividend as a result of the consolidation. Notwithstanding these concerns, the Court found that the likelihood of realization for unsecured creditors was so remote and the cost of maintaining separate estates so high that as a practical consideration, substantive consolidation was warranted in this case.

In *J.P. Capital Corp., Re*,[61] although the Court dismissed an application for substantive consolidation, it left open the possibility that such an order could ensue even where there was no operational and financial intermingling between members of a corporate group. In this case, the trustee of two corporate bankrupts and one individual bankrupt brought an application for substantive consolidation. In considering whether to grant the application, the Court first noted that the two bankrupt corporations had maintained distinct and separate bank accounts and operated as separate legal entities. Further, the Court considered the different position of the bankrupt individual in relation to his discharge to that of the two companies. However, the overriding concern expressed by the Court was the effect that the proposed consolidation order would have on the creditors of each estate, despite the fact that the majority of creditors had consented to the order and the administrative efficiency that would result:

> Although expediency is an appropriate consideration it should not be done at the possible prejudice and expense of any particular creditor.[62]

In the result, the Court dismissed the application but without prejudice to the trustee to reapply for consolidation once clearer evidence could be pre-

60 *Ibid.*, at para 12.

61 *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Bktcy.) [hereinafter *J.P. Capital*].

62 *Ibid.*, at para 18.

sented on the corporate structure of the group, the assets owned by each co pany and the effect of an equal distribution of assets to the unsecured creditors

In *Associated Freezers of Canada Inc., Re*,[64] the Court authorized t consolidation of five bankrupt companies. In doing so, the Court noted that t assets of the five companies were organized and intertwined in such a way th it was reasonable to require the trustee to deal with the assets *en bloc* to reali the greatest value for all creditors, both secured and unsecured.[65] Despite tl support of the principal secured creditor, the Court provided a reasonable o portunity to other creditors to advance any objections before the order becam effective.

More recently, in *Ashley v. Marlow Group Private Portfolio Manage ment Inc.*,[66] the Court cautioned against the use of substantive consolidation a a remedy since it may profoundly affect the substantive rights of debtors an creditors. In this case, the receiver brought a motion to have each of the fou corporate defendants assigned into bankruptcy. All four companies were run out of one office by one individual and shared one telephone and fax number one bank account and "one set of poorly kept books". As part of that motion, the receiver also sought an order authorizing both the procedural and substantive consolidation of each of the four corporate defendants such that all of the companies would be treated as one entity operating as a "securities firm" as that term is defined in the CCAA. The effect of such an order would result in the application of Part XII of the CCAA.

On the authorities cited, the Court noted that although expediency is an appropriate consideration in deciding whether to grant substantive consolidation, the order should not be made at the expense or possible prejudice of any particular creditor. The only potential creditor asserting any prejudice in the circumstances was the Canadian Investment Protection Fund, which, as a customer compensation body under the CCAA, had concerns about its possible additional exposure to claims if substantive consolidation were permitted. The Court ultimately granted the motion for procedural consolidation but dismissed the motion for substantive consolidation without prejudice to the receiver to renew its motion on further and better evidence on the effect that consolidation would have on the rights of creditors of a particular company and the reasons why each of the corporate defendants ought to be treated as a single securities firm for the purposes of Part XII of the CCAA.

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63 *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Bktcy.) at para 19.

64 *Associated Freezers of Canada Inc., Re* (1995), 36 C.B.R. (3d) 227 (Ont. Bktcy.) [hereinafter *Associated Freezers*].

65 *Ibid.* at para 1.

66 *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 22 C.B.R. (5th) 126 (Ont. S.J.C. [Commercial List]), additional reasons at (2006), 2006 CarswellOnt 3419 (Ont. S.C.J. [Commercial List]) [hereinafter *Marlow Group*].

The few reported decisions do provide a set of factors that a Court may consider in determining whether to grant substantive consolidation. These factors include:

1. the degree of difficulty in identifying each company's individual assets and liabilities;
2. the extent of intermingling of assets and operational functions between each individual company;
3. the extent to which costs associated with administering each estate separately would reduce or diminish the potential recoveries of creditors; and
4. the degree of prejudice that each creditor might suffer upon consolidation.

What emerges from the few decided cases under the CCAA is that where substantive consolidation has been approved, the courts have emphasized that no injury was being done to any particular creditor or creditors or that no objection was made.

(b) Substantive Consolidation under the CCAA

The CCAA does not contain any provisions that specifically authorize a court to consolidate the assets and liabilities of two separate entities. As a result, where the courts have authorized consolidation order, they have relied on their equitable jurisdiction and discretionary powers under the CCAA to consolidate the estates of related debtors.

In the context of CCAA proceedings, one of the first and only reported decisions to consider and analyze the issue of substantive consolidation was the decision of the British Columbia Superior Court in *Northland Properties Ltd., Re*.[67] In that case, the debtor companies sought, *inter alia*, a prospective order approving the preparation of a single reorganization plan for all the companies. The Court however determined that consolidation was not appropriate at that stage of the proceedings and refused to make the order. It should be noted that the debtor companies had applied for approval of the plan and for amalgamation under both the CCAA and the British Columbia Company Act.

In the *Northland* proceedings, the debtor companies were engaged in the business of real estate investment and development and collectively owned and operated a chain of hotels, office buildings and development land. Although

67 *Northland Properties Ltd., Re* (1988), 69 C.B.R. (N.S.) 266 (B.C. S.C.) [hereinafter *Northland Properties*].

separate companies were established to acquire various properties, their finances were inextricably intertwined and the day-to-day management and operation of the companies were conducted as if they were a single entity. Further, the companies were beneficially owned by the same persons. While the business operations were divided into separate hotel and office divisions, no distinction was made on the basis of legal ownership of the property and assets comprising each division as trade creditors and tenants dealt with the separate companies as a whole without regard to the actual legal ownership of a particular hotel by a particular company. Furthermore, the companies maintained a single operating account and, with the exception of one company, audited financial statements were prepared on a consolidated basis, although separate tax returns were filed and expenses and revenues were allocated solely for that purpose.

In considering whether substantive consolidation was appropriate in this case, Justice Trainor noted the paucity of Canadian jurisprudence and thus relied upon various U.S. decisions which set out the tests to be considered on an application for substantive consolidation. He began his analysis by adopting the balancing test articulated in *Baker & Getty Financial Services Inc., Re*,[68] which stated as follows:

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether the "creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition.[69]

After adopting this test, Trainor J. listed the factors identified in *Vecco*,[70] commonly referred to as the "elements of consolidation", which were developed by the courts to assist in the balancing of interests and then considered the test set out in *Re Snider Brothers Inc.*,[71] where the Court stated in making an application for substantive consolidation, "it must be clearly shown that not only are the 'elements of consolidation' present. . .but that the court's action is necessary to prevent harm or prejudice, or to effect a benefit generally".[72] Ultimately, it was found inappropriate in this case to make a consolidating order without first obtaining creditor approval since the effect of the order would be to approve an amalgamation of the companies. However, Justice Trainor stated that the debtor companies could return for court sanction of a consolidated plan

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68 *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio, 1987), cited in *Northland Properties Ltd., Re* (1988), 69 C.B.R. (N.S.) 266 (B.C. S.C.) at para. 49.

69 *Ibid.*

70 *In re Vecco Const. Industries, Inc.*, 4 B.R. 407 (Bankr. E.D. Va., 1980).

71 *Snider Brothers Inc., Re*, 18 B.R. 230 (U.S. Mass., 1982) [hereinafter *Re Snider Bros.*], cited in *Northland Properties Ltd., Re* (1988), 69 C.B.R. (N.S.) 266 (B.C. S.C.) at para. 58

72 *Northland Properties Ltd., Re* (1988), 69 C.B.R. (N.S.) 266 (B.C. S.C.) at para 58.

once they obtained the approval of their creditors. Hence, it was implicit in Justice Trainor's decision that the court had authority to approve a consolidation plan under the appropriate circumstances.

Although the consolidated plan was subsequently approved by the requisite majority of all classes of creditors and sanctioned by the court, certain creditors appealed the order on the basis that the CCAA does not authorize a consolidated plan. On appeal, the British Columbia Court of Appeal affirmed Justice Trainor's decision and thereby confirmed that a CCAA court has the jurisdiction to entertain a consolidated plan. [73] The Court of Appeal accepted that the correct test for substantive consolidation was that set out in *Re Snider Bros.* and interestingly also found statutory authority to make a consolidation order in s. 20 of the CCAA. That section provides that the CCAA provisions may be applied conjointly with the provisions of any Act authorizing compromises or arrangements between a company and its shareholders. The Court noted that if each of the companies were required to file separate plans, then that "would be to deny much meaning to s. 20 of the CCAA and would mean that when a group of companies operated conjointly. . .it would be necessary to propose separate plans for each company and those plans might become fragmented seriously". [74]

Although the decisions stemming from the Northland proceedings confirm that substantive consolidation is part of Canadian law, the courts failed to provide significant analysis of the principles to be applied in making a consolidation order. Since those decisions, few cases have addressed the issue of substantive consolidation in any meaningful way, and even fewer have offered any guidance as to how courts should attack the consolidation inquiry. More significantly, none of the subsequent cases have explicitly considered the decision in *Northland Properties* and have instead focused on facts of each particular case. Some notable examples are the decisions in *Fairview Industries Ltd., Re*,[75] *Lehndorff General Partner Ltd., Re*,[76] *Global Light Telecommunications Inc., Re*,[77] and *PSINET Ltd., Re*.[78]

In *Fairview Industries*, citing *Northland Properties* as authority, the Court simply held that the CCAA does allow for the consolidation of companies

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73 *Northland Properties Ltd., Re* (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195 (B.C. C.A.).

74 *Ibid.*, at para 33.

75 *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43 (N.S. T.D.) [hereinafter *Fairview Industries*].

76 *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) [hereinafter *Lehndorff*]

77 *Global Light Telecommunication Inc., Re* (2004), 2 C.B.R. (5th) 210 (B.C. S.C.) [hereinafter *Global Light*].

78 *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) [hereinafter *PSINET*].

in appropriate circumstances without further consideration of the principles enunciated in that case for substantive consolidation. In these proceedings, the Court originally granted six debtor companies a consolidating order before the presentation of a plan of compromise or arrangement. The Court made the order based on its findings that companies' financial affairs were interlocked and that no prejudice would arise at that stage of the proceedings since no intercorporate payments were being made and no fees were flowing to the parent companies.[79] In a subsequent motion, certain creditors who held security over most of the assets of the companies, challenged the propriety of the initial consolidation order and sought to vary it to require two of the six debtor companies to file separate plans of compromise or arrangement. The motion was granted.

The Court found that, in the circumstances of the case, it would be impractical and costly to continue with a consolidated plan given that the objecting creditors had categorically stated that they would oppose any plan on that basis. As a consolidated plan had no reasonable prospect of success, the Court ordered that the two debtor companies each file separate plans of compromise or arrangement.

In *Lehndorff*, Farley J. permitted a group of companies to file a consolidated plan of compromise or arrangement at the initial CCAA application. Justice Farley determined that a consolidated plan was appropriate in the circumstances on the basis that the companies' business affairs were significantly intertwined as there were multiple instances of inter-company debt, cross-default provisions, and guarantees, and that the companies operated a centralized cash-management system.

In *PSINET Ltd.* the Court sanctioned a consolidated liquidating CCAA plan of four related debtor companies. In sanctioning the plan, the Court did not engage in an in-depth analysis of the doctrine of substantive consolidation but rather made its decision based on the facts of the case. The Court simply referred to the decision in *Northland Properties* and *Lehndorff* as authority for permitting consolidation under the CCAA and stated that when considering whether to consolidate, although it is important to appreciate that the very nature of consolidation has the effect of benefiting some creditors while prejudicing others, it is appropriate to look at the overall general effect. In doing so, the Court distinguished the decisions in *Associated Freezers* and *J.P. Capital*, which held that prejudice to one creditor was sufficient to deny consolidation, on the basis that these cases were decided under the CCAA.

In this case, the factors which led the Court to sanction the plan included the fact the motion to approve the plan was unopposed; the plan was fair and reasonable and the creditors had sufficient time and information to make a reasoned decision. Further, a significant amount of creditors voted in favour of the plan. Also determinative was the fact that the consolidated plan avoided the complex and likely litigious issues surrounding the allocation of proceeds from

79 *Fairview Industries*, *supra*, note 75 at para 76.

the sale of substantially all of the debtor companies' assets. Moreover, the consolidated plan reflected the intertwined nature of the companies' business affairs which operated as a single business evidenced by the fact that the only one company had employees. Also, the Court noted that the companies kept incomplete and deficient records. More importantly, the Court found that any prejudice that might have resulted upon consolidation was ameliorated by the fact that the major creditor (who was also the parent company) made certain concessions with respect to the security it held against the debtor companies.

More recently, in *Global Light*, the Court sanctioned a consolidated plan of arrangement even through objections were raised by certain creditors. After filing for CCAA protection, the debtor company successfully applied to add two of its subsidiaries as petitioners in the proceedings. The two subsidiaries were incorporated in Bermuda and their only connection to Canada was a bank account opened immediately prior to the application. A consolidated plan of arrangement was approved by the requisite majority of creditors and an application was subsequently brought for court approval. At the sanction hearing, certain creditors raised objections that the plan was not fair and reasonable because the subsidiaries had no real connection to Canada other than the bank account. The objecting creditors had obtained guarantees from the subsidiaries and realized that the effect of a consolidated plan of arrangement would deprive them of the right to seek recovery on the guarantees.

The Court sanctioned the plan and found that the objections amounted to a back door attempt to oppose the permission granted to the petitioners to submit a consolidated proposal to creditors. The Court noted that these creditors did not initially oppose the consolidating proposal at the application to add the subsidiaries as petitioners, nor did those creditors appeal from that particular order. More importantly, the Court noted that a significant majority of creditors voted in favour of the plan and all creditors become involved with the original petitioner and its subsidiaries knowing that they were dealing with the original petitioner as parent. In addition, there was no evidence that the opposing creditors accommodated the debtor companies in a manner that should have resulted in them being the sole beneficiaries of the sale proceeds from one of the subsidiaries' investment.

As can be seen from the few reported decisions under the CCAA, the courts have not attempted to articulate any definitive test or list of factors to guide the determination of whether substantive consolidation will be granted. Rather, the approach taken by the courts is based on an analysis of the factual matrix presented by each particular case. While it seems that the courts may engage in some inquiry as to the overall benefit of consolidation to the CCAA proceedings, the presence or absence of such benefit is not determinative of the court approving an order for substantive consolidation. Thus, the *Northland Properties* decisions remain the leading authorities on the issue of substantive consolidation.

V. THE STATUTORY POOLING MECHANISM IN AUSTRALIA

The problems associated with the haphazard and inconsistent approac of the courts in the Canada and the US to resolve issues posed by the insolvenc of a corporate group have been dealt with differently in other common lav jurisdictions such as Australia.

Australian bankruptcy courts have long recognized the power to merg the estates of bankrupts into a common pool where the "estates are so inextri cably blended that it is impracticable to keep them separate," provided that "the proposed consolidation will be for the benefit of creditors generally".[8 However, in relation to corporate insolvencies, while Australian courts have sanctioned consolidation under various statutory procedures,[81] it was not until recently that Australia legislated a specific statutory pooling power (as substantive consolidation is known there).[82]

> The regime will permit creditors to agree (or the court to make an order) that the assets of two or more companies in liquidation be combined and the liquidation of the companies proceed together as if they were one company. This mechanism will streamline the administration of complex group liquidations, rather than introduce new rights of recourse against solvent group companies.[83]

The statutory pooling mechanism represents the culmination of years of judicial and institutional urging for certainty and consistency in dealing with the insolvency of a corporate group.[84] The new pooling mechanism is intended to facilitate the administration of corporate groups only in liquidation. As with substantive consolidation, pooling results in the combination of the assets of two or more related companies and the administration process proceeds as if the companies were a single entity.

The pooling proposals, forming part of a larger package of reforms designed to improve Australia's insolvency laws, were announced by the Aus-

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80 *Anmi Pty. Ltd. v. Williams*, [1981] 2 N.S.W.L.R. 138 (New South Wales S.C.) at 164.

81 Jenny Dickfos *et. al*, "The Insolvency Implications for Corporate Groups in Australia - Recent Events and Initiatives" (2007) 16 Int. Insolv. Rev. 103 at 107-8 [hereinafter Dickfos].

82 *Corporations Amendment (Insolvency) Act 2007*, (No. 132, 2007) [hereafter *Amendment Act*]. The Amendment Act was passed on August 1, 2007, received Royal Assent on August 20, 2007 and will come into force on a single day to be fixed by Proclamation. For the purposes of this paper, it will be assumed that the Amendment Act is in force.

83 The Australian Government Treasury, Insolvency Reform Package Release (Content ID 1303), 12 October 2005 [hereinafter Reform Package] at para 27.

84 Dickfos, *supra*, note 59 at 108.

tralian Government Treasury in October 2005. Initially, the reform proposals contemplated that the statutory pooling mechanism would be available in both liquidations and voluntary administrations.[85] However, the current legislation specifically limits the application of the pooling power to liquidations.

Traditional Sources of Power to Effect Pooling in Australia

In Australia, corporate insolvency law is governed exclusively by Chapter 5 of the *Corporations Act 2001* (Cth).[86] In relation to the insolvency of corporate groups, the *Act* generally applies an entity approach that results in each separate company being treated as a distinct legal entity.[87] However, the statutory pooling power illustrates a legislated recognition of commercial realities that corporate groups often operate as a single entity and that their treatment in insolvency must also be approached in a similar manner.

Although the new statutory pooling power establishes a clear process to make it easier to apply for pooling in liquidation, no such explicit power exists in relation to other insolvency proceedings such as voluntary administration.[88] As was the case prior to the introduction of the pooling mechanism, certain insolvency practitioners must still resort to the powers provided under the *Corporations Act 2001* to implement a pooling arrangement. Traditionally, insolvency practitioners have relied on five statutory procedures, which have been approved by the courts,[89] to effect a pooling arrangement:

1. a scheme of arrangement between each company and its creditors;[90]
2. compromise between the liquidator and creditors;[91]

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85 Reform Package, *supra*, note 83 at para 28.

86 *Corporations Act 2001* (Cth) [hereinafter *Corporations Act 2001*]

87 Dickfos, *supra*, note 59 at 103.

88 Voluntary administration was introduced in 1993 and is somewhat analogous to proceedings under Chapter 11 in the U.S. and the CCAA in Canada. An administrator is appointed to take control of the company and investigate its affairs in order to report to creditors. Based on the administrator's report, the creditors will ultimately decide whether to continue the company's operation or liquidate. See generally Part 5.3A of Chapter 5 of the *Corporations Act*.

89 See generally *Dean-Willcocks v. Soluble Solution Hydroponics Pty. Ltd.* (1997), 42 N.S.W.L.R. 209 (New South Wales S.C.) [hereinafter *Soluble Solution*], *Dean-Willcocks re Alpha Telecom (Aust) Pty. Ltd.*, [2004] N.S.W.S.C. 738 (New South Wales S.C.), *Re The Black Stump Enterprises Pty. Ltd.*, [2005] N.S.W.C.A. 480 (New South Wales C.A.) [hereinafter *Re Black Stump*] at para. 11.

90 *Corporations Act 2001*, s. 411.

91 *Corporations Act 2001*, s. 477(1)(c).

3. arrangement between the liquidator and creditors;[92]
4. a deed of company arrangement; and[93]
5. court order.[94]

A scheme of arrangement allows for a compromise or arrangement to be agreed upon between a company and its creditors and requires approval by a majority in number representing at least three-quarters in value of the creditors' debts and claims, and the approval of the court. However, due to the expensive and onerous nature of obtaining approval, schemes are rarely used for pooling arrangements.[95]

A compromise between a liquidator and the company's creditors requires court approval if the liquidator compromises a debt greater than $20,000 or enter into a commitment of longer than three months.[96] Arrangements apply only in a voluntary liquidation and must be sanctioned by a special resolution of the shareholders and by a resolution of the creditors.[97] In both cases, courts have been reluctant use their power to approve a pooling arrangement, especially where its effect will alter the *pari passu* payment to creditors.[98]

It has been held that the power to enter into a deed of company arrangement is sufficiently broad to permit creditors to vote on an arrangement binding two or more insolvent companies to consolidate their assets and liabilities.[99] However, this procedure can only apply following a voluntary administration. Finally, the court may authorize pooling under its general power to make any order it sees fit in respect of a company in voluntary administration but has also been applied in the context of voluntary liquidations.[100]

Despite the various pooling avenues available to insolvency practitioners, none of these methods specifically authorize the court to consolidate the assets and liabilities of related companies. Rather, the court merely sanctions a particular procedure adopted to effect a pooling. Further, while courts seem to agree that pooling is possible under the broad range of powers available to insolvency practitioners, the use of these measures has required that insolvency practitioners bring numerous applications before the court for directions and

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92 *Corporations Act 2001*, s. 510.

93 *Corporations Act 2001*, Div. 10 of Part 5.3A.

94 *Corporations Act 2001*, s. 447A.

95 Jason Harris, "Seeking Court Approval for Pooling Arrangements: Lessons from the Ansett Case" (2006) 24 C&SLJ 443 at 444.

96 *Corporations Act 2001*, ss. 477(2A),(2B).

97 Dickfos, *supra*, note 78 at 107.

98 Jason Harris, "Australia: Pooling Options for Insolvent Companies", (2005) 26:4 Comp.Law. 125 at 125 [hereinafter *Pooling Options*].

99 *Mentha v. GE Capital Ltd.* (1997), 27 A.C.S.R. 696 (Fed. Crt. Aus.).

100 *Dean-Willcocks v. Soluble Solution Hydroponics Pty. Ltd.* (1997), 42 N.S.W.L.R. 209 (New South Wales S.C.).

guidance regarding the actual implementation of the pooling arrangement. This has resulted in judicial inconsistencies and uncertainties.

Further, while the courts generally accepted that pooling was possible under the above five procedures, considerable uncertainty and inconsistency emerged from diverging judicial authorities regarding the appropriate procedure to use.[101] The recent decision New South Wales Court of Appeal in *Re Black Stump*[102] is illustrative of the problems associated with the judicial power to implement pooling.

In this case, the liquidators of nine related companies appealed an order denying a pooling arrangement. On appeal, the application was dismissed. After reviewing the companies' records, the liquidators concluded that the affairs of the companies were so intermingled that to identify the assets and liabilities of each company would entail great expense. The liquidators notified the creditors of each company of their intention to seek a pooling order. At no time were the creditors asked to actively consent to such an action or informed that their unanimous consent was necessary for the pooling to occur. The notice only required that any objections to the proposed pooling be submitted in writing to the liquidators.

On appeal, it was submitted that pooling could be approved by the court under one of five procedural methods. The Court of Appeal explicitly confirmed that the court has no power to order the pooling of assets in a liquidation of a corporate group, despite the commercial expediency of such an action. While the Court stated that were a number of possibilities to achieve pooling, "one cannot just cite them as saying that the court has the power to authorise pooling of assets. Indeed, it is quite clear to me that the court has no such power".[103]

As a result of decisions like this, judicial authorities called upon the government to create a statutory pooling power:[104]

> . . .[W]hilst courts can continue to deal with these sort of problems on a case to case basis, the time may shortly be coming where it would be a great saving for the Corporations Law itself to make provision for liquidators to consolidate in appropriate cases. One can see, both from the BCCI litigation and from the Maxwell corporate collapse, that it is not uncommon for people of commerce to be involved in a group of companies incorporated in different places with little care taken to document which company is contracting with whom.[105]

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101 Jason Harris, "Pooling: An Overview of Reforms" (2007) 19 Australian Insolvency Journal 16 at 19 [hereinafter *Overview of Reforms*].

102 *Re The Black Stump Enterprises Pty. Ltd.*, [2005] N.S.W.C.A. 480 (New South Wales C.A.).

103 *Ibid.*, at para. 16.

104 *Overview of Reforms*, *supra*, note 101 at 17.

105 *Re Charter Travel Co. Ltd; Re CTC Package Holidays Pty Ltd* (28 October 1997), New South Wales 2402/97; 2403/97 (NSWSC).

Overview of the Statutory Pooling Process in Liquidation

The statutory model for pooling in a liquidation provides for two separate methods to effect a pooling:

(i) voluntary pooling; and

(ii) court ordered pooling.

Voluntary Pooling

The following section provides a brief overview of the main pooling provisions in relation to liquidations.

In a voluntary pooling, the liquidator may make a determination that the winding-up of a group of companies should be conducted on a pooled basis if the following conditions are satisfied:

(a) each company in the group must be in the process of being wound up; and

  (i) each company must be related to each other company in the group; or

  (ii) the companies in the group are jointly liable for one or more debts or claims; or

  (iii) the companies jointly own or one of them owns or operates property that is or was used in connection with a business, scheme or undertaking carried on by them jointly. [106]

However, before a liquidator can make the determination to pool, certain procedural requirements must first be satisfied. First, written notice of the proposed pooling must be provided to all "eligible unsecured creditors" [107] of each company in the group and a meeting must be convened to seek creditor approval.[108] The notice must contain a statement identifying each of companies in the group,[109] and must also set out the liquidator's reasons for forming opinions about the following matters:[110]

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106 *Amendment Act*, s. 571.

107 *Amendment Act*, s. 579Q. The definition of "eligible unsecured creditor" does not include creditors that are companies in the pooled group.

108 *Amendment Act*, s. 574(1).

109 *Amendment Act*, s. 574(3)(b)(i).

110 *Amendment Act*, s. 574(3)(b)(ii).

(i) whether it will be in the creditors' interests for the pooling determination to be made;

(ii) the extent to which particular creditors and companies are likely to be disadvantaged;

(iii) the likely return to creditors in and outside pooling; and

(iv) any other information known to the liquidator that will enable creditors to make an informed decision.

In issuing the written statement, the liquidator must act with due care, in good faith and for the benefit of all creditors of the companies in the group, considered as a whole.[111] Thus, the pooling determination is not to be issued lightly.

For the pooling determination to take effect, a resolution to approve must be passed by a majority in number of creditors of each company voting and by a majority of such creditors whose debts or claims against the company amount in aggregate to at least 75% of the total amount of debts and claims.[112] If so resolved, then the pooling determination takes immediate effect and liquidation may proceed on a pooled basis. Where, however, the eligible unsecured creditors do not approve the pooling determination, then each company will proceed under separate liquidations. Alternatively, the liquidator may apply for a court ordered pooling.

Court Ordered Pooling

An application for court ordered pooling may only be brought by the liquidator(s) of the corporate group[113] on notice to each unsecured creditor of each company in the group or any other person if directed by the court.[114] The court has jurisdiction to order pooling only if it is satisfied that it is just and equitable to do so.[115] Further, the court must be satisfied that the following criteria have been met:

(a) each company in the group is in the process of being wound up; and

(i) each company is related to each other company in the group; or

111 *Amendment Act*, s. 579(1).
112 *Amendment Act*, s. 577(2).
113 *Amendment Act*, s. 579E(11)
114 *Amendment Act*, s. 579J(1).
115 *Amendment Act*, s. 579E(1).

(ii) the companies in the group are jointly liable for one or more debts or claims; or

(iii) the companies jointly own or one of them owns or operates property that is or was used in connection with a business, scheme or undertaking carried on by them jointly.

In determining whether it is just and equitable to make a pooling order, the court must have regard to a range of factors including:

(a) the extent to which companies (and their officers and employees) in the group were involved in the management or operations of other companies in the group;

(b) the conduct of the companies (and their officers and employees) towards creditors or other companies in the group;

(c) the extent to which circumstances that gave rise to the liquidation of any of the companies are directly or indirectly attributable to the acts or omissions other companies in the group (or their officers and employees);

(d) the extent of intermingling of the business activities of companies in the group;

(e) the extent to which creditors will be impacted by a pooling order; and

(f) any other relevant matters.[116]

The court is also vested with the broad jurisdiction to make ancillary orders including the power to exempt certain debts or claims from the operation of pooling; transfer liability for certain debts or claims from one company in the group to another; or make any order as the court thinks fit.[117]

The consequences of a pooling determination made by a liquidator or court ordered pooling are that each company in the group is taken to be jointly and severally liable for all unsecured debts owed by each group member and all inter-company debts and claims are extinguished.[118] Thus, the pooling determination or order will not apply to a secured creditor, unless the debt is payable by one company in the group to any other company in the group (i.e. secured intra-group debt).[119] Alternatively, a secured creditor may be bound by

116 *Amendment Act*, s. 579E(12).
117 *Amendment Act*, s. 579G(1).
118 *Amendment Act*, s.572(2); s. 579E(2).
119 *Amendment Act*, s. 572(9); s. 579E(9).

the effects of pooling if it surrenders its security to the liquidator for the benefit of creditors of the companies generally[120] or realizes its security and proves for the deficiency, if any, as an unsecured debt.[121]

Conclusion

Corporate groups dominate the modern business environment. As the structure of these corporate organizations has become increasingly complex, so have the issues surrounding the corporate group on its insolvency. In Australia, the implementation of a statutory pooling power, at least in liquidations, is a recognition of the effectiveness of pooling as a means of reducing the complexities within group insolvencies. Permitting a liquidator to effect a pooling arrangement, whether by court order or on its own motion, substantially increases the efficiency of administering the group insolvency proceedings. Further, it may be said that the Australian approach has now become much more aligned with the approach adopted by the courts in the U.S., and to a lesser extent, in Canada. Before, the issue of pooling was merely a procedural choice on the part of the insolvency practitioner. Now, the statutory power to pool has refocused the issue from being a procedural one to requiring the insolvency practitioner to engage in an analysis of the effects of the proposed pooling and consider whether it would be appropriate in the circumstances.

In the U.S., the equitable doctrine of substantive consolidation has evolved into a mechanism to remedy circumstances where creditors relied on unity of the group or to prevent injury to creditors where the financial affairs of the separate entities are so entangled that the cost of separating them is prohibitive. The decision in *Owens Corning* recognizes that substantive consolidation can significantly prejudice creditor rights and recoveries and thus limits the circumstances in which the remedy will be available.

In Canada, there are very few reported decisions addressing the issue of substantive consolidation. What emerges from these cases is that, in the context of bankruptcy, courts are keen to ensure that no creditor will be prejudiced by an order of substantive consolidation. In CCAA reorganizations, substantive consolidation may be appropriate where it will benefit the overall proceedings.

120 *Amendment Act*, s. 572(6); s. 579E(6).
121 *Amendment Act*, s. 572(7); s. 579E(7).

TAB 4

1988 CarswellBC 531, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, [1988] B.C.W.L.D. 2663, [1988] C.L.D. 1460, 11 A.C.W.S. (3d) 76

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1988 CarswellBC 531, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, [1988] B.C.W.L.D. 2663, [1988] C.L.D. 1460, 11 A.C.W.S. (3d) 76

Northland Properties Ltd., Re

Re NORTHLAND PROPERTIES LIMITED et al.

British Columbia Supreme Court

Trainor J.

Heard: June 27-30, 1988
Judgment: July 5, 1988
Docket: Vancouver No. A 880966

Counsel: *R. Clark, R.D. McCrae, R. Ellis* , and *G. Gardner* , for petitioners.

E.C. Chiasson, Q.C., G. Thompson , and *C.S. Bird* , for Bank of Montreal.

N. Kambas , for Excelsior Life Insurance and National Life Insurance.

S. Strukoff , for Metropolitan Trust.

A. Edson , for Touche Ross.

A.C. Zepil , for Guardian Trust.

Subject: Corporate and Commercial; Insolvency

Bankruptcy --- Interim receiver — Appointment.

Court discussing factors for consideration on application for consolidation order.

Additional monitoring of companies' affairs not required at present time.

The petitioning companies collectively owned and operated a chain of hotels, office buildings and development real estate. Although separate legal entities, the companies were managed and operated as a single entity without regard to which company owned which asset. Expenses and revenues were only allocated to each company for the purpose of filing separate tax returns. Owing $117 million in secured debt to the bank, the companies petitioned under the Companies' Creditors Arrangement Act and were granted permission to propose plans of compromise or arrangement to their creditors. The court further ordered that the companies remain in possession of their assets and carry on business and that any

bankruptcy or winding-up proceedings by creditors be stayed. The companies brought in chartered accountants to prepare audited financial statements, and consented to a "stand still" order and to a requirement that they report to the court and to the creditors until the plans could be presented at the creditors' meeting. In this present application, the bank sought, inter alia, an order appointing an interim receiver. The companies sought, inter alia, an order merging and consolidating their reorganizations.

Held:

Applications dismissed.

The role of the interim receiver would be that of a monitor or watchdog over the companies' activities until the creditors' meeting. It would take the receiver at least one month to familiarize itself with the corporate structure and finances before it could begin to assess and report on the companies' financial activities. In light of this, and as chartered accountants were already involved, reporting requirements existed, and stay of proceedings and "stand still" orders were in place, the appointment of an interim receiver was not warranted at this time.

In determining the appropriateness of a consolidation order, the court must balance the economic prejudice to the creditors resulting from continued corporate separateness against the economic prejudice caused by consolidation. It is not sufficient, on an application for consolidation, to show a unity of interest or an intermingling of funds; it must also be shown that consolidation would prevent a harm or prejudice or would effect a benefit generally. Although the companies had been run substantially as a single entity, their assets and liabilities had been capable of segregation for tax purposes. Further, at this time, a consolidation order would interfere or appear to interfere with the rights of the creditors by giving the appearance of approval of an amalgamation without reference to the creditors. The creditors could consider approving a consolidation plan when they had had the opportunity to review the individual reorganization plans submitted to them.

Cases considered:

Avery Const. Co., Re, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont.) — *referred to*

Baker and Getty Fin. Services Inc., Re, 78 B.R. 139 (Ohio Bankruptcy Court, 1987) — *considered*

Snider Bros., Re, 18 B.R. 230 (Mass. Bankruptcy Court, 1982) — *applied*

Vecco Const. Indust. Inc., Re, 3 B.R. at 410 — *referred to*

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25

ss. 3-7

s. 11

United States Bankruptcy Code, c. 11

Application for orders appointing interim receiver and consolidation of companies' reorganizations.

Trainor J. **:**

1 There are several motions before me in which both the petitioner companies and the Bank of Montreal ask for orders and directions pursuant to the provisions of the Companies' Creditors Arrangement Act. Not only the rights of the companies and the bank, but those of all creditors will be affected by my rulings and I have also heard submissions of counsel and representatives of other creditors. The submissions of counsel have been lengthy and supported by their review of affidavits and exhibits thereto. The motions of course must be considered in the light of that evidence. It is therefore appropriate to set out something of the background or history of the relationship of the parties involved in these proceedings.

2 The companies are engaged in the business of real estate invest ment and development in western Canada and in the western United States. They collectively own and operate:

3 (a) A chain of 20 hotels and motels in Western Canada known as the "Sandman Inns";

4 (b) Five office buildings in Calgary and Vancouver;

5 (c) An office building in Portland, Oregon;

6 (d) Development land in California;

7 (e) A number of other smaller office buildings and parcels of land.

8 The Sandman Inns chain of hotels was founded in 1967. All hotels, inns and office buildings, with a couple of exceptions, were constructed by the companies as new facilities. Until 1977, separate companies were incorporated to acquire property in selected communities for the purpose of establishing a hotel, the purpose of separate corporate ownership being to permit the management of each hotel to participate. This policy was changed at that time and the interest of each participating owner was bought out. In his affidavit sworn 27th May 1988, Robert John Gaglardi, who is the president and a director of each of the companies, avers:

> 24. In summary, although legal title to the companies' real estate and other assets is disbursed among the companies, beneficial ownership ultimately resides for the most part in myself and Ralph Beck [the father-in-law of Robert John Gaglardi], albeit in differing proportions. The companies' separate legal existence has been maintained only for the purpose of reflecting the different degrees of beneficial ownership of the companies' assets and as required to satisfy certain lenders including Bank of Montreal (the "bank"). Otherwise, and for all other intents and purposes, and in particular for the purpose of day-to-day management and operations, the companies are treated internally and by others as a single business entity.

9 Mr. Gaglardi further says that the companies' business operations are divided into the hotel division and the office division with no distinction being made on the basis of legal ownership of the property and assets comprising each division. He states:

> 26. By virtue of operating as two divisions without regard to corporate niceties and actual legal ownership, the finances of the companies are inextricably intertwined. As a rule, trade creditors of the hotel division bill their accounts to "Sandman Inns", notwithstanding that a particular hotel may be owned by any one of Sandman Inns, Northland or Sandman Four.
>
> 28. Cheques and other instruments generated from hotel operations are also made payable to Sandman Inns without

regard to the corporate entity actually owning the particular hotel to which the income is attributable.

29. Similarly, the office division operates generally under the name of "Northland Properties" notwithstanding actual legal ownership of each office building. Cheques received from tenants of office properties are as a rule all made out in favour of Northland.

30. Until recently, the companies collectively maintained a single operating account with the bank in Vancouver, British Columbia. Into this account were deposited all cheques and cash from the hotel and office divisions regardless of their source and without heed to the company which owned the property in respect of which the income was generated. This account was maintained in the name of "Sandman Inns" and no attempt was ever made by the bank or by the companies to allocate revenues, deposits or withdrawals to each company. As to payroll, all cheques are issued by Sandman Inns in relation to both the hotel division and the office division.

10 He further says that the audited financial statements of the companies, with the exception of Northland, are prepared on a consolidated basis only, although he does acknowledge that separate tax returns have been filed each year and that it has been necessary to allocate expenses and revenues for that purpose.

11 On the other hand, I have an affidavit of Mr. Bygott, a manager with the special accounts management unit of the Bank of Montreal, sworn 23rd June 1988, in which he challenges a further statement by Mr. Gaglardi that "the system is incapable of producing separate financial summaries for each company". Mr. Bygott exhibits to his affidavit materials produced on behalf of the companies from which he concludes that it is "quite possible and relatively simple for the companies to determine and set out comprehensive particulars of the debts owed by each of them and the security therefor on an unconsolidated basis".

12 The companies began to experience financial problems starting in 1981 and 1982 when their revenues declined and interest rates rose sharply. The suspension of payment of interest to the bank led to a number of attempts to restructure the companies' indebtedness. The bank worked closely with the companies in those processes. One of the issues to be resolved between the companies and the bank is the claim by the companies that the bank is liable to them for damages for what has been described in argument as "lender liability". This claim is based on dealings between the companies and the bank and allegations of damage arising from the exercise of control by the bank over the business operations of the companies. That issue may be relevant to a determination of the voting rights of the bank with respect to the plan proposed by the companies under the Companies' Creditors Arrangement Act. Otherwise, that issue is not before me at this time.

13 By the spring of 1988, the financial status of the companies, in general terms, was that they owed slightly less than $200 million and had assets valued at approximately $100 million. The amount owing to the bank, which was included in that general indebtedness, was in the sum of approximately $117 million.

14 Other indebtedness of the companies was roughly as follows:

1. Priority mortgagees $77,000,000

2. General unsecured creditors 2,000,000

3. Property and business taxes 3,700,000

4. Corporation capital tax 300,000

15 The indebtedness to the bank, in its submission, is made up as follows:

1. Series A bonds $45,000,000

2. Series C bonds 2,000,000

3. The Put debt secured by the A bonds, the U.S. trust deeds and the other security 70,000,000

16 In December 1987 the bank authorized the commencement of a receivership action against the companies. Royal Trust Corporation of Canada, acting on behalf of the bank under a trust deed to which the companies were parties, moved in the receivership action for summary judgment against the companies under the trust deed and the appointment of a receiver-manager of the companies. The motions for summary judgment and the request for the appointment of a receiver-manager of the companies were heard by Boyle L.J.S.C. on 1st and 2nd February 1988. The companies sought and obtained an adjournment of the applications until 8th April 1988 to allow them time to obtain evidence confirming the availability of alternate financing. At the time of granting those adjournments, Boyle L.J.S.C. said:

> Although the long history of negotiations and agreements are relevant here, there is no need to detail them. There is some bitterness on the companies' part as a result of what they see as interference by the bank in their operations at consequent cost to the companies but, even if their operation had been ideal day-to-day, their financial distress now would remain acute.
>
> It is enough to say that the bank gave the companies many opportunities to refinance and in no sense sandbagged them unexpectedly with the present proceedings.

17 The hoped-for alternate financing did not materialize. Consequently, on 6th April 1988 the companies filed petitions in the bankruptcy court for the district of Oregon pursuant to c. 11 of the United States Bankruptcy Code acknowledging indebtedness in the amount of $200 million with assets having a value of approximately half that amount.

18 On 7th April 1988 the companies petitioned this court under the Companies' Creditors Arrangement Act. That Act provides:

> 3. This Act does not apply in respect of a debtor company unless
>
> (*a*) the debtor company has outstanding an issue of secured or unsecured bonds, debentures, debenture stock or other evidences of indebtedness of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee, and
>
> (*b*) the compromise or arrangement that is proposed under section 4 or section 5 in respect of the debtor company includes a compromise or arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

19 I found that the companies in these proceedings were debtor companies which, on the material filed in support of the petition, qualified them to invoke the Companies' Creditors Arrangement Act.

20 The Companies' Creditors Arrangement Act further provides:

4. Where a compromise or arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of such creditors or class of creditors, and, if the court sodetermines, of the shareholders of such company, to be summoned in such manner as the court directs.

5. Where a compromise or arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of such creditors or class of creditors, and, if the court so determines, of the shareholders of such company, to be summoned in such manner as the court directs.

6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of such sections, agree to any compromise or arrangement either as proposed or as altered or modified at such meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding on all the creditors, or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and is also binding on the company, and in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy Act or is in course of being wound up under the Winding-up Act, is also binding on the trustee in bankruptcy or liquidator and contributories of the company.

7. Where an alteration or modification of any compromise or arrangement is proposed at any time after the court has directed a meeting or meetings to be summoned, such meeting or meetings may be adjourned on such term as to notice and otherwise as the court may direct, and such directions may be given as well after as before adjournment of any meeting or meetings, and the court may in its discretion direct that it shall not be necessary to adjourn any meeting or to convene any further meeting of any class of creditors or shareholders that in the opinion of the court is not adversely affected by the alteration or modification proposed, and a compromise or arrangement so altered or modified may be sanctioned by the court and have effect under section 6.

21 As the initial step with respect to the compromise or arrangement to which reference is made in those sections, I ordered as follows:

AND THIS COURT FURTHER ORDERS that the Petitioners be and are hereby authorized and permitted to file with this Honourable Court, on or before August 25, 1988, or such other date as may be ordered by this Court, a formal plan of compromise or arrangement (the "Reorganization Plan") between the Petitioners and its secured and unsecured creditors ...

AND THIS COURT FURTHER ORDEERS that the Petitioners shall remain in possession of their undertaking, property and assets and shall continue to carry on their business and upon approval of the Reorganization Plan as provided for in the Petition, to implement same according to its terms.

22 The Companies' Creditors Arrangement Act also provides:

11. Notwithstanding anything in the *Bankruptcy Act* or in the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on such notice to any other person, or without notice as it may see fit, make an order staying until such time as

the court may prescribe or until further order all proceedings taken or that might be taken in respect of such company under the *Bankruptcy Act* and the *Winding-up Act* or either of them, and the court may restrain further proceedings in any action, suit or proceeding against the company upon such terms as the court sees fit, and the court may also make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

23 Pursuant to the authority of that section, I ordered as follows:

AND THIS COURT FURTHER ORDERS that all proceedings taken or that might be taken by any of the Petitioners' creditors under the Bankruptcy Act, R.S.C. 1970, c. B-3 and the Winding-up Act, R.S.C. 1970, c. W-10, or either of them, shall be stayed until further order of this Court upon notice to the Petitioners and that further proceedings in any action, suit or proceeding commenced by any person against any of the Petitioners be stayed until further order of this Court upon notice to the Petitioners, that no action, suit or other proceeding may be proceeded with or commenced against any of the Petitioners by any person except with leave of this Court, upon notice to the Petitioners, and subject to such terms as this Court may impose, and that the right of any person to realize upon or otherwise deal with any security held by that person on the undertaking, property and assets of any of the Petitioners be and the same is postponed on such terms and conditions as this Court may deem proper.

24 On 20th June 1988 I heard a motion by counsel on behalf of Guardian Trust Company, one of the priority mortgagees in these proceedings. Because it is fundamental to the motions before me now, I want to repeat a portion of what I said in dealing with the Guardian Trust motion:

With respect to this particular legislation, I would like to refer to what is said by the court in *Meridian Dev. Inc. v. T.D. Bank*, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 11 D.L.R. (4th) 576, 53 A.R. 39 (Q.B.) . At p. 113, Mr. Justice Wachowich said:

> This Act, though little used, is one of a number of federal statutes dealing with insolvency. In common with the various other statutes, it envisages the protection of creditors and the orderly administration of the debtor's affairs or assets.

Then he cites authority for that proposition and continues:

> In the words of Duff C.J.C. who spoke for the court in *A.G. Can. v. A.G. Que.*, [1934] S.C.R. 659, 16 C.B.R. 1 at 2, [1934] 4 D.L.R. 75 :
>
> '... the aim of the Act is to deal with the existing condition of insolvency in itself to enable arrangements to be made in view of the insolvent condition of the company under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy. *Ex facie* it would appear that such a scheme in principle does not radically depart from the normal character of bankruptcy legislation.'
>
> The legislation is intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.

I adopt that as a statement of the purpose of this legislation and the underlying purpose behind the order which was made on 7th April last.

25 At the time I made that order I was satisfied on the basis of the material filed in support of the petition that the companies should have an opportunity to lay before their creditors a proposal as to how their liabilities could be met and the companies continue in operation. The purpose of this legislation is to keep companies in business if possible. That is the sense in which this legislation is to be distinguished from winding-up or bankruptcy proceedings: *Re Avery Const. Co.*, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont.) .

26 There are separate motions before me for consideration and decision at this time. I will consider each in detail but, in summary, they are as follows:

1. Motion by the companies for an order that:

27 (a) Their reorganizations be merged and consolidated for all purposes;

28 (b) The form of proof of claim and its instructions annexed to the motion be approved;

29 (c) They be granted liberty to file a single consolidated reorganization plan;

30 (d) The process for accepting and determining the claims of creditors be as set forth in the instructions to proof of claim;

31 (e) They be granted liberty to constitute preliminary classes of creditors.

2. Motion by the bank:

32 (a) For a "stand still" order;

33 (b) For the appointment of Touche Ross Limited as interim receiver of the companies.

3. Motion by the bank for an order:

34 For directions with respect to the bank's entitlement to vote at any meeting of creditors called in these proceed- ings.

35 At the time of drafting these reasons for judgment, counsel have not completed their submissions with respect to all of the issues raised in the notices of motion. However, I propose to deal with those matters in respect of which they have confirmed to me that their submissions have been completed.

Motion No. 2 — For a "stand still" order and the appointment of an interim receiver

36 I will not set out all of the detail with respect to the powers and duties sought for Touche Ross Limited as interim receiver of the companies authorizing it to monitor the operations and affairs of the companies. Suffice to say that noth- ing turns at this time, and in the particular circumstances of this case, on the extent and nature of those powers and du- ties.

37 The stand still order sought is as follows:

> THIS COURT ORDERS THAT, until further Order of this Honourable Court, the Petitioners, and each of them, be and are hereby enjoined and restrained from:

(a) issuing any further shares, bonds, debentures or other securities, or permitting the transfer of any such instruments or otherwise changing in any way their corporate or share structure;

(b) selling, transferring, or otherwise disposing of or charging, encum bering or otherwise mortgaging any of their assets, save and except leases of office space entered into in the ordinary and usual course of management of office properties;

(c) incurring any debts or obligations whatsoever, except in the ordinary and usual course of business and as necessary to continue business operations in the manner conducted prior to 7th April 1988;

(d) applying any of their cash flow in any manner or for any purpose other than in the ordinary and usual course of business and for the purpose of continuing present business operations; and

(e) entering into or effecting any arrangements or compromises with, or making any payments other than in the ordinary and usual course of business and for the purpose of continuing present business operations to any creditors, including secured creditors, without obtaining an Order of this Honourable Court following proper notice to the parties of record.

38 Consideration of the matters raised in this motion involves a recognition of the fact that there has been in place an order staying any and all proceedings which might be taken by any creditor of the companies since 7th April 1988. Reorganization plans need not be filed until 25th August 1988 and the meetings of creditors are scheduled for 16th September 1988. During the whole of that period there is no order directing the companies to report to their creditors. The operations of the companies continue to be controlled and directed by their boards of directors and there is no mechanism in place to ensure that the rights of the creditors are being properly protected.

39 In the course of submissions, counsel for the companies informed me that he would consent to the stand still order as set out above subject only to some possible minor adjustment of the wording thereof. On that basis, that order will be made. If counsel have a problem with the wording, they may arrange to speak to me.

40 I also understood in the course of submissions that counsel for the companies consented to an order being made obliging the companies to report to the creditors and the court as follows:

Reporting Requirements

Section in:		
Credit Agreement	Trust Deed	Item
7.2	6.4	Evidence of maintenance of corporate existence
7.3	-	Evidence of maintenance of federal, provincial and municipal licences, consents and permits
7.4	6.9	Evidence of payment of taxes when due (including 1988 tax rolls).

7.5	6.7	Access to all properties and right to physically inspect.
7.8-7.11	6.18	Evidence of maintenance of adequate insurance coverage, payment of premiums when due and renewal when due (August 1, 1988).
9.1		1987 annual audited financial statements (draft, if necessary).
9.2	-	Quarterly (within 30 days) unaudited financial statements (commencing quarter ended March 31, 1988).
9.3	-	Monthly (within 30 days) unaudited profit/loss, cash flow and variance reports (in the form as traditionally provided, by individual property and combined on a divisional basis).
9.4	-	Bi-weekly (within 5 days) daily revenue summaries for all hotels (in the form of the "Flash Reports" as traditionally provided).
9.5	-	Annual budgets and business plans (combined, divisional and by corporate entity).
8.12	6.6	Evidence of capital expenditures since August 1987 (actual vs. plan vs. budget).
8.12	-	Details of major individual expenditures, greater than $20,000 per corporate entity or $200,000 for all entities combined in the fiscal year.
7.5	6.5	Monthly detailed listing of: -aged payables -aged receivables -reconciliations of bank accounts (including outstanding cheques)
7.16 and 7.13	6.6 and 6.14	Details of any municipal health, fire or work orders over any of the properties, and evidence of compliance.
8.3 and 8.4	6.13	Details of prior mortgages: -current balance outstanding

		-current status (arrears, if any) -status of renewals as they occur including details of terms.
7.5	6.5	Detailed occupancy/tenancy information for properties: (a) Hotels -occupancy levels by property -room rates by property -commencing March 1988 (b) Commercial -current rent rolls -tenant inducements (cash/free rent/lease takeovers/others) -commitments for tenant improvements -leases under negotiations

41 A further significant fact to be considered on this motion is that the companies have engaged a firm of chartered accountants to prepare material for the creditors' meetings. In his affidavit sworn 27th June 1988 John Bowles, a partner of Coopers & Lybrand chartered accountants, avers that they:

> ... are currently in the process of preparing for the audit of the 1987 financial statements of the Northland/Sandman Group, which, together with the stub period financial statements for the period January 1, 1988 to July 31, 1988 with a review engagement report will be included with the Petitioners' information circular to be delivered to their creditors in conjunction with their final proposed plan.

42 He further avers that the books and records of the companies have been reviewed for the period 7th April to 31st May 1988 and that Coopers & Lybrand:

> ... have not become aware of anything that would lead us to believe that the Petitioners have not continued to conduct themselves in the normal course of their business and in furtherance of the finalization of their reorganization plan.

43 On the basis of all of that material, it appears that the companies will be reporting and that a firm of chartered accountants are in the process of doing an audit and preparing a full financial statement for the purposes of full consideration of the plan proposed at the creditors' meeting.

44 I am satisfied that I have jurisdiction to appoint an interim receiver and spell out the responsibilities of that office such that his true role would be that of a monitor or watchdog during this interim period. The cost would be significant, but is not a factor of great weight considering the total indebtedness of the companies. The most significant factor militating against the appointment of a monitor at this time is the evidence that it probably would require at least one month for him to familiarize himself with the corporate structures and finances before he could even begin to assess the financial activities of the companies and report on them. When the material is provided in response to the reporting requirements and the reports from Coopers & Lybrand, the creditors may wish to apply for an order for further or other directions to the companies. In the meantime, however, the motion for the appointment of an interim receiver is refused.

Motion No. 1(a) and (c)

45 The order sought under this motion is under the general heading of consolidation. The particular request is for an order that:

> a) The within reorganizations with respect to Northland Properties Limited, Sandman Inns Ltd., Sandman Four Ltd., Unity Investment Company, Limited, B & W Development Co. (1986) Ltd., and T N Developments Ltd. under the Company Act and the Companies' Creditors Arrangements Act be merged and consolidated for all purposes.

46 In putting forward this motion, the companies assert that they are not seeking to vary their obligations to the creditors at this time. However, the proposal is that the court approve the preparation of a single reorganization plan for presentation to the creditors of all of the companies. The companies say this is realistic and practical because all of the businesses of the companies were carried on as a single entity which resulted in the financial affairs of the companies being so interwoven that they have become inseparable. They point as well to the common ownership and management of the companies and to the greater cost involved in the preparation of a separate reorganization plan for each corporation.

47 Counsel for the bank in opposing this motion questions the jurisdiction of the court to make such an order. Consolidation is not specifically authorized under the Companies' Creditors Arrangement Act. The end result of the process which the companies ask that they be given leave to set in motion at this time would be amalgamation of the companies. The companies would appear to be insolvent and that fact is a bar to amalgamation in many jurisdictions in Canada. A company seeking amalgamation as a general rule is required to satisfy the court that its creditors approve of the amalgamation. Of course, that request can be made by the companies. However, I do not think that it would be appropriate for the companies to obtain from the court what might appear to be approval of amalgamation without any reference to the creditors.

48 I appreciate that there is evidence that the companies have, in large part, been run as a single entity. However, as I have pointed out, their assets, income and liabilities have been segregated for the purposes of income tax returns and there is some evidence that separate schedules of assets and liabilities have been filed in the United States bankruptcy proceedings.

49 There is a scarcity of Canadian cases dealing with this subject and none of the ones referred to me has been of assistance. Both counsel have referred to American cases dealing with the somewhat analogous c. 11 bankruptcy proceedings. In *Re Baker and Getty Fin. Services Inc.*, 78 B.R. 139 (Ohio Bankruptcy Court, 1987), the court said:

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".

The court then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors are:

50 1. Difficulty in segregating assets;

51 2. Presence of consolidated financial statements;

52 3. Profitability of consolidation at a single location;

53 4. Commingling of assets and business functions;

54 5. Unity of interests in ownership;

55 6. Existence of intercorporate loan guarantees; and

56 7. Transfer of assets without observance of corporate formalities.

57 (*Re Vecco Const. Indust. Inc.* , 4 B.R. at 410)

58 I have considered the submissions of counsel with respect to each of those factors. I also refer to *Re Snider Bros.*, 18 B.R. 230 (Mass. Bankruptcy Court, 1982), where the court said at p. 234:

> It must be recognized and affirmatively stated that substantive consolidation, in almost all instances, threatens to prejudice the rights of creditors ... This is so because separate debtors will almost always have different ratios of assets to liabilities. Thus, the creditors of a debtor whose asset-to-liability ratio is higher than that of its affiliated debtor must lose to the extent that the asset-to-liability ratio of the merged estates will be lower. Why then would substantive consolidation ever be permitted?
>
> A review of the case law reveals that equity has provided the remedy of consolidation in those instances where it has been shown that the possibility of economic prejudice which would result from continued corporate separateness outweighed the minimal prejudice that consolidation would cause. While several courts have recently attempted to delineate what might be called "the elements of consolidation", *In re Food Fair, Inc.*, 10 B.R. 13 , 124 (Bkrtcy. S.D.N.Y. 1981); *In re Veccon Construction Industries, Inc.*, 4 B.R. 407 , 6 B.C.D. 461, 1 C.B.C. 2d 216 (Bkrtcy. E.D. Va. 1980), I find that the only real criterion is that which I have referred to, namely the economic prejudice of continued debtor separateness versus the economic prejudice of consolidation.

And at p. 238:

> Moreover, the evidence in support of an application to consolidate must do more than show a unity of interest or an intermingling of funds. It must show a harm which has resulted therefrom, *Soviero v. Franklin National Bank of Long Island* , supra, or that prejudice will result from a lack of consolidation, *Chemical Bank New York Trust Co. v. Kheel* , supra. Indeed, consolidation has been denied even though the debtors had always conducted their business on a consolidated basis, with a joint bank account, inter-corporate loans, and joint payroll, because the court was not satisfied that the prior practice of operating as a single unit was necessary or desirable. *In re Coventry Energy Corporation*, 5 B.C.D. 98 (S.D. Ohio 1979). In addition, consolidation was denied in that case despite the absence of objections by any party. Hence, it must be clearly shown that not only are the "elements of consolidation" present in a given bankruptcy setting, but that the court's action is necessary to prevent harm or prejudice, or to effect a benefit generally.

59 I accept the analysis contained in the *Snider* case. It would be improper for the court to interfere with or appear to interfere with the rights of the creditors. In my view, that appearance would be created by making an order that the reorganizations be merged and consolidated for all purposes. The order sought in this part of the motion is refused. Of course that does not mean that the companies are barred from seeking from the creditors their approval of a consolidated plan. I say that consolidation is not appropriate at this time. The creditors may decide to accept a consolidated plan when they have had a full opportunity to consider the reorganization plans submitted to them.

Motion No. 1(b) and (d)

60 The companies move for an order that:

b) The form of Proof of Claim and its instructions attached hereto as Schedule "A" be approved by this Honourable Court for mailing by the Petitioners to their creditors;

d) The process for accepting and determining the claims of creditors of the Petitioners be as set forth in the Instructions to the Proof of Claim attached hereto.

61 I have reviewed the proof of claim form and the instructions accompanying it. As well, I have considered the submissions of counsel for the companies and the bank. I confirm the ruling which I made on 29th June 1988 that because of the unusual financial arrangements between the companies and the bank, it would be inappropriate to require the bank to attempt to set out its claims on that form. I ruled that the bank should have leave to file a separate individual statement of its claims. That statement must be filed by 6th July 1988. If the companies take objection to the statement, they are entitled to reply by 13th July 1988, following which a date may be obtained from the registrar to appear before me in respect of those differences.

62 I confirm that there are two matters contained in the motions still to be resolved. Counsel have agreed to exchange written submissions following which a date for a further hearing will be arranged if necessary. Those two matters are the companies' motion that they be granted liberty to constitute preliminary classes of creditors and a motion by the bank for an order for directions with respect to the bank's entitlement to vote at any meeting of creditors called in these proceedings.

Order accordingly.

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1989 CarswellBC 334, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122

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1989 CarswellBC 334, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122

Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada

NORTHLAND PROPERTIES LIMITED et al. v. EXCELSIOR LIFE INSURANCE COMPANY OF CANADA, NATIONAL LIFE ASSURANCE COMPANY OF CANADA and GUARDIAN INSURANCE CO. OF CANADA

British Columbia Court of Appeal

McEachern C.J.B.C., Esson and Wallace JJ.A.

Judgment: January 5, 1989
Docket: Vancouver Nos. CA010238; CA010198; CA010271

Counsel: *F.H. Herbert* and *N. Kambas*, for appellant Excelsior Life Insurance Company of Canada and appellant National Life Assurance Company of Canada.

A.P. Czepil, for appellant Guardian.

H.C.R. Clark and *R.D. Ellis*, for respondent companies.

G.W. Ghikas and *C.S. Bird*, for respondent Bank of Montreal.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by Court — "Fair and reasonable".

Corporations — Arrangements and compromises — Reorganization plan under Companies' Creditors Arrangement Act providing for consolidation of petitioner companies and grouping all priority mortgagees into one voting class — Two priority mortgagees, not being fully secured creditors, voting against and appealing court order approving plan — Appeal dismissed — Consolidation being appropriate where economic prejudice less than prejudice arising from continued debtor separateness — Composition of priority creditors not being unfair since plan formulated for benefit of all creditors, who had indicated approval — Plan being fair and reasonable since priority mortgagees assured value of security without liquidation expenses and this result being unavailable in absence of plan.

After the petitioners' bank commenced receivership proceedings against the petitioners, the court approved a reorganization plan filed under the Companies' Creditors Arrangement Act. The plan incorporated a settlement

agreement that had been reached between the bank and the petitioners. In addition, the plan proposed consolidation of all the petitioners and provided that all priority mortgagees would be grouped into one class for voting purposes. Of the 15 priority mortgagees, 11 were fully secured while the remaining four, including the respondents, faced deficiencies. All classes of creditors had voted unanimously in favour of the plan, except the priority mortgagee class, which had none the less approved the plan by the requisite majority under the Act. Prior to the settlement with the bank, R. Ltd., a priority mortgagee facing a deficiency, had struck an agreement with the petitioners on the value of its security amounting to approximately $900,000 over a disputed appraisal value. R. Ltd. agreed in the settlement to vote in favour of the plan. Had it voted against, the petitioners would not have obtained the requisite majority from the priority mortgagee class. The respondents appealed the order approving the plan on a number of grounds.

Held:

Appeal dismissed.

There was some merit in the respondents' argument that the Act does not authorize the creditors of one company to vote on the disposition of a creditor's security in another company. However, the plan contemplated the consolidation of the petitioners and the chambers judge correctly concluded that consolidation was appropriate if its economic prejudice was less than the prejudice arising from continued debtor separateness.

Furthermore, the composition of the class of priority creditors was not unfair. The plan was not only for the benefit of the undersecured priority mortgagees, but also for the benefit of the companies and other creditors who, by their votes, had indicated that they thought the plan was in their best interest. Nor was the plan tainted by the agreement between R. Ltd. and the respondents. The agreement was not made for the purpose of ensuring a favourable vote because at the time it was made the petitioners had not yet reached a settlement with the bank. Furthermore, the agreement with R. Ltd. was fully disclosed in the plan and it was the bank, not the respondents, which stood to lose by that agreement.

Finally, the plan was neither unfair nor unreasonable. Only the appellants had voted against it and the court should not be astute in finding technical arguments to overcome the majority's decision. Moreover, the plan assured all priority mortgagees the full value of their security without liquidation expenses, which was more than they could have expected in the absence of the plan. Although they lost the right to pursue the petitioners for any deficiency, this right was wholly illusory given the petitioners' overwhelming debt to the bank.

Cases considered:

Alabama, New Orleans, Texas & Pac. Junction Ry. Co., Re, [1891] 1 Ch. 231 (C.A.) — *referred to*

Associated Investors of Can. Ltd., Re, [1988] 2 W.W.R. 211, 56 Alta. L.R. (2d) 259, 67 C.B.R. (N.S.) 237, 38 B.L.R. 148, (sub nom. *Re First Investors Corp. Ltd.)* 46 D.L.R. (4th) 669 (Q.B.) — *referred to*

Baker & Getty Fin. Services Inc., Re, 78 B.R. 139 (U.S. Bankruptcy Ct., N.D. Ohio, 1987) — *referred to*

Br. Amer. Nickel Corp. v. O'Brien Ltd., [1927] A.C. 369 (P.C.) — *followed*

Companies' Creditors Arrangement Act, Re; A.G. Can. v. A.G. Que., [1934] S.C.R. 659, [1934] 4 D.L.R. 75 — *referred to*

Dairy Corp. of Can. Ltd., Re, [1934] O.R. 436, [1934] 3 D.L.R. 347 — *referred to*

Meridian Dev. Inc. v. T.D. Bank; Meridian Dev. Inc. v. Nu-West Ltd., [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 52 C.B.R. (N.S.) 109, 53 A.R. 39 (Q.B.) — *referred to*

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) — *followed*

Snider Bros., Re, 18 B.R. 320 (U.S. Bankruptcy Ct., D. Mass., 1982) — *followed*

Sovereign Life Assur. Co. v. Dodd, [1892] 2 Q.B.D. 573 (C.A.) — *referred to*

Wellington Bldg. Corp., Re, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626 — *referred to*

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36]

s. 20

Company Act, R.S.B.C. 1979, c. 59

ss. 276-278

Appeal from order of Trainor J. approving reorganization plan filed under Companies' Creditors Arrangement Act.

McEachern C.J.B.C. **(Excerpt from the transcript):**

1 We are giving an oral judgment this morning because of the commercial urgency of these appeals and because counsel's helpful arguments have narrowed the issues substantially. We are indebted to counsel for their useful submissions.

2 The petitioners (respondents on these appeals) are a number of companies (which I shall call "the companies") who have outstanding issues of secured bonds and are all engaged in real estate investment and development in Western North America and who collectively own and operate a number of office buildings and the Sandman Inn chain of hotels and motels. The appellants, Excelsior Life and National Life and Guardian Trust, are creditors of the petitioners who hold mortgages over specific properties owned by certain of the companies. They, along with eleven other lenders, are called "priority mortgagees".

3 The companies ran into financial problems starting in 1981 and by spring of 1988, the companies owed approximately $200 million against assets of $100 million. The major creditor, the Bank of Montreal (which I shall sometimes call "the bank"), was owed approximately $117 million by the companies and the bank authorized the commencement of a receivership action. The bank holds security in all of the assets of the companies by way of trust deeds and bonds ranking second in priority to the security held by the priority mortgagees. Before decision in the receivership proceedings, the companies petitioned under the Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36] (which I shall sometimes refer to as "C.C.A.A.") for an order directing meetings of the secured and unsecured creditors to consider a proposed compromise or arrange-

ment plan.

4 Mr. Justice Trainor, on 7th April 1988, granted the petition authorizing the companies to file a reorganization plan with the court, and that in the meantime, the companies would continue to carry on business and remain in possession of their undertaking, property and assets. Further, all proceedings against the companies were stayed. The original reorganization plan was filed on 25th August 1988. It provided that each priority mortgagee holding security over the property of the individual petitioners would constitute a separate class.

5 The petitioners obtained an order to hold a creditors' meeting on 31st October 1988 and 1st November 1988. The order provided that in addition to meetings of individual classes of creditors, there should be a later general meeting of all creditors to consider the plan. In addition, the petitioners obtained an order to file and serve the amended plan seven days before the creditors' meeting along with their information circular. Other applications were brought which dealt with notices, proxies, proof of claim forms, exchange rates and directions for the calling of meetings.

6 The amended plan was based on the following classes of creditors (descriptions of which are contained in the reasons for judgment of Trainor J. at pp. 6-7) namely:

7 — shareholder creditors

8 — A bondholders

9 — PUT debt claimants and C bondholders

10 — priority mortgagees

11 — government creditors

12 — property tax creditors

13 — general creditors

14 The amended plan also proposed consolidation of all the petitioner companies. The amended plan provided that all priority mortgagees would be grouped into one class for voting purposes. There were fifteen priority mortgagees in total, eleven of which were fully secured while the remaining four (including the appellants) faced deficiencies. The amended plan also authorized the companies to negotiate with creditors in order, if possible, to reach as much agreement as possible so that the plan would have a better chance of gaining the requisite majorities.

15 The companies and the Bank of Montreal reached a settlement agreement on 20th October 1988, dealing with (a) the amounts owing to the bank by the companies; (b) claims by the companies and others against the bank in relation to a lender liability lawsuit; and (c) the terms of a compromise between the bank and the companies. The Bank of Montreal, according to the information circular, would only realize $32,859,005 upon liquidation. The settlement agreement between the Bank of Montreal and the companies, which is incorporated as part of the plan, provides that as of 17th January 1989, the bank is to receive the sum of $41,650,000 in either cash or in cash plus properties. A copy of this agreement was provided to creditors, along with such other documents including a notice of the meetings, the reorganization plan, and an extensive information circular.

16 The class meetings and the general meetings of creditors were held in Vancouver on 31st October and 1st November 1988. All classes of creditors voted unanimously in favour of the plan except the priority mortgagee class. This class approved the plan by the requisite majority pursuant to the provisions of the C.C.A.A., that is, a simple majority of creditors in the class holding at least 75 per cent of the debt voting in favour of the plan. 73.3 per cent of the priority mortgagees holding 78.35 per cent of the debt voted in favour of the plan.

17 Relax Development Corporation Ltd., a priority mortgagee facing a deficiency, voted in favour of the plan. If Relax had not voted in favour of the plan, the companies would not have obtained the requisite majority from the priority mortgagee class. Prior to the settlement with the bank, Relax struck an agreement with the companies on the value of its security amounting to about $900,000 over an appraisal value which was in dispute. Relax agreed in the settlement to vote in favour of the plan. More about that later.

18 The appellants on these appeals voted against the plan, and raised objections that the plan improperly put all priority mortgagees into one class, and also that the plan preferred some creditors over others. They allege that the net effect of the plan on the fully secured priority mortgagees is different than that on the mortgagees facing deficiencies, in that the plan reduces the amount of debt owed to the mortgagees facing deficiencies to the market value of the subject property of their respective security, and required assignment of the deficiency for $1. They lose the right to obtain an order absolute of foreclosure pursuant to their security. On the other hand, the fully secured priority mortgagees recover the entire amount of their indebtedness.

19 The appellants Excelsior and National are secured creditors of the petitioner, Northland Properties Ltd., one of the companies. They hold a first mortgage jointly over an office tower in Calgary adjacent to the Calgary Sandman Inn. Both buildings share common facilities. The principle amount of the debt owing to Excelsior and National as of 26th October 1988, is $15,874,533 plus interest of $311,901. The market value of the office tower as of 13th May 1988 was stated to be $11,675,000. They, therefore, face a potential deficiency of $4,512,434.

20 Guardian Trust is a secured creditor of the petitioner, Unity Investment Company Limited, and holds a first mortgage over a small office building in Nelson, British Columbia. The amount owing to Guardian is $409,198.46 and the estimated deficiency is approximately $150,000 exclusive of transaction costs.

21 Mr. Justice Trainor, on 12th December 1988, found that the companies had complied with the provisions of the C.C.A.A., and, therefore, the court could exercise its discretion and sanction the reorganization plan. Excelsior and National and Guardian appeal against that decision.

22 Mr. Justice Trainor had the carriage of this matter almost from the beginning and he heard several preliminary applications. In a careful and thorough judgment, he set out the facts distinctly, reviewed the authorities and approved the plan. I do not propose to review the authorities again because they are extensively quoted in nearly every judgment on this subject. It will be sufficient to say that they include *Re Companies' Creditors Arrangement Act; A.G. of Can. v. A.G. Que.*, [1934] S.C.R. 659, [1934] 4 D.L.R. 75; *Meridian Dev. Inc. v. T.D. Bank; Meridian Dev. Inc. v. Nu-West Ltd.*, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 52 C.B.R. (N.S.) 109, 53 A.R. 39 (Q.B.); *Re Associated Investors of Can. Ltd.*, [1988] 2 W.W.R. 211, 56 Alta. L.R. (2d) 259, 67 C.B.R. (N.S.) 237, 38 B.L.R. 148, (sub nom. *Re First Investors Corp. Ltd.)* 46 D.L.R. (4th) 669 (Q.B.) ; *Re Alabama, New Orleans, Texas & Pac. Junction Ry. Co.*, [1891] 1 Ch. 231 (C.A.); *Re Dairy Corp. of Can. Ltd.*, [1934] O.R. 436, [1934] 3 D.L.R. 347; *Re Wellington Bldg. Corp.*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626; *Br. Amer. Nickel Corp. v. O'Brien Ltd.*, [1927] A.C. 369 (P.C.); *Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B.D. 573 (C.A.), and others.

23 The authorities do not permit any doubt about the principles to be applied in a case such as this. They are set out over and over again in many decided cases and may be summarized as follows:

24 (1) There must be strict compliance with all statutory requirements (it was not suggested in this case that the statutory requirements had not been satisfied);

25 (2) All material filed and procedures carried out must be examined to determine if anything has been done which is not authorized by the C.C.A.A.;

26 (3) The plan must be fair and reasonable.

27 Similarly, there can be no doubt about the purpose of the C.C.A.A. It is to enable compromises to be made for the common benefit of the creditors and of the company, particularly to keep a company in financial difficulties alive and out of the hands of liquidators. To make the Act workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable.

28 There were really four issues argued on this appeal but, as is so often the case, there is some overlapping. I shall attempt to deal with them individually.

29 First it was alleged, principally by Mr. Czepil, that the Act does not authorize a plan whereby the creditors of other companies can vote on the question of whether the creditors of another company may compromise his claim. He called this the cross-company issue.

30 This argument arises out of the particular facts that Mr. Czepil's client found itself in where it had a first mortgage, that is, Guardian had a first mortgage on a building owned by Unity which was the only asset of Unity, and he says the C.C.A.A. does not permit creditors of other companies to vote on the disposition of Guardian's security. I think there would be considerable merit in this submission except for the fact that the plan contemplates the consolidation of all the petitioner companies and the applications are made in this case not just under the C.C.A.A., but also under ss. 276-78 of the British Columbia Company Act, R.S.B.C. 1979, c. 59. In this respect, it is necessary to mention s. 20 of the C.C.A.A. which provides:

> 31 20. The provisions of this Act may be applied conjointly with the provisions of any Act of Canada or of any province, authorizing or making provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

32 During the argument of these appeals, we were treated to a review of the history of this matter in the court below. In reasons for judgment dated 5th July 1988 [now reported *Re Northland Properties Ltd.* (1988), 29 B.C.L.R. (2d) 257, 69 C.B.R. (N.S.) 266], Mr. Justice Trainor recited that he had been asked by some of the parties to approve a consolidation plan, but he declined to do so as the plan was not then before him in final form. It is implicit that Trainor J. thought he had authority to approve a consolidation plan and he referred to American authorities particularly, Re Northland Properties Ltd. [B.C.] Trainor J. 219 *Re Baker & Getty Fin. Services Inc.*, 78 B.R. 139 (U.S. Bankruptcy Ct., N.D. Ohio, 1987), and in *Re Snider Bros.*, 18 B.R. 320 (U.S. Bankruptcy Ct., D. Mass., 1982), and he said that he accepted the analysis of *Snider*, which proposes the test between economic prejudice of continued debtor separateness versus the economic prejudice of consolidation, and holds that consolidation is preferable if its economic prejudice is less than separateness prejudice.

33 I think Mr. Justice Trainor was right for the reasons described in the American authorities and because to hold otherwise would be to deny much meaning to s. 20 of the C.C.A.A. and would mean that when a group of companies operated conjointly, as these companies did (all were liable on the Bank of Montreal bonds), it would be necessary to propose separate plans for each company and those plans might become fragmented seriously.

34 I am satisfied there is jurisdiction to entertain a consolidation proposal.

35 Secondly, it was agreed that the composition of the class of priority creditors was unfair by reason of including all priority mortgagees without regard to the fact that some of them faced a deficiency and some did not. The appellants were each in the latter difficulty and they argue that they should have been placed in a different class because the other 11 priority mortgagees were going to get paid in full whether the plan was approved or not. This argument would have more merit if the plan were only for the benefit of the undersecured priority mortgagee. But the plan was also for the benefit of the company and the other creditors who, by their votes, indicted that they thought the plan was in their best interest. The learned chambers judge considered this question carefully. At p. 25 of his reasons he said this:

> 36 An examination of the relationship between the companies and the priority mortgagees satisfies me that they are properly in the same class. The points of similarity are:
>
> 37 1. The nature of the debt is the same, that is, money advanced as a loan.
>
> 38 2. It is a corporate loan by a sophisticated lender who is in the business and aware of the gains and risks possible.
>
> 39 3. The nature of the security is that it is a first mortgage.
>
> 40 4. The remedies are the same — foreclosure proceedings, receivership.
>
> 41 5. The result of no reorganization plan would be that the lender would achieve no more than the value of the property, less the costs of carrying until disposal, plus the legal costs as well would come out of that. A possible exception would be if an order absolute left the creditor in the position of holding property for a hoped-for appreciation in value.
>
> 42 6. Treatment of creditors is the same. The term varied to five years, the interest rates 12 per cent or less, and the amount varied to what they would get on a receivership with no loss for costs; that is, it would be somewhat equivalent to the same treatment afforded to the Bank of Montreal under the settlement agreement.
>
> 43 The points of dissimilarity are that they are separate priorities and that there are deficiencies in value of security for the loan, which vary accordingly for particular priority mortgagees. Specifically with respect to Guardian and Excelsior, they are both in a deficiency position.
>
> 44 Now, either of the reasons for points of dissimilarity, if effect was given to them, could result in fragmentation to the extent that a plan would be a realistic impossibility. The distinction which is sought is based on property values, not on contractual rights or legal interests.

45 I agree with that, but I wish to add that in any complicated plan under this Act, there will often be some

secured creditors who appear to be oversecured, some who do not know if they are fully secured or not, and some who appear not to be fully secured. This is a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both.

46 I adopt, with respect, the reasoning of Forsyth J. of the Court of Queen's Bench of Alberta, in a recent unreported decision in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, No. 8801-14453, 17th November 1988 [now reported 63 Alta. L.R. (2d) 361, 92 A.R. 81], particularly at pp. 13 and 14 [pp. 369-70]. I am unable to accede to this ground of appeal.

47 Thirdly, I pause to mention that it was not suggested that the arrangement with the Bank of Montreal constituted a preference. It was argued, however, that the entire plan was tainted by the agreement made by the companies with Relax. Apparently, there was an appraisal showing a value of its security at $3.7 million while other evidence suggests a value of between $4.5 million to $4.6 million. The amount owing to Relax on its mortgage was $6 million.

48 Early in the history of this matter before the plan was finalized, and before the companies struck their crucial arrangement with the Bank of Montreal, the companies and Relax agreed to a future cash payment of $500,000 and a valuation of $4 million for the Relax property which could, in total, amount to a preference of up to $900,000 to Relax and that company, in consideration of that compromise, agreed to vote for the plan.

49 It should be mentioned that the plan, from its inception, ensured to the priority mortgagees the full market value of their security to be determined either by agreement, appraisal, or, if necessary, arbitration. Thus, the appellants do not stand to lose anything by the agreement made with Relax. It is the bank which carried the burden of that expense.

50 There is no doubt that side deals are a dangerous game and any arrangement made with just one creditor endangers the appearance of the bona fides of a plan of this kind and any debtor who undertakes such a burden does so at considerable risk. In this case, however, it is apparent that this agreement was not made for the purpose of ensuring a favourable vote because at the time the deal was struck the companies had not reached an accommodation arrangement with the bank. I think the companies were negotiating, as businessmen do, on values for the purpose of putting a plan together.

51 Further the arrangement with Relax was fully disclosed in the plan. This does not ensure its full absolution if it was improper, but at least it removes any coloration of an underhanded or secret deal. In fact, there were also negotiations between the companies and the appellants but nothing came of those discussions.

52 After referring to the fact that the plan anticipated and permitted negotiations about values and other matters, the learned chambers judge said this at pp. 28 and 29 of his reasons:

> 53 The negotiations might, on the surface, appear to have been in the nature of an excessive payment to Relax for the consideration in their agreement, which agreement, incidentally, included an undertaking to vote in favour of the plan. But the answer given by the companies is that what in effect was happening at that meeting was a negotiation as to the agreed price and that this negotiation took place earlier rather than later and that the parties in fact came to an accord with respect to the agreed price and that the settlement between them was on that basis.

54 If that is so, it is something which took place in accordance with what is proposed by the reorganization plan. I have reviewed and reread a number of times the submissions by the companies and particularly by counsel on behalf of Guardian and Excelsior. I am satisfied that I should accept the explanation as to what took place, which has been advanced on behalf of the companies.

55 In the circumstances of this case, I would not disagree with the learned chambers judge in that connec- tion.

56 Lastly, it remains to be considered whether the plan is fair and reasonable. I wish to refer to three mat- ters.

57 First, the authorities warn us against second-guessing businessmen (see *Re Alabama*, supra, at p. 244). In this case, the companies and their advisors, the bank and its advisors, and all the creditors except the two appellants, voted for the plan. As the authorities say, we should not be astute in finding technical arguments to overcome the decision of such a majority.

58 Secondly, I wish to mention Mr. Czepil's argument that the plan was unfair, perhaps not conceptually, but operationally by authorizing negotiations. He says this put the parties in a difficult position when it came to vote because they risked retribution if they failed to reach agreement and then voted against the plan. He complains that some benefits offered in negotiations are no longer available to his clients.

59 With respect, negotiations between businessmen are much to be desired and I would not wish to say anything that would impede that salutory process. If negotiations lead to unfairness, then other considerations, of course, arise. But that, in my view, is not this case.

60 Thirdly, the plan assures all the priority mortgagees the full market value of their security without liquidation expenses. That is more than they could expect to receive if there had been no plan.

61 What they gave up is the right to take the property by order absolute or to seek a judicial sale and pursue the borrower for the deficiency. Guardian was actually offered its security but declined to accept it. The difficulty about this whole matter is the uncollectability of the deficiency having regard to the overwhelming debt owed to the bank which would practically eliminate any real chance of recovery of the deficiency.

62 In my view, the obvious benefits of settling rights and keeping the enterprise together as a going concern far outweigh the deprivation of the appellants' wholly illusory rights. In this connection, the learned chambers judge said at p. 29:

63 I turn to the question of the right to hold the property after an order absolute and whether or not this is a denial of something of that significance that it should affect these proceedings. There is in the material before me some evidence of values. There are the principles to which I have referred, as well as to the rights of majorities and the rights of minorities.

64 Certainly, those minority rights are there, but it would seem to me that in view of the overall plan, in view of the speculative nature of holding property in the light of appraisals which have been given as to value, that this right is something which should be subsumed to the benefit of the majority.

65 I agree with that.

66 I also agree with the learned chambers judge that the plan should have been approved and I would dismiss these appeals accordingly.

Esson J.A.:

67 I agree.

Wallace J.A.:

68 I agree.

McEachern J.A.:

69 The appeals are dismissed with costs.

Appeal dismissed.

END OF DOCUMENT

TAB 5

1991 CarswellNS 35, 11 C.B.R. (3d) 43, (sub nom. Fairview Industries Ltd., Re (No. 2)) 109 N.S.R. (2d) 12, 297 A.P.R. 12

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1991 CarswellNS 35, 11 C.B.R. (3d) 43, (sub nom. Fairview Industries Ltd., Re (No. 2)) 109 N.S.R. (2d) 12, 297 A.P.R. 12

Fairview Industries Ltd., Re

Re Application of FAIRVIEW INDUSTRIES LIMITED, F.I.L. HOLDINGS LIMITED, SHELBURNE MARINE LIMITED, VGM CAPITAL CORPORATION, 683297 ONTARIO INC., and CANEAST CAPITAL LIMITED

Nova Scotia Supreme Court (Trial Division)

Glube C.J.T.D. [in Chambers]

Heard: October 8, 10 and 24, 1991
Judgment: November 6, 1991
Docket: Doc. S.H. 78982/91

Counsel: *David S. Farrar*, for Nova Scotia Business Capital Corporation.

John D. Stringer and *B. Miller*, for Bank of Nova Scotia and Royal Bank of Canada.

Gerald R.P. Moir, for RoyNat Inc.

R.G. MacKeigan, Q.C., for Central Capital Corporation.

Dara Gordon, Janet Stairs and *D. Tupper*, for Fairview Industries Limited et al.

Carl Holm, Q.C., for monitor, Coopers & Lybrand Limited.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Approval by Court.

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Jurisdiction of court — Application to court with plan of arrangement — Payments to officers and monitor — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

An ex parte application was made with respect to six companies pursuant to the *Companies' Creditors Arrange-*

ment Act (the "CCAA"). Each of the corporations was insolvent as they were unable to meet their financial obligations as they became due. The companies were found to be debtor companies within the CCAA. The applicants were secured creditors who sought to have a previous order rescinded based on several issues that they raised. The six companies believed that the original order should be maintained as initially granted.

Held:

The previous order was varied.

The court first determined that it had the jurisdiction to vary a previous order, pursuant to the CCAA. A plan of compromise or arrangement is not a prerequisite to obtaining an initial order under the CCAA, although a trust deed is a prerequisite for making an application to the court. In this case, the wording of the application amounted to an interim plan in that it set out how the company would operate for a limited time. To require a finished plan or one which sets out the restructuring or final proposal would defeat the intent of the legislation. A discussion of the plan prior to making the application would precipitate the action the CCAA is out to delay. However, the court should be provided with as much information as is available concerning the proposed plan at the time of the initial application. The applicant would not be bound; however, the information provided would help the court make the decision as to whether the application should be granted.

While the court has the power to appoint a monitor, there is no jurisdiction in the CCAA to give the monitor priority of payment unless the parties agree. The same applies to professional assistance to be rendered to the companies. Although professionals must be paid, payment to them in priority to the creditors could result in the deterioration of the value of the security held by the creditors. Therefore, the court should approve any payments to the monitor for fees and expenses incurred and that sum should be paid out of the proceeds of carrying on the business of the corporation. With respect to payment to principals of the corporations who assist in the operations of the companies, the court should fix some reasonable amount as payment. This payment would be presented to the court by the monitor.

Cases considered:

Braeside Farms Ltd. v. Nova Scotia (Farm Loan Board) (1973), 5 N.S.R. (2d) 685, 42 D.L.R. (3d) 480 (C.A.) — *referred to*

Canadian Imperial Bank of Commerce v. Quintette Coal Ltd. (1991), 1 C.B.R. (3d) 253, 53 B.C.L.R. (2d) 34 (S.C.) — *referred to*

Diemaster Tool Inc. v. Skvortsoff (Trustee of) (1991), 3 C.B.R. (3d) 133 (Ont. Gen. Div.) — *referred to*

Dominion Chair (1985) Ltd., Re (June 26, 1991), Doc. S.H. 78067/91, Nathanson J. (N.S. T.D.) — *referred to*

First Treasury Financial Inc. v. Cango Petroleums Inc. (1991), 3 C.B.R. (3d) 232, 78 D.L.R. (4th) 585 (Ont. Gen. Div.) — *referred to*

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) — *referred to*

Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (1989), 102 A.R. 161 (Q.B.) — *referred to*

Keddy Motor Inns Ltd., Re (sub nom. *Re Keddy Motor Inns Ltd. (No.2)*) (1991), 107 N.S.R. (2d) 419, 290 A.P.R. 419 (T.D.) — *referred to*

Keppoch Development Ltd., Re (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) — *referred to*

Norm's Hauling Ltd., Re, 6 C.B.R. (3d) 16, [1991] 3 W.W.R. 23, (sub nom. *Norm's Hauling Ltd. v. Canadian Imperial Bannk of Commerce)* 91 Sask. R. 210 (Q.B.) — *referred to*

Northland Properties Ltd., Re (1988), 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146 (S.C.) — *referred to*

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1 O.R. (3d) 289 — *referred to*

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.) — *referred to*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) [affirmed (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.), leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 b.C.L.R. (2d) xxxii (note)] — *referred to*

R. v. Kussner, 18 C.B.R. 58, [1936] Ex. C.R. 206, [1936] 4 D.L.R. 752 — *referred to*

Royal Bank v. Perfection Foods Ltd. (1991), 90 Nfld. & P.E.I.R. 302, 280 A.P.R. 302 (P.E.I.T.D.) — *referred to*

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C.S.C.) — *referred to*

Sydney Steel Corp. v. Al E. & C. Ltd. (1983), 33 zC.P.C. 249, 58 N.S.R. (2d) 369, 123 A.P.R. 369, 148 D.L.R. (3d) 348 (C.A.) — *considered*

Tamlin v. Hannaford, [1949] 2 All E.R. 297, [1950] 1 K.B. 18 (C.A.) — *referred to*

Ultracare Management Inc. v. Zevenberger (Trustee of) (1990), 3 C.B.R. (3d) 151, (sub nom. *Ultracare Management Inc. v. Gammon)* 1 O.R. (3d) 321 (gen. Div. — *referred to*

United Maritime Fishermen Co-operative, Re (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.) [varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), reversed (1988), 69 C.B.R. (N.S.) 161, 88 N.B.R. (2d) 253, 224 A.P.R. 253, (sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.)* 51 D.L.R. (4th) 618 (C.A.)] — *referred to*

Westeel-Rosco Ltd. v. South Saskatchewan Hospital Centre, [1977] 2 S.C.R. 238, [1976] 5 W.W.R. 688, 11 N.R. 514, 69 D.L.R. (3d) 334 — *referred to*

Statutes considered:

Agriculture and Rural Credit Act, R.S.N.S. 1989, c.7 —

s. 3

s. 4

s. 9

Business Capital Corporation Act, R.S.N.S. 1989, c.49 —

s. 3

s. 4

s. 5

s. 6

s. 7

s. 8

s. 9

s. 10

s. 11(1)

s. 11(2) [Not yet proclaimed in force]

s. 12

s. 13

s. 13(1)(a)

s. 13(1)(b)

s. 13(1)(c)

s. 13(2)

s. 14

s. 16

s. 17

s. 18

s. 19

s. 20

s. 21

s. 22 [Not yet proclaimed in force]

s. 23

s. 24 [Not yet proclaimed in force]

Business Corporations Act, 1982, S.O. 1982, c. 4 [now R.S.O. 1990, c. B. 16].

Canada Corporations Act, R.S.C. 1952, c. 53.

Companies Act, R.S.N.S. 1967, c.42 [now Companies Act, R.S.N.S. 1989, c. 81].

Companies Act, R.S.N.S. 1989, c. 81.

Companies' Creditors Arrangement Act, 1933, The, S.C. 1932-33, c. 36 [am. S.C. 1952-53, c.3].

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 —

s. 2

s. 3

s. 3(a)

s. 3(b)

s. 4

s. 5

s. 9

s. 11

Corporations Securities Registration Act, R.S.N.S. 1989, c. 102.

Industrial Estates Limited Act, R.S.N.S. 1989, c. 223.

Interpretation Act, R.S.C. 1927, c. 1.

Interpretation Act, R.S.C. 1985, c. I-21 —

s. 17

s. 33(2)

Proceedings against the Crown Act, R.S.N.S. 1989, c. 360.

Regulations Act, R.S.N.S. 1989, c. 393.

Sydney Steel Corporation Act, R.S.N.S. 1989, c. 456.

Rules considered:

Nova Scotia, Civil Procedure Rules.

Regulations considered:

Business Capital Corporation Act, S.N.S. 1986, c. 4 — Financial Assistance Regulations,

N.S. Reg. 58/88,

s. 6

s. 7

Application under *Companies' Creditors Arrangement Act.*

Glube C.J.T.D.:

1 On September 6, 1991, an ex parte application was heard on behalf of six companies requesting an order pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "C.C.A.A."). The companies are Fairview Industries Limited ("Fairview"), F.I.L. Holdings Limited ("F.I.L."), Shelburne Marine Limited ("Shelburne"), VGM Capital Corporation ("VGM"), 683297 Ontario Inc. ("683297") and CanEast Capital Limited ("CanEast") (collectively referred to as "the six companies"). Each of the companies carry on business and have their head office in the province of Nova Scotia.

2 Fairview was incorporated on March 22, 1974, pursuant to the Nova Scotia *Companies Act*, R.S.N.S. 1989, c. 81. It is in the business of metal fabrication and ship repair with a work force which fluctuates from 30 to 55 employees.

3 F.I.L. was incorporated on September 1, 1988, pursuant to the *Companies Act* [R.S.N.S. 1967, c. 42]. It is a private holding company whose sole asset is 100 per cent of the issued and outstanding common shares of Fairview.

4 Shelburne was incorporated on June 17, 1975, pursuant to the *Companies Act* [R.S.N.S. 1967, c. 42]. It is in the business of ship repair and employs a work force fluctuating from 40 to 70 employees.

5 On February 8, 1966, a company called Vestgron Mines Limited was incorporated under the provisions of the *Canada Corporations Act*, R.S.C. 1952, c. 53 by letters patent. The company name was changed to VGM Capital Corporation on April 1, 1987. VGM is a publicly traded company listed on the Toronto Stock Exchange. It owns 100 per cent of the shares of Shelburne and 100 per cent of the shares of F.I.L. (F.I.L. owns 100 per cent of Fairview.) VGM's operations are carried on through its subsidiaries, Fairview and Shelburne. VGM provides management and administrative services to its subsidiaries.

6 683297 was incorporated pursuant to the Ontario *Business Corporations Act, 1982*, S.O. 1982, c. 4. It is a private holding company whose sole asset is the ownership of approximately 53 per cent of the issued and out-

standing common shares of VGM.

7 CanEast was incorporated on April 8, 1981, pursuant to the *Companies Act* [R.S.N.S. 1967, c. 42]. CanEast owns 100 per cent of 683297.

8 Finally, in this chain of companies, Brian Flemming owns 100 per cent of CanEast. Mr. Flemming filed an affidavit on behalf of the applicants. He is the chairman and secretary of both Fairview and F.I.L.; the chairman, president and secretary of Shelburne; the chairman and chief executive officer of VGM; and the president of both 683297 and CanEast.

9 CanEast and 683297 have an outstanding loan of approximately $970,000 due to Central Capital Corporation ("Central Capital"). VGM has an outstanding loan of approximately $2,600,000 due to Central Capital.

10 Fairview has an operating line of credit of $500,000 with the Bank of Nova Scotia ("BNS"), an outstanding loan of approximately $250,000 due to RoyNat Inc. ("RoyNat") and a loan of approximately $240,000 due to Royal Trust. The BNS loan provides that the line of credit shall not exceed 75 per cent of good quality accounts receivable.

11 Shelburne has an operating line of credit of $581,000 with the Royal Bank of Canada ("RBC") and has an outstanding loan of approximately $555,000 due to the Nova Scotia Business Capital Corporation ("N.S.B.C.C."). The RBC loan provides that the line of credit shall not exceed 85 per cent of government and 75 per cent of non-government good trade accounts receivable not exceeding 90 days, 75 per cent of unbilled revenues under 30 days and 50 per cent of inventory to a maximum lending value of $250,000.

12 Fairview's line of credit with the BNS and Shelburne's line of credit with the RBC are both in default of certain covenants. All of the other loans of Fairview and Shelburne are in arrears as to principal and interest. By a letter dated September 3, 1991, the BNS demanded payment in full of its loan to Fairview in the amount of $491,515 by September 17, 1991; by a letter dated August 2, 1991, the RBC demanded payment in full of its loan to Shelburne in the amount of $719,570.89 by August 31, 1991; and by letter dated September 6, 1991, the N.S.B.C.C. demanded payment in full of its loan to Shelburne in the amount of $555,358.72 by October 18, 1991. Neither Fairview nor Shelburne can meet these demands. As of July 31, 1991, Shelburne's current liabilities exceeded its current assets by $228,532 and Fairview's current liabilities exceeded its current assets by $316,181.

13 Both of the Central Capital loans to VGM and CanEast are in default and the forbearance agreements of both have expired. Central Capital is entitled to make a demand at any time. If a demand is made, neither VGM nor CanEast could respond.

14 In the opinion of Mr. Flemming, and Marcus Wide, a chartered accountant and partner in the firm of Coopers & Lybrand Limited ("Coopers & Lybrand"), each of the corporations is insolvent as they are unable to meet their financial obligations as they fall due. Mr. Wide reached this conclusion after reviewing various financial statements as well as discussing matters with Ross Drake, the corporate secretary/corporate controller for VGM and its associated companies.

15 I find that these six companies are debtor companies within the meaning of s. 2 of the C.C.A.A.

16 In para. 20 of his affidavit sworn on September 16, 1991, Mr. Flemming states:

> THAT Fairview and Shelburne are the main operating businesses in VGM Corporate Group and the lenders for the VGM Corporate Group have relied upon the cash flow from these operating businesses to service not only the loans of Fairview and Shelburne but also the loans of VGM and CanEast.

17 Mr. Flemming then describes how the various loans are secured, showing the intertwinings of the operations of the companies. The most complex example is set out in para. 22 of Mr. Flemming's affidavit, as follows:

> THAT the VGM-Central Loan in the approximate principal amount of $2,600,000 is secured, inter alia, by a pledge of all of the common shares of Shelburne beneficially owned by VGM, by a pledge of all of the common shares of Fairview beneficially and indirectly owned by VGM, by a debenture containing a first fixed and floating charge over all the assets of VGM, by the corporate guarantee of Fairview limited to $3,000,000, by the corporate guarantee of CanEast secured by a debenture containing a floating charge over the assets of CanEast, by the corporate guarantee of 683297 secured by a pledge of all of the common shares of VGM beneficially owned by 683297 and by the assignment of a loan due by Shelburne to Halco earlier acquired by VGM from Shelburne ('Halco-Shelburne Loan').

18 Although Shelburne and Fairview have been and are expected to continue generating income, the income generated is not sufficient to service all the loans in the VGM corporate group, which total approximately $7,433,000.

19 As solicitor for each of the six companies, Janice A. Stairs filed an affidavit setting out that on September 16, 1991, each of the six companies issued trust debentures in favour of the trustee for the benefit of unsecured debenture holders, and on the same day, the trust indentures were filed with the registrar of joint stock companies at Halifax pursuant to the provisions of the *Corporations Securities Registration Act*, R.S.N.S. 1989, c. 102. Also, "two debentures were issued in consideration of the payment of $50.00 each by the debenture holders pursuant to each of the Trust Indentures on September 16, 1991", by each of the six companies.

20 At the initial ex parte application, the six companies expressed concern that if they were required to give notice of the application, that would give a secured creditor the opportunity to appoint a receiver, which could prevent the applicant from qualifying under the C.C.A.A. (see *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101, *(*sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1 O.R. (3d) 289 [hereinafter *Elan*]. After hearing the applicant, the order which is now in dispute was granted without any oral or written decision but on the basis that the court had jurisdiction under ss. 2 and 9 of the C.C.A.A., and that the companies met the test as set out in s. 3, which states:

> This Act does not apply in respect of a debtor company unless
>
> (*a*) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and
>
> (*b*) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (*a*).

21 My conclusion that the test in s. 3 was met was based upon my understanding of cl. (*a*) and upon a num-

ber of cases dealing with trust deeds referred to during the submissions of counsel on September 16, 1991.

22 Of considerable concern to the court at the first hearing was the issue of consolidation; however, after hearing the submissions of counsel, I determined that these companies qualified for a consolidated order based in part on the interrelationship of their financial structure.

23 The order includes, among other clauses, the following:

24 — that the corporations submit the classes of creditors to the court for approval within 60 days;

25 — that a formal plan be filed within 120 days;

26 — that, if ordered, a vote be taken within 135 days;

27 — that there be a stay of any proceedings against the companies;

28 — that there be no right of set-off by any creditor of the corporations or by any bank or financial institu- tion;

29 — that the corporations continue to carry on business in the ordinary course;

30 — that the corporations be allowed to hire persons to prepare the plan to be paid in priority to all of the creditors of the corporations out of the proceeds of carrying on the business of the corporations or any one of them;

31 — that Coopers & Lybrand be appointed as monitor, to be paid in priority to all of the creditors of the corporation, with an obligation

— to audit and report monthly on the receipts and disbursements of the corporations,

— to report to the court any non-compliance with the terms of the order,

— to supervise the preparation and negotiation of the plan; and

— to appoint persons as necessary to carry out their duties.

Applications to amend the order were to be on 10 days' notice to the corporations.

32 Since this order was granted, several matters have been heard by the court, including the issue of whether the C.C.A.A. applies to an individual guarantor and the disposition of certain funds by the banks after the order was in place.

33 This decision arises out of applications by N.S.B.C.C., BNS, RBC and RoyNat to vary the original order. These applications, which were heard on October 8 and 10, 1991, raise a number of issues. In general, all of these applicants seek to have the September 16th order rescinded entirely. On the other side, the six companies, supported by Central Capital, believe that the order should be maintained as initially granted. A number of affidavits were filed in support of and against these several applications.

34 At the conclusion of these two days of hearing, the decision on all issues was reserved except for the fol-

lowing:

35 1. Paragraph 3 of the original order was amended to allow the companies to bring in one consolidated plan or six separate plans or a combination thereof;

36 2. Priority of payment to the monitor and inferentially to the corporation's solicitors contained in para. 18 was suspended as of October 10th; and

37 3. The monitors, who by consent had been reporting weekly to the BNS and the RBC, were ordered to revert to monthly reporting.

38 The following issues were raised by the several applicants:

39 1. Does the court have jurisdiction to vary its order of September 16, 1991?

40 2. Are the trust deeds valid? (s. 3(*a*) C.C.A.A.)

41 3. Is the filing of a plan or, at least, the presentation of evidence that to do so is impossible a prerequisite to jurisdiction in the first application? (s. 3(*b*) C.C.A.A.)

42 4. Is a consolidated order appropriate for the six companies?

43 5. Is a consolidated plan appropriate when there is no reasonable prospect that the plan will be accepted?

44 6. Should a custodian be appointed to supervise the operations of Fairview and Shelburne?

45 7. Is the provision to give priority to payment for the cost of the plan out of the operating capital of the companies valid?

46 8. Are the salaries being paid to two of the managers of the companies appropriate in the circumstances?

47 9. Should an amendment be made to the order

48 (a) to incorporate the terms of the BNS and RBC agreements as to operating credit, and

49 (b) to deal specifically with the proceeds of the accounts receivables of Shelburne and Fairview?

50 10. Is the N.S.B.C.C. a Crown corporation and thus exempt from the operation of the C.C.A.A.?

51 The court would add two other matters of concern, namely, the overall costs involved in this application and some of the time frames set out in the order. These will be dealt with under the appropriate issues or separately.

1. Does the court have jurisdiction to vary its order of September 16, 1991?

52 Throughout the original order there is an anticipation of further orders. In particular, paras. 20 and 21 state as follows:

> ... that liberty be reserved to any and all parties interested to apply to this Honourable Court for a further or other order.

and

> ... all applications to amend the terms of this Order shall be by way of application inter partes upon 10 days notice to the Corporations.

53 In addition, s. 11 of the C.C.A.A. provides the court with statutory jurisdiction. (See also *Re Keddy Motor Inns Ltd.*, unreported decision, S.H. 77974, August 30, 1991, Nathanson J. (N.S. T.D.) [now reported at 107 N.S.R. (2d) 419, 290 A.P.R. 49].)

54 I find that the court has jurisdiction to amend or rescind the order of September 16, 1991.

55 In my opinion, however, the requirement for 10 days' notice to the corporations to amend the order is too long. I see no reason why the notice period should exceed the normal four days' notice required by the *Civil Procedure Rules*.

2. Are the trust deeds valid?

56 In the 1930's, the C.C.A.A. [S.C. 1932-33, c. 36] applied to any company that was bankrupt or insolvent, but an amendment in 1953 limited the application of the C.C.A.A. to companies with outstanding issues of bonds or debentures issued under a trust deed. The explanation given at the time the legislation was introduced in the House of Commons was that it was the intention to restrict the application of the C.C.A.A. to companies with complex financial structures and those whose creditors were secured by a trust deed requiring a trustee to look after the interests of the creditors. ("Developments and Trends in Companies' Creditors Arrangement Act Restructuring", by Frank J.C. Newbould, Q.C. and Geoffrey B. Morawetz, June 4, 1991.)

57 The trust deeds in the present case were "instant trust deeds" issued solely to permit the debtors to qualify under the C.C.A.A. I find that there is no evidence that this application was made other than to advance a legitimate reorganization of the companies (*Elan*, supra).

58 After reviewing a number of cases I choose to follow those which permit the use of "instant trust deeds". I find that the trust indentures created on September 16, 1991 were not shams. I confirm that each of the six companies met the preliminary test contained in s. 3(*a*) of the C.C.A.A. (See *Elan*, supra; *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.); *Diemaster Tool Inc. v. Skvortsoff (Trustee of)* (1991), 3 C.B.R. (3d) 133 (Ont. Gen. Div.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (1990), 3 C.B.R. (3d) 151, (sub nom. *Ultracare Management Inc. v. Gammon)* 1 O.R. (3d) 321 (Gen. Div.); and *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.). Note is also taken of the decision in *Re Norm's Hauling Ltd.* (January 28, 1991), Doc. Q.B. J.C.S. 13/91 (Sask. Q.B.) [now reported at 6 C.B.R. (3d) 16, [1991] 3 W.W.R. 23, (sub nom. *Norm's Hauling Ltd. v. Canadian Imperial Bank of Commerce)* 91 Sask. R. 210], which rejected the use of an "instant trust deed".)

3. Is the filing of a plan or, at least, the presentation of evidence that to do so is impossible a prerequisite to jurisdiction in the first application?

59 Argument was presented that the court should interpret s. 3(*b*) and ss. 4 or 5 as speaking in the present and that because a trust deed is a prerequisite, a compromise or arrangement is also a prerequisite to obtaining an initial order. With deference, I cannot agree. A company needs time to come up with a plan and that is what can be granted in the initial order. Some companies may be able to come in with a plan initially, but it cannot be

an absolute requirement. Even if this is a correct position, in my opinion, the wording of much of the ex parte order (paras. 7 to 16 inclusive) amounts to an interim plan. Although it does not state how the six companies will deal with its past debts, it does set out how they will operate for a limited period of time, which could be categorized as an interim plan. To require a finished plan or one which sets out the restructuring or the final proposal would defeat the intent of the legislation.

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. ... When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

(*Hongkong Bank of Canada v. Chef Ready Foods Ltd* (1990), 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, [1991] 2 W.W.R. 136 (C.A.), at p. 140 [W.W.R.])

60 The issue of whether or not an arrangement must be in place at the time an application is made is discussed in *Bankruptcy Law of Canada*, by L.W. Houlden and C.J. Morawetz (3rd ed.), vol. 2 (Toronto: Carswell, 1989) (looseleaf), at p. 10A-13:

> Although the plan to be submitted to creditors is usually put before the court when the application is made under ss. 4 and 5, this may not always be possible. In some cases, the court may be asked to make a stay order while the terms of the plan are being worked out. If this procedure is followed, the court will fix a date by which the plan must be filed. This procedure is similar to a holding proposal under the *Bankruptcy Act: Fisher Oil & Gas Corp. and Peat Marwick Ltd. v. Guaranty Bank and Trust Co.* (1982), 44 C.B.R. (N.S.) 225, 40 O.R. (2d) 548, 142 D.L.R. (3d) 43 (C.A.); *Re Northland Properties Ltd.* (1988), 69 C.B.R. (N.S.) 266, 73 C.B.R. (N.S.) 146, 29 B.C.L.R. (2d) 257 (S.C.); *Re 229531 B.C. Ltd.* (1989), 72 C.B.R. (N.S) 310 (B.C. S.C.).
>
> Where the court grants a stay order while the terms of the plan are being worked out, it may appoint an interim receiver or some other person to control the affairs of the company during the interim. As an alternative to such an appointment, it may impose rigorous reporting requirements with respect to the affairs of the company: *Re Northland Properties Ltd., supra.*

61 Also, in the article "Arrangements Under The *Companies' Creditors Arrangement Act*", by D.H. Goldman, D.E. Baird, Q.C., and M.A. Weinczok (1991) 1 C.B.R. (3d) 135, it states at p. 156:

> In *United Co-Operatives of Ontario*, the stay of proceedings was imposed prior to the actual filing of an arrangement. In *Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (No. 2)* (1990), 102 A.R. 225 (Alta. Q.B.), three associated companies to whom protection was granted under the CCAA applied to extend the time by 14 days to file their plan under the Act. Marshall J. accepted that the three companies were making some progress toward the formulation of a successful plan and that matters would not be significantly different if the 14-day extension were granted. He noted that should the plan fail, unsecured creditors would be substantially affected and that, by providing the extension, the possibility remained that the plan might succeed for the benefit of all the creditors as well as the three applicant companies.

62 The following are some cases where it appears that no plan was filed at the time of the initial application are: *Ultracare Management*, supra; *Re Stephanie's Fashions Ltd.*, supra; and *Royal Bank v. Perfection Foods Ltd.*, [1991] P.E.I. J. No. 11 (GSC-10428) (unreported decision of MacDonald C.J.T.D.) [now reported at 90 Nfld. & P.E.I.R. 302, 280 A.P.R. 302 (P.E.I. T.D.)].

63 In Nova Scotia, recent initial orders have not required either a plan or a reason why a plan at the first stage is impossible. (See *Re Keppoch Development Ltd.* (S.H. No. 77901 June 14, 1991 unreported decision) (N.S. T.D.) [now reported at 8 C.B.R. (3d) 95]; *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.); *Keddy Motor Inns*, supra, and *Re Dominion Chair (1985) Ltd.*, Doc. S.H. 78067, order dated June 26, 1991.)

64 Thus, the status quo is maintained to allow the six companies time to find a plan to meet the demands of its creditors. To require that plan initially would mean, in some cases, that discussions with creditors would be required in advance of the first application which could well precipitate the action which the C.C.A.A. is intended to hold at bay for a period of time.

65 On the other hand, the court should be provided with as much information as is available concerning a proposed plan at the time of the initial application. It would not bind the applicant, but it would be one additional piece of information which might assist the court in reaching its decision as to whether or not the application should be granted. However, to present a plan just for the sake of a plan would also be meaningless and could possibly do more harm than good.

66 I recognize that without a specific plan, other than the original order, the creditors are left in considerable uncertainty; however, a plan or plans will be forthcoming in due course.

67 A serious general concern which I have is the length of time which the courts in Nova Scotia have been giving to a company to present a plan. There is no question that 120 days is a long period of time. Until the plan is presented, the initial order may place the bank which finances a company's operating loan in a precarious position. If the position of the operating company deteriorates dramatically during that period, this could seriously affect the bank's position. Although in most cases a monitor is in place, that will not necessarily prevent serious deterioration occurring. In my opinion, shorter time periods should be considered by the courts both for the application to approve the appropriate classes of creditors and for the presentation of the formal plan of compromise or arrangement. The court should be given reasons why longer periods are necessary and I suggest that on any new applications by companies under the C.C.A.A. that the length of time granted for any of the steps be given very careful consideration. Although several recent applications in Nova Scotia contain the same times as in the present case, there are a number of cases in other provinces which have much shorter time frames, which may be more appropriate.

68 Unfortunately, in this case, well over 30 days has been taken up with several court applications, this two-day hearing and the time necessary to render this decision. As a result, I do not propose to shorten any of the time frames in this case.

69 In conclusion on this point, I find that the requirement for a plan of compromise or arrangement is not a prerequisite to obtaining an initial order under the C.C.A.A.

4. Is a consolidated order appropriate for the six companies?

70 The case of *Re Northland Properties Ltd.* (1988), 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146 (S.C.) is noted in conjunction with the arguments on consolidation.

71 It is submitted that the companies are not so intertwined as to require a consolidated order. For example, RoyNat submits that Fairview should be separated out from the order because it has uncomplicated financing, namely, a mortgage on the building with Royal Trust, a mortgage on the equipment with RoyNat and the revolving line of credit with the BNS. Only BNS has any involvement with the other corporations. It has a guarantee from CanEast.

72 It is also argued that the C.C.A.A. speaks of "debtor company" and not "debtor companies" and thus consolidation is not specifically authorized. The answer to that argument is found in the *Interpretation Act*, R.S.C. 1985, c. I-21, which provides in s. 33(2) that "[w]ords in the singular include the plural ...".

73 I was referred to several cases where orders were granted which appear to deal with a group of companies applying concurrently and later applying for a consolidation or being consolidated from the beginning. In the case at bar, a consolidated order was requested and granted initially.

74 It does not appear to be disputed that the six companies under consideration could each have applied separately and qualified for an order under the C.C.A.A. (As a matter of interest, by dealing with them all in the one order, it would appear that a cost saving may have been effected.)

75 Although I have some doubts as to whether there should have been an order to consolidate Shelburne and Fairview with the other companies in light of the understanding I now have about the finances of those two companies, I do not have the same difficulty with the other four corporations.

76 In spite of these doubts, I find that the C.C.A.A. does allow for a consolidation of companies in the appropriate circumstances and that given the finances of these companies and the interlocking that does exist even in Fairview, that a consolidation order was appropriate initially. As the companies have stated, there is no prejudice being suffered by the consolidation at this stage; no intercorporate payments are being made and no fees are flowing to the parent companies. The time when difficulties might arise is with the proposal for classes of creditors or at the presentation of a plan. I make no ruling on whether consolidation is appropriate for these six companies. This leads to the next issue.

5. Is a consolidated plan appropriate when there is no prospect that the plan will be accepted?

77 It appears to be a universal concern, on the part of the applicants to vary the order, that one plan of compromise or arrangement for these six companies is inappropriate. The BNS and the RBC, as well as RoyNat, categorically state that they will oppose any plan on a consolidated basis; thus, there is no reasonable prospect of success.

78 As noted above, at the conclusion of the October hearing I ordered that the original order be amended to allow for more than one plan.

79 The six companies submit that the necessary analysis including proper tax information is not before the court; to decide now that there was no probable chance of acceptance would be premature (*Ultracare*, supra); that Shelburne and Fairview are not hopelessly insolvent; therefore, the efforts to achieve a plan should not be prejudiced. The argument was made that if a consolidated plan provided for the retirement of the loans from the

banks, then they would not have a vote. With due deference to that general argument, I am sure that if the companies can rearrange their financing so that the banks are paid out, that would be perfectly satisfactory to the banks. I propose to decide this issue on the basis that the BNS and the RBC will remain creditors.

80 I have no hesitation in accepting the line of cases which are concerned with the concept of requiring a reasonable probability of success in the meetings to be held to deal with any proposal. (See *Diemaster Tool*, supra, and *First Treasury Financial Inc. v. Cango Petroleums Inc.* (1991), 3 C.B.R. (3d) 232, 78 D.L.R. (4th) 585 (Ont. Gen. Div.)). In my opinion, it would seem to be totally impractical and extremely costly to continue to prepare a plan when there is no hope that it will be approved. If the two operating companies had separate plans, then it would be a matter of the several applicants considering those individual plans.

81 The order shall be amended to state that Shelburne and Fairview shall each file a separate compromise or arrangement. Whether this makes it practical for a plan to be presented involving the other four companies together, or separately, I leave to those companies to decide.

6. Should a custodian be appointed to supervise the operations of Fairview and Shelburne?

82 On behalf of the BNS and the RBC, it was submitted that a custodian be appointed for each of Fairview and Shelburne if they remain under the C.C.A.A. order. This would permit review of the financial and business affairs of the two companies by the creditors.

83 In my opinion, the appointment of a custodian would hamper the day-to-day operations of the companies. As I understand it, a custodian would take over the control of the assets of each of the companies. This was done in *NsC Diesel*, supra; however, that company had ceased operations and it was appropriate to have someone come in and take control to avoid dissipation or waste of the assets. This is not the situation with Fairview or Shelburne.

84 In my opinion, it would be a very costly process and the court has grave concerns about the legal and other costs which have already occurred in this case.

85 I find it is inappropriate to order a custodian for either Shelburne or Fairview. The existing management should be allowed to continue in operation without a custodian becoming involved.

7. Is the provision to give priority to payment for the cost of the plan out of the operating capital of the companies valid?

86 Clause 18 of the original order, in part, gives priority of payment over all creditors of the six companies to persons employed to prepare the plan, including the classification of creditors or shareholders, to negotiate with those groups and to make applications as necessary to the court. Payment is to be made out of the proceeds of carrying on the businesses of the corporations or any one of them. This priority of payment specifically includes the monitor and, by reference, also includes the solicitors for the six companies or any other person hired to assist the companies in preparing their plan. It puts the cost of preparing all necessary matters to accomplish what the six companies seek by way of accommodation or arrangements in priority to any of the creditors, secured or otherwise, without the assurance that the efforts will succeed.

87 Since the October hearing and my ruling that as of October 10th the priority of payment provided in para. 18 be suspended, I have received correspondence from counsel on behalf of the monitor, Coopers & Ly-

brand, which has been communicated to other counsel involved. Further submissions have been received.

88 I now perceive that there are two matters in issue under this topic.

89 (1) Priority of payment as set out in paragraph 18 of the original order, and

90 (2) the status of the court-appointed monitor and whether it should continue.

91 It was submitted that the amount of work involved in these applications, including the ongoing work of preparing a plan, is substantial and that without priority of payment the six companies could be left without professional assistance to pursue the stated ends of the C.C.A.A. Although this position may have some validity, an analysis of the legislation does not lead me to conclude that such an extension can be attached to the wording of the C.C.A.A. Although such advisors and professionals must be paid, payment in priority to all of the creditors could result in deterioration of the value of the security held by the creditors.

92 The article by Newbould and Morawetz, supra, expresses concern about super priority financing and states at p. 19:

> This super priority issue is critical. Cash is desperately required by debtors using the *CCAA* and if a trend develops whereby super priority orders become common, the scope for the *CCAA* greatly expands. However, it would be extremely surprising if this kind of order can be legally imposed on dissenting secured creditors. The *CCAA* does not contain the authority and in fact, this form of order goes contrary to the status quo arrangements that are supposed to be preserved during the interim period. Secured creditors will also object on the basis that orders of this type amount to a confiscation of security. If this is what Parliament intended, the governing legislation should be drafted accordingly.

93 Whether or not the authors intended to refer to super priority of payment of monitors and solicitors and the like is somewhat of a question mark in my mind; however, I have no hesitation in saying that there cannot be super priority for anyone, other than perhaps a court-appointed monitor, unless all parties agree.

94 On the first issue concerning para. 18 of the initial order, I conclude that the payment in priority to anyone other than the monitor was void ab initio.

95 As to the court-appointed monitor, it is with reluctance that I conclude that although the court has the power to appoint such a monitor, there is no jurisdiction in the C.C.A.A. to give the monitor priority of payment unless the parties agree.

96 The second issue is the status of the court-appointed monitor and whether it should continue.

97 As stated in the article by Goldman, Baird and Weinczok, supra, at pp. 200-201 with reference to the original order in the case of *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 47 B.C.L.R. (2d) 193, 2 C.B.R. (3d) 291 (S.C.):

> Appointment of a monitor with powers similar to those described above is consistent with the requirement that the interest of creditors and employees, as well as those of the debtor company, be considered to the greatest extent possible when a stay of proceedings is granted under the CCAA.

98 In the case of *Canadian Imperial Bank of Commerce v. Quintette Coal Ltd.* (1991), 1 C.B.R. (3d) 253, 53

B.C.L.R. (2d) 34 (S.C.), Thackray J. states at p. 41 et seq. [B.C.L.R.]:

> I am again going to refer to the words of Gibbs J.A. but this time as they appear in *Chef Ready Foods Ltd. v. Hongkong Bank of Can.*, Vancouver No. CA 12944 [now reported 51 B.C.L.R. (2d) 84 at 88, [1991] 2 W.W.R. 136]:
>
> > The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business ... When a company has recourse to the C.C.A.A. the court is called upon to play *a kind of supervisory role* to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.
>
> The definition of 'a kind of supervisory role' is the problem. I am going to apply to the task the principles of liberal interpretation of which I spoke earlier in order to best ensure the attainment of the objectives of the Act. The objectives are clear and have not changed from what was said by the Honourable C.H. Cahan when he introduced the bill in the House of Commons. He said that it is designed to permit a corporation, through reorganization, to continue its business and thereby prevent its organization from being disrupted and its goodwill lost.
>
> I am hard pressed to decide if the parties as now constituted are the best vehicle to obtain those objectives, or if a strengthened role by the court through the monitor would be preferable. I am conscious of what was said by Stanley E. Edwards in 'Reorganizations Under the Companies' Creditors Arrangement Act' (1947), 25 Can. Bar Rev. 587. He listed a significant number of facts that should be known by the court before it approves a plan and said [p. 601]:
>
> > It would also be desirable that the proposed plan be carefully analyzed in the light of all this information, preferably by a competent expert, and that the result of the analysis indicate that all of the tests of compliance with the words and purpose of the statute were satisfied.
>
> Although he is speaking of the s. 6 step, I find his thoughts appealing. That is, that at some stage an 'independent and competent expert' be authorized to review and report upon the plan.
>
> Using the principles and objectives earlier noted, I am of the opinion that the court has jurisdiction to appoint such a person. Indeed it might be that this has already been done in the person of the monitor. The court is by statute involved in the process and should seek competent and expert assistance. The need for an objective assessment is directed toward the court's obligation to protect the public interest. There can be no doubt but that the public of this province has a vital interest in the future of the business now being operated by Quintette.

99 It is interesting to note that although Mr. Justice Thackray found that the liberal interpretation of the C.C.A.A. gives the court the jurisdiction to appoint a monitor, he says nothing about payment of the monitor.

100 I am concerned that the court should have an independent assessment to determine the validity of the plan unless the parties reach some kind of consensus, which may or may not occur. I am also concerned to ensure that Coopers & Lybrand maintains that independence. If they have been working with the six companies in the preparation of a plan or plans or if they believe that is the role they wish to perform, then it would seem appropriate to pay them to date and at an appropriate time to order appointment of a new monitor. The monitor

must be an agent of the court, it must assist the court and it must be independent of any of the parties. I appreciate that the form of the order in existence might have led Coopers & Lybrand to conclude that its role was other than or in addition to being an agent of the court and if so, payment should be made to them to date and they should be relieved of their duties as monitor. Without further information I am unable to assess what has taken place up to this time. I will await word from the monitor, but in any event they are entitled to payment for fees and expenses reasonably incurred as a monitor and as an agent of the court to date, to be approved by the court and to be paid out of the proceeds of carrying on the businesses of the six corporations or any of them.

101 If the parties can find any order or authority where a monitor has been paid in priority to all creditors, I would be pleased to reconsider the conclusion which I have reached on this question.

102 Any new monitor, or if Coopers & Lybrand are able to and choose to continue as monitors, shall receive payment out of the proceeds of business of the corporations but not in priority to other creditors.

8. Are the salaries being paid to two of the managers of the companies appropriate in the circumstances?

103 The existing order contains the following:

> 14 (f) to pay out of the proceeds of carrying on the businesses of the Corporations, at the times and in the amounts that may be necessary to enable the Corporation to carry on their businesses:
>
> . . . . .
>
> (vii) employees of the Corporations with respect to obligations arising out of their employment, including reimbursement for expenses, payroll deductions and withholdings; provided however, that Brian Flemming and Peter K. King have agreed from the date of this Order to reduce their remuneration to 50% of the amounts otherwise payable under their employment contracts for the duration of this Order without prejudice to their rights under their employment contracts with Shelburne Marine Limited and Fairview Industries Limited;

104 The BNS and the RBC submit that since Mr. Flemming is the principal shareholder of the debtor companies and may stand to benefit significantly from any successful plan of arrangement, that during the term of the order, payments to him should be limited since many creditors will be unpaid during this period. Further, that the court fix payments in a reasonable amount to be made to Brian Flemming or Peter King and not as set out in the order.

105 Although information was given to the court concerning the amount of payments being made to Mr. King and Mr. Flemming, in my opinion, this is a classic situation where a monitor could advise the court. I have no knowledge of the work being done by these two individuals and what additional responsibilities, if any, they have taken on as a result of the initial order under the C.C.A.A. To arbitrarily fix a figure would be wrong.

106 If the BNS and the RBC wish to pursue this matter, then they should so advise the court, recognizing that the court would then ask the monitor to investigate and advise the court, which would entail additional fees to be paid to the monitor.

9. Should an amendment be made to the order

(a) to incorporate the terms of the BNS and the RBC agreements as to operating credit, and

(b) to deal specifically with the proceeds of the receivables of Shelburne and Fairview?

107 In my opinion, the answer to both of these questions is no.

108 The BNS and the RBC each presented evidence by affidavit to show that their positions are deteriorating because the companies are further out of margin than they were previously. The six companies argued that it depends upon what figures you use and also that both the banks want their individual accounts brought back into margin not to pay the creditors but to reduce their loans.

109 An order under the C.C.A.A. is intended to allow a plan to be prepared to accommodate everyone. To proceed in the manner requested by the banks would frustrate the operation of the C.C.A.A. (See *Icor Oil and Gas Co. v. Canadian Imperial Bank of Commerce* (1989), 102 A.R. 161 (Q.B.) at p. 165; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at pp. 140 and 143-144 [W.W.R.]; and *Perfection Foods*, supra.)

110 I am unable to accept that there has been substantial deterioration in the banks' position such that either of the requested changes to the order are warranted.

10. Is the N.S.B.C.C. a Crown corporation and therefore exempt from the operation of the C.C.A.A.?

111 On December 11, 1987, Industrial Estates Limited ("I.E.L.") entered into an agreement with VGM and Shelburne. A debenture was created and issued pursuant to the provisions of the agreement. By an order in council dated February 27, 1990, all loan accounts held by I.E.L. as lender were assigned to N.S.B.C.C. effective March 31st, 1990.

112 The N.S.B.C.C. is the assignee of the debenture issued by Shelburne and guaranteed by VGM to I.E.L. The indebtedness to N.S.B.C.C. is secured by a debenture with a first fixed charge on the equipment of Shelburne, a floating charge on all the assets of Shelburne and by the corporate guarantee of VGM. N.S.B.C.C. made a demand for payment of its loan on September 6, 1991, as payment was in arrears.

113 The N.S.B.C.C. submits that it is a Crown corporation and that s. 17 of the *Interpretation Act* applies.

> 17 No enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except as mentioned or referred to in the enactment.

114 *R. v. Kussner*, 18 C.B.R. 58, [1936] Ex. C.R. 206, [1936] 4 D.L.R. 752 held because of the words in the *Interpretation Act* [R.S.C. 1927, c. 1, s. 16] and because the C.C.A.A. does not except the Crown, the C.C.A.A. is not binding on the Crown nor can it affect the rights of the Crown. In spite of the fact that the Crown has been a party in many C.C.A.A. applications, including the case of *Elan*, and in *Re United Fishermen*, supra, I find that as the C.C.A.A. makes no reference to the Crown, then the Crown is not bound by any order made under the C.C.A.A. unless the Crown agrees to be so bound.

115 The question is whether the N.S.B.C.C. is a Crown corporation. The N.S.B.C.C. was created by the *Business Capital Corporation Act*, R.S.N.S. 1989, c.49 (the "B.C.C. Act").

116 Crown privilege applies to the Crown and its agents, but not all emanations of the Crown are its agents.

117 In *Tamlin v. Hannaford*, [1949] 2 All E.R. 297, [1950] 1 K.B. 18 (C.A.) at p. 22 [K.B.], Denning L.J states:

> In considering whether any subordinate body is entitled to this Crown privilege, the question is not so much whether it is an 'emanation of the Crown', a phrase which was first used in *Gilbert v. Corporation of Trinity House* (1886) 17 Q.B.D. 795, 801, but whether it is properly to be regarded as the servant or agent of the Crown. (See *International Railway Co. v. Niagara Parks Commission*, [1941] A.C. 328, 342-3.)

[Footnotes omitted.]

118 The test as to whether a body is a Crown agency is found in *Westeel-Rosco Ltd. v. South Saskatchewan Hospital Centre*, [1977] 2 S.C.R. 238, [1976] 5 W.W.R. 688, 11 N.R. 514, 69 D.L.R. (3d) 334 where Ritchie J. states at p. 530 [N.R.]:

> Whether or not a particular body is an agent of the Crown depends upon the nature and degree of control which the Crown exercises over it. This is made plain in a paragraph in the reasons for judgment of Mr. Justice Laidlaw, speaking on behalf of the Court of Appeal for Ontario in *Reg. v. Ontario Labour Relations Board ex parte Ontario Food Terminal Board* (1963), 38 D.L.R. (2d) 530, at 534, where he said:
>
> > It is not possible for me to formulate a comprehensive and accurate test applicable in all cases to determine with certainty whether or not an entity is a Crown agent. The answer to that question depends in part upon the nature of the functions performed and for whose benefit the service is rendered. It depends in part upon the nature and extent of the powers entrusted to it. *It depends mainly upon the nature and degree of control exercisable or retained by the Crown.*

119 Is the N.S.B.C.C. a Crown agency "which is subject at every turn to the control of the Crown in executing its powers ..." (at p. 534 *Westeel*, supra)?

120 To determine that, there must be an examination of the legislation. (See *Braeside Farms Ltd. v. Nova Scotia (Farm Loan Board)* (1973), 5 N.S.R. (2d) 685, 42 D.L.R. (3d) 480 (C.A.) at p. 696 [N.S.R.].)

121 Generally, the B.C.C. Act applies to businesses with 50 or more employees and annual sales volume of $2,000,000 or more (s. 3). The Minister of Small Business Development has the general supervision and management of the Act (s. 4). Section 5 establishes the N.S.B.C.C. with a board of directors who are appointed by the Governor in Council (s. 6) and whose remuneration, allowances, terms of office and reappointment are determined by the Governor in Council (s. 7 and s. 8). The object and purpose of the N.S.B.C.C. is to encourage business development in the province by giving businesses financial assistance or other assistance determined by the Governor in Council (s. 9). Section 10 allows the Governor in Council to assign to the corporation all or any part of the duties of the Industrial Loan Board, the Resources Development Board and the Venture Corporations Board. Section 11(1) deals with winding up I.E.L. and ss. 11(2) and 22 relating to I.E.L. appear not to have been proclaimed to date. The duties of the N.S.B.C.C. [s. 12] are to:

> (*a*) aid, assist and promote the development of industries, businesses and activities within the Province;
>
> (*b*) assist departments, boards, commissions and agencies of the Province engaged in giving financial and other assistance to industries and businesses and co-ordinate the activities of the departments, boards, commissions and agencies with respect to industry and business;
>
> (*c*) administer, in accordance with the regulations, the Fund and any money or security as from time to time comes under the control of the Corporation; and

(*d*) exercise and perform the functions and duties conferred on it by this Act or the regulations, any enactment, the Governor in Council or the Minister. 1986, c. 4, s. 12.

122 Section 13(1)(*a*) gives the N.S.B.C.C. full powers to deal with real and personal property, and subject to the regulations, to render financial or other assistance "which in the opinion of the Board will encourage, sustain, improve or develop business in the Province." (s. 13(1)(*b*)). Ministerial approval is required for the N.S.B.C.C. to make by-laws, to employ people and to establish advisory boards (s. 13(1)(*c*)). Borrowing or raising money is subject to the approval of the Governor in Council. Other than provided in the B.C.C. Act, or by the Governor in Council from time to time, the N.S.B.C.C. has all the powers of a company incorporated pursuant to the *Companies Act* (s. 13). Section 14 vests the government, control and management of the corporation in the board, which may exercise the powers of the corporation. Section 16 sets up a fund in the office of the Minister of Finance, but administration expenses of the Act are paid by the Department of Development and do not come out of the fund. The Governor in Council, on the Minister's recommendation, may transfer amounts to the fund from various provincial accounts (s. 17). The accounting system of the N.S.B.C.C. is subject to the approval of the Minister of Finance and subject to audit by the Auditor General (s. 18) and the fiscal year is the same as the province (s. 19). The N.S.B.C.C.'s annual financial statement and report concerning its work shall be submitted to the Minister annually and the Minister tables it at the next session of the legislature (s. 20).

123 Section 23 gives the Governor in Council authority to make regulations dealing in particular with the aspects of financial assistance. These regulations exist and although they limit the board's authority to approve financial assistance and to setting the rate of interest to be charged (Regs. 6 & 7, N.S. Reg. 58/88 Financial Assistance Regulations) the overall scheme of the regulations gives the board substantial discretionary power.

124 It should be noted that although s. 24 says that the exercise of authority by the Governor in Council under s. 23 shall be regulations within the meaning of the *Regulations Act*, R.S.N.S. 1989, c. 393, s. 24 has never been proclaimed. I am not purporting to rule on the validity of the several regulations passed in 1988 and 1989. For the purposes of this discussion they are considered to be properly in place.

125 Counsel for the N.S.B.C.C. submits that a comparison with the Farm Loan Board as analyzed by the court in *Braeside*, supra, should lead one to conclude that the N.S.B.C.C. is a Crown corporation.

126 On the other hand, counsel for the six companies submits that a comparison of the N.S.B.C.C. with the Sydney Steel Corporation as analyzed in *Sydney Steel Corp. v. Al E. & C. Ltd.* (1983), 33 C.P.C. 249, 58 N.S.R. (2d) 369, 123 A.P.R. 369, 148 D.L.R. (3d) 348 (C.A.) shows that the N.S.B.C.C. is not a Crown corporation.

127 In my opinion there are several major differences between the Farm Loan Board and the N.S.B.C.C. Under s. 3 of the *Agriculture and Rural Credit Act*, R.S.N.S. 1989, c. 7 the Farm Loan Board is the corporation, that is, there is no provision that the corporation will be managed by a board. Further, the board is under the general supervision and direction of the Minister. (s. 4)

128 In contrast, the N.S.B.C.C. is managed by the board (s. 6) and the Act, not the corporation and not the board, is managed and supervised by the Minister (s. 4).

129 In the *Agriculture and Rural Credit Act* there is no separate fund segregating board money from provincial money (s. 9). In the B.C.C. Act a separate fund is established.

130 Finally, the Farm Loan Board is not given the powers of a corporation incorporated under the *Compan-*

ies Act, whereas the N.S.B.C.C. is (s. 5 and also s. 13(2)).

131 In my opinion, the above shows that the two boards are substantially different and the control by the respective ministers is quite different.

132 With respect to the *Sydney Steel Corporation Act*, R.S.N.S. 1989, c. 456 and the N.S.B.C.C., both have boards of directors and powers of corporations under the *Companies Act*. There are many similarities including the relationship of funds with the Minister of Finance, and the requirements of financial reporting.

133 In my opinion, s. 14 of the B.C.C. Act, which says "The government, control, and management of the Corporation are vested in the Board which may exercise the powers of the Corporation.", goes a long way to determining the issue. It shows considerable independence in the N.S.B.C.C.

134 Another section of the B.C.C. Act which must be examined is s. 21.

> **Deemed Crown board**
>
> 21 The Corporation is and is deemed to be a board acting on behalf of the Crown for the purpose of Section 28 of the *Bills of Sale Act*.

135 It must surely be asked why such a section is necessary if it is clearly a Crown corporation. If the legislature had intended it to be a Crown corporation, surely it would have said so in plain language.

136 In the *Sydney Steel Corporation Act*, there is a specific section which provides that the provisions of the *Proceedings against the Crown Act*, R.S.N.S. 1989, c. 360 apply to the Sydney Steel Corporation.

137 In *Tamlin*, supra, at p. 25 [K.B.] Lord Denning states:

> When Parliament intends that a new corporation should act on behalf of the Crown, it as a rule says so expressly, as it did in the case of the Central Land Board by the Town and Country Planning Act, 1947, which was passed on the very same day as the Transport Act, 1947. In the absence of any such express provision, the proper inference, in the case, at any rate, of a commercial corporation, is that it acts on its own behalf, even though it is controlled by a government department.

138 In the case of *Sydney Steel Corporation*, supra, Jones J.A., in upholding the decision of Richard J. that Sydney Steel is not a Crown corporation, states in part at p. 373 [N.S.R.]:

> There is no express provision in the Act declaring the Corporation an agency of the Crown. In the absence of such a provision I agree with the comments of Denning, L.J., in *Tamlin v. Hannaford*. It should not be incumbent on the courts to strain the provisions of the statute to extend prerogatives which in the present case are anachronistic. In the event the Crown considers that special immunities are necessary to the Corporation it is free to incorporate them in the statute.

139 Industrial Estates Limited was specifically stated to be a Crown Corporation in its incorporating statute, the *Industrial Estates Limited Act*, R.S.N.S. 1989, c. 223. No such statement is contained in the B.C.C. Act.

140 It is my opinion that if the legislature intended N.S.B.C.C. to be a Crown corporation it would have stated that in the B.C.C. Act and it did not do so.

141 It would be wrong for the court to insert words into a statute which the legislature could have but chose not to include.

142 I find that the N.S.B.C.C. is not subject to the control necessary to make it a Crown corporation. An analysis of the B.C.C. Act leads me to conclude that the N.S.B.C.C. is not a Crown Corporation and cannot claim exemption from the operation of the C.C.A.A.

143 The following is a summary of the decisions made in this decision:

144 1. The six companies are debtor companies within the meaning of s. 2 of the C.C.A.A.

145 2. The court has jurisdiction to amend or rescind its original order.

146 3. The "instant trust deeds" issued by each of the six companies are valid and fulfill the requirement of s. 3(*a*) of the C.C.A.A.

147 4. The requirement for a plan of compromise or arrangement under s. 3(*b*) is not a prerequisite to obtaining a first order under the C.C.A.A.

148 5. Although the C.C.A.A. permits consolidation of companies in appropriate circumstances, because of other conclusions, no specific ruling is made on whether Fairview and Shelburne are appropriate to include with the other four corporations.

149 6. One plan is not appropriate when there is no reasonable prospect of success. Shelburne and Fairview shall each file a separate plan. The other four corporations may file a consolidated or separate plans.

150 7. Custodians are not ordered for Fairview and Shelburne.

151 8. Section 18, providing priority of payment, is void ab initio vis-à-vis payment to others than the mon- itor.

152 9. Unless there is agreement, the C.C.A.A. does not allow priority of payment to the monitor. The monitor shall be paid out of the proceeds of carrying on the business of the six companies or any one of them but not in priority to other creditors.

153 10. The court requires a monitor. Coopers & Lybrand will continue if they are able to say they are independent of any of the parties and wish to continue. If not, a new monitor will have to be appointed and the court will seek recommendations from the parties.

154 11. Subject to review by the monitor, the salaries of Mr. Flemming and Mr. King shall remain as set out in the initial order. In light of the cost, a review will only occur if a specific request is made to the court.

155 12. No amendment shall be made to the initial order to incorporate the terms of the Bank of Nova Scotia and the Royal Bank agreements relating to operating credit.

156 13. No amendment shall be made to the initial order to deal with the proceeds of the receivables of Shelburne and Fairview.

157 14. The court finds that the N.S.B.C.C. is not a Crown corporation; therefore, it is not exempt from the

operation of the C.C.A.A.

158 Appropriate amendments shall be made and an order prepared to incorporate and reflect points 5., 6. and 8. above.

Directions given.

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TAB 6

2002 CarswellOnt 1261, 33 C.B.R. (4th) 284, 113 A.C.W.S. (3d) 760

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2002 CarswellOnt 1261, 33 C.B.R. (4th) 284, 113 A.C.W.S. (3d) 760

PSINet Ltd., Re

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

In the Matter of a Plan of Compromise or Arrangement of PSINet Limited, PSINet Realty Canada Limited, PSINetworks Canada Limited and Toronto Hosting Centre Limited, Applicants

Ontario Superior Court of Justice [Commercial List]

Farley J.

Heard: March 14, 2002
Judgment: March 14, 2002
Docket: 01-CL-4155

Counsel: *Lyndon A.J. Barnes*, *Monica Creery*, for Applicants

Geoffrey B. Morawetz, for the Monitor, PricewaterhouseCoopers Inc.

Peter H. Griffin, for PSINet Inc.

Edmond F.B. Lamek, for 360Networks Services Ltd.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"

Corporations proposed consolidated plan of arrangement or compromise — Consolidated plan was approved by creditors at meeting — Unsecured creditors strongly supported consolidated plan — Since meeting of creditors negotiations with respect to some aspects of plan had been ongoing — Corporations brought motion to sanction consolidated plan of arrangement or compromise — As result of negotiations, sanction was unopposed — Motion granted — Consolidated plan avoided complex and potentially litigious issues arising from allocation of proceeds from sale of corporations' assets — Consolidated plan was in strict compliance with statutory requirements and adhered to previous orders of court — Determination was made that all done or purported to be done was authorized by Companies' Creditors Arrangement Act — Creditors had sufficient time to make reasoned decision — As to fairness and reasonableness of plan, perfection was not required — In circumstances, given intertwined nature of business, consolidated plan was appropriate — Companies' Creditors Arrangement Act,

R.S.C. 1985, c. C-36.

Cases considered by *Farley J.*:

Associated Freezers of Canada Inc., Re, 36 C.B.R. (3d) 227, 1995 CarswellOnt 944 (Ont. Bktcy.) — considered

Canadian Airlines Corp., Re, 2000 ABCA 238, 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]) — referred to

Canadian Airlines Corp., Re, 2000 ABQB 442, 2000 CarswellAlta 662, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.) — considered

Central Guaranty Trustco Ltd., Re, 21 C.B.R. (3d) 139, 1993 CarswellOnt 228 (Ont. Gen. Div. [Commercial List]) — referred to

J.P. Capital Corp., Re, 31 C.B.R. (3d) 102, 1995 CarswellOnt 53 (Ont. Bktcy.) — referred to

Lehndorff General Partner Ltd., Re, 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Northland Properties Ltd., Re, 73 C.B.R. (N.S.) 175, 1988 CarswellBC 558 (B.C. S.C.) — considered

Northland Properties Ltd., Re, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* [1989] 3 W.W.R. 363, 1989 CarswellBC 334 (B.C. C.A.) — referred to

Northland Properties Ltd., Re, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, 1988 CarswellBC 531 (B.C. S.C.) — referred to

Sammi Atlas Inc., Re, 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

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

Generally — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

MOTION by corporations to sanction consolidated plan of arrangement or compromise.

***Farley J.*:**

1 This motion was for the sanctioning of the consolidated plan of arrangement or compromise of the four

Canadian applicants under the *Companies' Creditors Arrangement Act* ("CCAA"). The consolidated plan was approved by the creditors of the applicants at meetings held February 28, 2002. Since that time and as permitted by the consolidated plan there have been ongoing negotiations concerning various aspects of the plan. It is a tribute to the expertise and experience of the parties involved and their counsel that they have been able to negotiate resolutions of the various points in issue with the result that this sanction motion is unopposed. I also think it commendable that the Monitor so amply demonstrated the objectivity and neutrality which is the hallmark of a court-appointed officer.

2 I am advised that while the applicants initially considered an unconsolidated plan which had the support of PSINet Inc. ("Inc."), their parent and major creditor, it was considered that the consolidated route was the way to go. The consolidated plan avoids the complex and likely litigious issues surrounding the allocation of the proceeds from the sale of substantially all of the assets of the applicants to Telus Corporation. The consolidated plan also reflected the intertwined nature of the applicants and their business operations, which businesses in essence operated as a single business and with only one of the applicants having employees. I have previously alluded to the incomplete and deficient record keeping of the applicants. While shooting oneself in the foot should not be endorsed, this is another factor favouring consolidation and the elimination of expensive allocation (amongst the four Canadian applicants) litigation.

3 I note that the consolidated plan also provides that Inc. valued its charge against the assets of PSINet Limited ("Ltd.") one of the applicants to $55 million. The Monitor, PricewaterhouseCoopers Inc. found this to be a reasonable amount and within the range of values which might reasonably be anticipated. Again however I would repeat my observation about incomplete and deficient record keeping.

4 At the February 28th meeting of creditors, a single class of creditors, namely the unsecured creditors, voted on the consolidated plan as it then existed. Secured creditors were not affected by the plan, but were of course characterized as unsecured creditors to the extent that their claim exceeded the expected deficiency in the deemed realization of their security. 92.7% of the creditors voting, representing 98.8% in value of the claims, voted in favour of the plan. Had the votes of Inc. and other creditors affiliated with the applicants been ignored, then 92.5% of the class, representing 87.2% in value voted in favour of the plan.

5 Since the vote, 360Network Services Ltd. (and other affiliates) ("360Networks") have reached agreement with the applicants and Inc. to resolve a motion brought by 360Networks in respect of its concerns regarding the consolidation of the estates of the applicants in the plan of arrangement.

6 Similarly Inc. has made certain concessions as to the plan with an eye to making good on the condition imposed on it to make a material (albeit modest) adjustment so as to compensate the other creditors for the "frustration cost" associated with Inc.'s late blooming discovery of its security vis-à-vis Ltd. and its motion to reperfect this security.

7 The three part test for sanctioning a plan is laid out in *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *Sammi Atlas Inc., Re*, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]):

> (a) There must be strict compliance with all statutory requirements and adherence to the previous orders of the court;

(b) All material filed and procedures carried out are to be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA or other orders of the court; and

(c) The plan must be fair and reasonable.

8 It appears to me that parts (a) and (b) have been accomplished, now that Inc. has made the further concessions. The creditors have had sufficient time and information to make a reasoned decision. They have voted in favour of the consolidated plan by a significant margin over the statutory requirement, even where one eliminates the related vote of Inc. and its affiliates. In reviewing the fairness and reasonableness of a plan, the court does not require perfection. As discussed in *Sammi* at p. 173:

> A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment... One must look to the creditors as a whole (i.e. generally) and to the objecting creditors (specifically), and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights...

9 There is a heavy onus on parties seeking to upset a plan that the required majority have supported: See *Sammi* at p. 174 citing *Central Guaranty Trustco Ltd., Re*, 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List])

10 The fairness and reasonableness of a plan are shaped by the unique circumstances of each case, within the context of the CCAA. In *Canadian Airlines Corp., Re*, [2000] 10 W.W.R. 269 (Alta. Q.B.), leave to appeal refused [2000] 10 W.W.R. 314 (Alta. C.A. [In Chambers]) Paperny J. at p. 294 considered factors such as the composition of the unsecured vote, what creditors would receive on liquidation or bankruptcy as opposed to the plan, alternatives available (to the plan and bankruptcy) and the public interest. I have already discussed the first element; the third and fourth do not appear germane here. As to the second, it is clear that the creditors generally are receiving more than in a bankruptcy and to the extent that Inc. is impacted, it has consented to such impact.

11 In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C. S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect. Here as well the concessions of Inc. have ameliorated that prejudice. Further I am of the view if consolidation is appropriate (and not proceeded with by any applicant for tactical reasons of minimizing valid objections), then it could be inappropriate to segregate the creditors into classes by corporation which would not naturally flow with the result that one or more is given a veto, absent very unusual circumstances (and not present here). I would also note that *Associated Freezers of Canada Inc., Re*, 36 C.B.R. (3d) 227 (Ont. Bktcy.) and *J.P. Capital Corp., Re*, 31 C.B.R. (3d) 102 (Ont. Bktcy.) which referred to prejudice to one creditor were not CCAA cases, but rather *Bankruptcy and Insolvency Act* cases; secondly *Associated Freezers* merely kept the door open for the objecting party to reconsider its position given the short notice and provided that if on reflection it wished to come back to make its submissions, it was entitled to do so for a period of time.

12 In the end result (and with no creditors objecting), I approve and sanction the consolidated plan as amended. Order to issue accordingly as per my fiat.

Motion granted.

END OF DOCUMENT

TAB 7

2008 CarswellNB 195, 2008 NBQB 144, 42 C.B.R. (5th) 107, 855 A.P.R. 143, 333 N.B.R. (2d) 143

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2008 CarswellNB 195, 2008 NBQB 144, 42 C.B.R. (5th) 107, 855 A.P.R. 143, 333 N.B.R. (2d) 143

Atlantic Yarns Inc., Re

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

And IN THE MATTER OF ATLANTIC YARNS INC., a body corporate and ATLANTIC FINE YARNS INC., a body corporate

RE: GE CANADA FINANCE HOLDING COMPANY MOTION

New Brunswick Court of Queen's Bench

P.S. Glennie J.

Heard: April 1, 2008
Judgment: April 1, 2008
Written reasons: April 11, 2008
Docket: S/M/92/07

Counsel: Orestes Pasparakis, M. Robert Jette Q.C. for GE Canada Finance Holding Company

Joshua J.B. McElman, Rodney E. Larsen for Atlantic Yarns Inc., Atlantic Fine Yarns Inc.

James H. Grout, Sara Wilson for Integrated Private Debt Fund Inc., First Treasury Financial Inc.

John B.D. Logan for Province of New Brunswick

William C. Kean for Paul Reinhart Inc., Staple Cotton Co-operative

Subject: Insolvency

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Secured creditor GE Co. had first charge over debtors' equipment — Debtors obtained relief under Companies' Creditors Arrangement Act — Debtors were affiliated debtor companies — Claims Procedure Order was issued — Debtors filed consolidated plan of compromise and arrangement — Creditors Meeting Order was issued — Meeting Order provided that classes of creditors for voting on planned proposal were class of secured creditors of both debtors and class of unsecured creditors of both debtors, that secured creditors were permitted to vote face amount of claim, and that GE Co. was classified with all other secured creditors — GE Co. asserted there

should be no consolidation of creditors for voting purposes and that either GE Co. should be treated as separate class or secured claims should be valued and voted in accordance with value — GE Co. brought motion challenging voting procedures in Meeting Order — Motion dismissed — Nature of businesses of debtors were intertwined — Consolidation was fair and reasonable — To require valuation based on realizable value for voting ignored value of security in reorganization and legislative intent of Act — GE Co. was aggressive creditor manoeuvring to get itself into position to veto proposed plan — Relief GE Co. sought was not fair and reasonable — Proposed classification of creditors in proposed plan should not be amended — Debtors' secured creditors had commonality of interests — Classification GE Co. sought would result in fragmented approach that could jeopardize and likely defeat proposed plan — Proposed classification was fair and reasonable.

Cases considered by *P.S. Glennie J.*:

Boutiques San Francisco Inc., Re (2004), 5 C.B.R. (5th) 174, 2004 CarswellQue 300, [2004] R.J.Q. 986 (Que. S.C.) — considered

Canadian Airlines Corp., Re (2000), 19 C.B.R. (4th) 12, 2000 CarswellAlta 623 (Alta. Q.B.) — considered

Federal Gypsum Co., Re (2007), 2007 NSSC 384, 2007 CarswellNS 630, 261 N.S.R. (2d) 314, 835 A.P.R. 314, 40 C.B.R. (5th) 39 (N.S. S.C.) — considered

Keddy Motor Inns Ltd., Re (1992), (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 299 A.P.R. 246, 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 110 N.S.R. (2d) 246, 1992 CarswellNS 46 (N.S. C.A.) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — considered

Minds Eye Entertainment Ltd. v. Royal Bank (2004), 1 C.B.R. (5th) 89, (sub nom. *Minds Eye Entertainment Ltd., Re)* 249 Sask. R. 139, 2004 SKCA 41, 2004 CarswellSask 192 (Sask. C.A.) — referred to

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 146, 1988 CarswellBC 531, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257 (B.C. S.C.) — considered

PSINET Ltd., Re (2002), 33 C.B.R. (4th) 284, 2002 CarswellOnt 1261 (Ont. S.C.J. [Commercial List]) — considered

San Francisco Gifts Ltd., Re (2004), 5 C.B.R. (5th) 92, 42 Alta. L.R. (4th) 352, 2004 ABQB 705, 2004 CarswellAlta 1241, 359 A.R. 71 (Alta. Q.B.) — followed

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

Uniforêt inc., Re (2003), 43 C.B.R. (4th) 254, 2003 CarswellQue 3404 (Que. S.C.) — referred to

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

s. 12 — referred to

s. 12(2)(b) — referred to

MOTION by secured creditor challenging voting procedures set out in relation to proposed plan of compromise and arrangement filed by debtors under *Companies' Creditors Arrangement Act*.

***P.S. Glennie J.*:**

1 Atlantic Yarns Inc. ("AY") and Atlantic Fine Yarns Inc. ("AFY") obtained relief pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c-36, as amended (the "CCAA") by order of this Court dated October 26, 2007 (the "Initial Order").

2 On December 18, 2007, this Court issued a Claims Procedure Order (the "Claims Procedure Order") and on February 20, 2008 it issued a Creditors Meeting Order (the "Meeting Order").

3 Subsequent to the issuance of the Meeting Order the parties determined whether there could be a global resolution of all outstanding issues. When no resolution could be realized, one of the secured creditors of AY and AFY (collectively "the Companies"), GE Canada Finance Holding Company ("GE"), brought this motion to address the manner in which voting on the proposed Plan of Arrangement is to be conducted. On April 1, 2008 I denied GE's motion with reasons to follow. These are those reasons.

4 GE's submission is that the voting procedures set out in the Meeting Order are improper in that they violate the express provisions of both the Initial Order and the Claims Procedure Order; in that the procedures are manifestly unfair and unreasonable; and in that they appear to be designed to silence GE's objections by gerrymandering the voting and diluting GE's voting rights.

5 In particular, GE asserts that there should be no consolidation of the creditors of the Companies for voting purposes. GE says each of AY and AFY should hold separate meetings with their creditors. As well, GE argues that the current treatment of the secured creditor class is flawed. It says that either GE ought to be in a separate class or the secured claims ought to be valued and voted in accordance with their value.

6 The Companies filed a consolidated plan of compromise and arrangement (the "proposed Plan") with this Court on February 19, 2008. The proposed Plan includes two classes of creditors for the purposes of voting on the proposed Plan: a Secured Class (all creditors of each of the Companies holding any security regardless of the value of their security) and an Unsecured Class (all unsecured creditors of each of the Companies).

7 The Court Appointed Monitor of the Companies, Pricewaterhouse Coopers Inc., delivered a report to the Companies' creditors dated February 21, 2008 which report contains the following:

The Plan

The Applicants have filed a Joint Plan of Arrangement the key Financial Elements of which are:

- Unsecured creditors will received up to 90% of their claim over a relatively short period of time; and

- Secured Creditors will be afforded payments in respect of their claims based on an amount that in all cases exceeds the liquidation value of the assets held as security.

Alternatives to the Plan

These Companies operate in northern New Brunswick, and the filing of this Plan was in response to a notice from a secured creditor of its intention to appoint a Receiver. It is a virtual certainty that if this plan is not approved, the secured creditor will appoint a receiver and will liquidate the assets subject to its charges by a sale, possibly under Court supervision.

There is a little likelihood that any other party will purchase these assets to operate in situ.

Liquidation Ananlysis

The Monitor has considered and reviewed a series of different liquidation analysis, and there is one common theme — the unsecured creditors will receive nothing under any realization plan.

Counsel to the Companies and the Monitor have reviewed the security held by the various secured creditors and concluded that the various security interests are duly registered, filed and recorded, and accordingly create valid and enforceable security against the Applicants.

As can be seen from the Plan terms and conditions, the Secured Creditors holding first charges on the assets of the Companies are being asked to take write downs in their positions. Each of these Secured Creditors has prepared their own analysis which has generally been shared with the Monitor and in the event of a liquidation the Monitor believes that each of such secured creditors will receive a shortfall greater than the alternative provided for in the Plan.

Accordingly, there would be nothing available for distribution to the Unsecured Creditors.

The Secured Creditors will likely wish to consider a sale on a going concern basis. It is the opinion of the Monitor that such a sale is unlikely (except perhaps back to the existing owner) and regardless, the value of the assets that will be realized will be close to the liquidation values.

Consequences of Rejecting the Plan

As noted above, if the Plan is rejected by the Creditors or the Court, the assets will be liquidated and:

- Approximately 400 direct jobs will be lost in a largely export oriented business located in a high unemployment area of Canada;

- Approximately 600 indirect jobs will be lost in Canada, with great impact on the remote communities of Atholville and Pokemouche, New Brunswick;

- The Unsecured Creditors will receive nothing on their claims, which in some cases will result in further hardship and business closures.

Monitor's Recommendation

It is the recommendation of the Monitor that ALL affected creditors should approve the Plan.

As a result, creditors are encouraged to send in positive voting ballots and/or proxies as soon as possible.

8 GE argues that from the start of these CCAA proceedings the Initial Order directed that each of the AY and AFY convene separate creditors' meetings. Paragraph 24 of the Initial Order provides as follows:

> Each Applicant shall, subject to the direction of this Court, summon and convene meetings between each Applicant and its secured and unsecured creditors under the Plan to consider and approve the Plan (collectively, the "Meetings").

9 GE says the Claims Procedure Order directed the valuation of secured claims and required all secured claims to be valued in accordance with the realizable value of the property subject to security. Paragraph 9 of the Claims Procedure Order provides:

> 9. THIS COURT ORDERS that any Person who wishes to assert a Claim against the Applicants, other than an Excluded Claim, must file a properly completed Proof of Claim, together with all supporting documentation, including copies of any security documentation and a valuation of such Creditor's security if a Secured Claim is being asserted, with the Monitor by 5:00 p.m. on January 15, 2008 (defined herein as the Claims Bar Date). The Applicants will be allowed to review the Proofs of Claim and Monitor will provide copies to the Applicants of any Proofs of Claim that they may request from time to time.

10 The Claims Procedure Order defines 'Secured Claims' as follows:

> ...any Claim or portion thereof, other than the Excluded Claim, which is secured by a validly attached and existing security interest...which was duly and properly registered or perfected in accordance with applicable legislation at the Filing date or in accordance with the Initial Order, to the extent of the realizable value of the property of the Applicants subject to such security having regard to, among other things, the priority of such security.

11 The Proof of Claim form approved in the Claims Procedure Order required creditors to submit an estimate of the value of their security with their claim, and the approved Notice of Disallowance/Revision indicates that secured claims are to be recognized:

> to the extent of the value of the assets encumbered by such security and subject to any prior encumbrances or security interests.

12 On January 22, 2008, the Monitor accepted GE's claim and valuation regarding AFY but delivered a Notice of Disallowance in respect of part of GE's claim against AY. The Notice of Disallowance reserved the Monitor's right to value GE's security in respect of this claim if an agreement could not be reached.

13 On January 31, 2008, for the first time, GE challenged the Companies' CCAA process and sought an alternative course to the Companies' restructuring efforts. GE sought a parallel sales process for the Companies, either on a turn key or piecemeal basis. GE was also critical of the Companies and their failures to meet certain deadlines previously promised by them under the CCAA process. As a consequence, GE withdrew its support of the Companies' CCAA process.

14 As mentioned, on February 19, 2008 AY and AFY filed a consolidated plan of compromise and arrange-

ment with this Court. The proposed Plan is on a joint and consolidated basis for the purpose of voting on the proposed Plan and receiving distributions under the proposed Plan. The proposed Plan consolidated the Creditors of AY and AFY and allowed all secured claims to be recognized in accordance with their face amount, not their actual value.

15 GE asserts that the Companies' attempt to fundamentally change the Court's mandated process "came on the heels of GE's opposition the Companies' plans."

16 Subsequent to the issuance of the Initial Order and the Claims Procedure Order, the Meeting Order was issued by this Court on February 20, 2008 and provides that only two classes of creditors for voting on the proposed Plan: a secured class of all creditors of both Companies and an unsecured class of all unsecured creditors of both Companies; that secured creditors be permitted to vote the face amount of their claim, regardless of the value of their claims; and that GE be classified with all of the other secured creditors.

17 GE asserts that the effect of the Meeting Order is to consolidate all of the Creditors and permit them to vote the face amount of their claims which GE asserts "serves to swamp GE's vote."

18 GE has a first charge over the equipment of each of AY and AFY. It obtained an expert valuation report early on in the CCAA process and has provided that valuation to the Companies and the Monitor. Based on the valuation GE says it would recover the full amount of its claims plus accrued interest and costs in an orderly liquidation of the equipment.

19 GE says its position is very different form the other creditors being compromised under the proposed Plan. GE has security over the Companies' equipment which ought to cover its claims. GE asserts that no other creditor has the same relationship with the Companies or their assets.

20 Thus, the CCAA process in this case essentially involves two differing interests. On the one hand there are stakeholders, including the Province of New Brunswick, which collectively appear to have lost tens of millions of dollars, as well as the hundreds of employees who currently have no employment. These stakeholders have already suffered a loss. On the other hand, there is GE, which had sufficient security at the time of filing to cover its claims.

21 In spite of its unique interest, GE asserts that the Companies have placed GE in a class of creditors where there is no commonality of interest. GE argues that the Companies have gerrymandered the process to try to prevent GE from properly exercising its voting rights.

22 It is obvious that GE wants to be able to vote down, or veto, the Companies' proposed consolidated Plan of Arrangement on its own. It wants the right to jettison the proposed Plan. No other stakeholder supports GE's position.

23 The Court appointed Monitor says the proposed Plan of Arrangement and the process which is now in place for the creditors' meeting and the voting process are fair and equitable. In this regard, the Monitor has confirmed that even if this Court were to order two separate creditors meetings with an unconsolidated vote, GE would not be able to veto the proposed consolidated Plan of Arrangement on its own. It should also be noted that GE does not object to the actual proposed Plan of AY and AFY being made on a consolidated basis. It is the voting process that it has a problem with. GE asserts that by consolidating the votes of the Companies' creditors, an "enormous" prejudice to GE is created. However, the Court appointed Monitor has confirmed that there is no prejudice

resulting in this regard because GE could not vote down the proposed Plan on its own even if there were two separate meetings and creditors' votes were not consolidated.

24 It is clear that GE no longer supports the Companies and wants to immediately enforce its security and get paid out now rather than waiting until later.

25 As mentioned, the Monitor has confirmed that the voting process as it is now structured for the April 2nd meeting of creditors is equitable. The Monitor is of the opinion that the proposed Plan is fair to all parties.

26 According to its Fourth Report dated March 27, 2008, the Monitor says it is not aware of any creditor, other than GE, which would be voting against the proposed Plan.

27 GE's position is dealt with in the proposed Plan of Arrangement in paragraph 4.3(b) as follows:

> **b) GE Canada Finance Holding Company**
>
> GE shall receive 100% of the amount of its Proven Distribution Claim excluding any Claim for costs, penalties, accelerated payments or increased interest rates resulting from any default of either of the Atlantic Yarn Companies occurring prior to the Plan Implementation Date as follows:
>
> > (i) All accrued interest not paid as of the Plan Implementation Date shall be paid within 30 days of the Sanction order;
> >
> > (ii) Interest shall accrue at the non-default rate and be paid monthly in arrears;
> >
> > (iii) Principle repayment shall be deferred until and commence on January 31, 2009 and continue in 48 equal monthly installments until paid in full; and
> >
> > (iv) The Proven Distribution Claims of GE shall be secured by the existing Charges held by GE subject to the February DIP Order.

28 The Monitor says that the Province of New Brunswick revisions which have been made to the proposed Plan improve the position of GE by virtue of increasing cash flow and deferring cash expenditures until after GE is repaid.

Consolidation of Creditors

29 GE wants separate creditors meetings for each of the Companies and that there not be a consolidation of the Companies' creditors for the purpose of voting on the proposed Plan.

30 AY and AFY are affiliated debtor companies within the meaning of section 3 of the CCAA.

31 Although the Companies are distinct legal entities, they are intertwined in that they are both wholly owned subsidiaries of Sunflag Canada Inc.; there is a commingling of business functions between the Companies in that the marketing divisions, upper employee management, finance management and most suppliers for the Companies are the same, and the employees of both Companies are represented by the same union. As well, AY has guaranteed certain indebtedness of AFY.

32 In addition, for the purposes of its security, GE treated the Companies as intertwined or linked by virtue of cross default provisions contained in the security held by GE from each of the Companies.

33 In *Rescue! The Companies' Creditors Arrangement Act*, by Dr. Janis Sarra, Carswell 2007, the author writes at page 242:

> The court will allow a consolidated plan of arrangement or compromise to be filed for two or more related companies in appropriate circumstances. For example, in *PSINet Ltd.* the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business. The Court found the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor. Other cases of consolidated proceedings such as *Philip Services Canadian Airlines, Air Canada and Stelco*, all proceeded without issues in respect of consolidation.
>
> Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

34 In *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.) Justice Trainor writes:

> In *Baker and Getty Financial Services Inc.*, U.S. Bankruptcy Court, N.D. Ohio (1987) 78 B.R. 139, the court said:
>
> > The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition.
>
> The Court then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors are:
>
> 1. difficulty in segregating assets;
>
> 2. presence of consolidated financial statements;
>
> 3. profitability of consolidation at a single location;
>
> 4. commingling of assets and business functions;
>
> 5. unity of interests in ownership;
>
> 6. existence of intercorporate loan guarantees; and
>
> 7. transfer of assets without observance of corporate formalities.

35 In *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) Justice Farley noted that

consolidation of creditors may be appropriate in certain cases where, for example, the nature of the businesses was intertwined, the businesses were operated as a single business or where the allocation of value and claims between the businesses would be burdensome. He discusses consolidation at paragraph 11 as follows:

> In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C. S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p.31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect. Here as well the concessions of Inc. have ameliorated that prejudice. Further I am of the view if consolidation is appropriate (and not proceeded with by any applicant for tactical reasons of minimizing valid objections), then it could be inappropriate to segregate the creditors into classes by corporation which would not naturally flow with the result that one or more is given a veto absent very unusual circumstances (and not present here).

36 In my opinion the nature of the businesses of AY and AFY were intertwined and, looking at the overall general effect, consolidation is fair and reasonable in the circumstances of this case.

Voting Value of Assets Secured versus Voting Value of Claim

37 GE wants the claims of secured creditors to be allowed only to the extent of the realizable value of the property of the Companies subject to the security underlying the claim and that any portion of a claim in excess of the underlying security should be listed as an unsecured claim.

38 Section 12 of the CCAA provides as follows:

> 12.(1) For the purposes of this Act, "claim" means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act*.
>
> (2) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be determined as follows:
>
> (a) the amount of an unsecured claim shall be the amount
>
> (i) in the case of a company in the course of being wound up under the *Windings-up and Restructuring Act*, proof of which has been made in accordance with that Act,
>
> (ii) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, proof of which has been made in accordance with that Act, or
>
> (iii) in the case of any other company, proof of which might be made under the *Bankruptcy and Insolvency Act*, but if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor; and
>
> (b) the amount of a secured claim shall be the amount, proof of which might be made in respect thereof under the *Bankruptcy and Insolvency Act* if the claim were unsecured, but the amount if not admitted by the company shall, in the case of a company subject to pending proceedings under the

> *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, be established by proof in the same manner as an unsecured claim under the *Winding-up and Restructuring Act* or *Bankruptcy and Insolvency Act*, as the case may be, and in the case of any other company the amount shall be determined by the court on summary application by the company or the creditor.

> (3) Notwithstanding subsection (2), the company may admit the amount of a claim for voting purposes under reserve of the right to contest liability on the claim for other purposes, and nothing in this Act, the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act* prevents a secured creditor from voting at a meeting of secured creditors or any class of them in respect of the total amount of a claim as admitted.

39 In my view, the amount of a secured claim is the amount admitted by the company governed by the CCAA after receiving a proof of the claim. This was the legislative intent. Nowhere in section 12, or anywhere else in the CCAA, is the limit of the value of a secured creditor's claim to be the realizable value of the assets secured. Where a company governed by the CCAA has developed a plan for its reorganization, the value of a claim should be determined in accordance with paragraph 12(2)(b). The CCAA does not establish a requirement or a procedure for valuing claims. The CCAA is broad and flexible so that Courts can apply the legislation with the overall purpose of restructuring in the context of the facts for any given company.

40 The value of a secured creditor's claim is the amount outstanding. In my opinion, to require a valuation based on realizable value for voting ignores the value of the security in reorganization and the legislative intent of the CCAA.

41 I am of the view that the relief sought by GE in this regard is an attempt to maneuver for a better voting position amoung the Companies' secured creditors. It is attempting to fortify its bargaining position in order to negotiate with the Companies for a better deal pursuant to the proposed Plan.

42 If GE's request in this regard is granted and the claims of the Companies' secured creditors are limited to the realizable value of their security, GE would be able to trump the interests of other stakeholders who would benefit from a plan of arrangement or continuation of the Companies' business. The Quebec Superior Court in *Boutiques San Francisco Inc., Re* (2004), 5 C.B.R. (5th) 174 (Que. S.C.), notes as follows:

> Surely, maintaining the status quo involves balancing the interests of all affected parties and avoiding advantages to some of the others. Under the CCAA, the restructuring process and general interest of all creditors should always be preferred over the particular interests of individual ones.

43 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), the Court notes:

> The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. **It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning amoung the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position**

> **making it even less likely that the plan will succeed.** The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. **The court's primary concerns under the CCAA must be for the debtor and all of the creditors:** *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 4 C.B.R. (3d) 311 at pp 315-318. [Emphasis Added]

44 In my opinion, GE is clearly an aggressive creditor maneuvering for positioning in order to get itself into a position to veto the proposed Plan.

45 I am satisfied that the purpose of the proposed Plan is to provide a fair recovery to the creditors of AY and AFY and to successfully restructure the Companies as a going concern. The Monitor has confirmed that the Companies have acted in good faith.

46 The Monitor says it was never its intention that the Proof of Claim forms were being completed by creditors of the Companies for voting purposes. Counsel for GE says what the Monitor had "in its minds eye" is irrelev- ant.

47 Counsel for GE goes on to say that he does not understand how there could be any misunderstanding with respect to the purpose of the Order being to determine the value of creditors claim for the purpose of voting. At the hearing of this Motion counsel for GE asked: "*If a creditor was under a misunderstanding whose lookout was it? Is it somebody who reads the reasonable words and relies on them, GE, or is it somebody whose interpretation seems to be contrary to the words of this document?*"

48 Counsel for Integrated Private Debt Fund Inc. and First Treasury Financial Inc. counters by saying that GE's interpretation is inconsistent with the wording of the Order and inconsistent with CCAA practice.

49 In my opinion, given the overall purpose and intent of the CCAA, the relief sought by GE with this Motion is not fair and reasonable. It is an attempt by GE to obtain a better voting position and to trump the rights of other secured creditors, none of which support GE's Motion. No other secured creditor supports the voting scheme sought by GE. The purpose of the proposed Plan is to provide a fair recovery to the creditors of AY and AFY and to successfully restructure the Companies as a going concern.

50 In the result, GE's request that the claims of the Companies' secured creditors be allowed only to the extent of the realizable value of the property of the Companies subject to the security underlying the claim, and that any portion of a claim in excess of the value of the underlying security be listed as and unsecured claim, is denied.

Classification of Creditors

51 GE also wants to be put in a separate class of creditors by itself for the purposes of voting on the proposed Plan.

52 Madam Justice Paperny of the Alberta Court of Queen's Bench set out the starting point for determining the classification of creditors under the CCAA in *Canadian Airlines Corp., Re*, [2000] A.J. No. 1693 (Alta. Q.B.) at paragraph 14 where she writes:

> The starting point in determining classification is the statue under which the parties operating and from

which the court obtains its jurisdiction. The primary purpose of the C.C.A.A. is to facilitate the re-organization of insolvent companies, and this goal must be given proper consideration at every stage of the C.C.A.A. process, including classification of claims. See for example, *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta Q.B.).

53 Classification of creditors must be based on a commonality of interest and is a fact driven determination that is unique to the particular circumstances of every case. In *Canadian Airlines Corp., Re, supra*, Justice Paperny writes at paragraphs 16-18:

16 A frequently cited description of the method of classification of creditors for the purposes or voting on a plan, under the C.C.A.A., is *Sovereign Life Assurance Co. v. Dodd* (1891) [1892] 2 Q.B. 573, (Eng. C.A.).

17 At page 583 (Q.B.), Bowen L.J. writes:

> The word 'class' is vague and to find out what is meant by it, we must look at the scope of the section which is a section enabling, the court to order a meeting of a class of creditors to be called. It seems plain that we must give such a meaning to the term 'class' as will prevent the section, being so worked as to result in confiscation and injustice, and that it must be confined to those persons, whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest.

This test has been described as the "commonality of interest" test. All counsel agree that this is the test to apply to classification of claims under the C.C.A.A. However, there is a dispute on the types of interests that are to be considered in determining commonality.

18 Generally, the cases hold that classification is a fact-driven determination unique to the circumstances of every case upon which the court should be loathe to impose rules for universal application, particularly in light of the flexible, and remedial jurisdiction involved: see, for example, *Re Fairview Industries Ltd.* (1991) 11 C.B.R. (3d) 71 (N.S.T.D.)

54 Justice Blair writing for the Ontario Court of Appeal in *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.) discussed the principles to be considered by the courts with respect to the question of commonality of interest as follows:

22 These views have been applied in the CCAA context. But what comprises those "not so dissimilar" rights and what are the components of the "common interest" have been the subject of debate and evolution over time. It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover, given the nature of the CCAA process and the underlying flexibility of that process — a flexibility which is its genius — there can be no fixed rules that must apply in all cases.

23 In *Re Canadian Airlines Corp.* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:

> In summary, the cases establish the following principles applicable to assessing commonality of in- terest:
>
> 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an iden-

> Fairness' and 'reasonableness' are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which makes its exercise in equity — and 'reasonableness' is what lends to objectivity to the process.

62 A plan under the CCAA can be more generous to some creditors but still be fair to all creditors. Where a particular creditor has invested considerable money in the debtor to keep the debtor afloat, that creditor is entitled to special treatment in the plan, provided that the overall plan is fair to all creditors: *Uniforêt inc., Re* (2003), 43 C.B.R. (4th) 254 (Que. S.C.).

63 The classification of classes of secured creditors must take into account variations tailored to the situations of various creditors within a particular class. Equality of treatment, as opposed to equitable treatment, is not a necessary, nor even a desirable goal: *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.); *Minds Eye Entertainment Ltd. v. Royal Bank*, 2004 CarswellSask 192 (Sask. C.A.).

64 It is clear that the objective of GE in this case is to defeat the proposed Plan and in order to have the ability to do so it wants to gain veto power. Allowing GE's motion would, in my opinion, doom the proposed Plan because GE wants to be in a position to veto it and have it fail.

65 Counsel for GE suggested at the hearing of this Motion that if the relief sought by GE is granted, "*the Companies are going to have to rethink and in the next couple of days they're either going to come to a deal that's going to work, and if it's a viable company they'll be able to do it, or they're not, and it just was never meant to be.*" In other words, if GE's motion is granted, its negotiating power would be fortified.

66 In *San Francisco Gifts Ltd., Re*, [2004] A.J. No. 1062 (Alta. Q.B.), Madam Justice Topoloniski writes at paragraphs 11 and 12:

> The commonality of interest test has evolved over time and now involves application of the following guidelines that are neatly summarized by Paperny J. (as she then was) in Resurgence *Asset Management LLS v. Canadian Airlines Corp.* ("Canadian Airlines"):
>
> > 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
> >
> > 2. The interests to be considered are the legal interest that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as liquidation.
> >
> > 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if possible.
> >
> > 4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
> >
> > 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelev- ant.

> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.

67 Justice Topoloniski goes on to write:

> To this pithy list, I would add the following considerations:
>
> (i) Since the CCAA is to be given a liberal and flexible interpretation classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.
>
> (ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of a plan.

68 I agree with Madam Justice Topoloniski's analysis including her additional considerations. In the case at bar, the Monitor in its Report dated March 27, 2008 states that on balance the proposed Plan is fair to all parties subject to the proposed Plan. The March 27, 2008 Monitor's Report states as follows with respect to the major benefit of a successful restructuring:

> The major benefit of a successful restructuring will be significant, including:
>
> (a) The continuing employment of approximately 400 direct employees with high paying jobs in New Brunswick and Ontario;
>
> (b) The continuing employment of a further approximately 600 indirect jobs as a result of a high export content of the sales of the Companies;
>
> (c) The payment of a significant portion of the outstanding unsecured debt of the Companies owed to its suppliers; and
>
> (d) The future expenditure of significant amounts other than payroll in Canada and New Brunswick, which expenditures and payroll are of significance to the economy of the areas around the mills and the Province of New Brunswick.

69 With respect to the practical effect of a failure of the proposed Plan, the Monitor has stated "*the unsecured creditors will receive nothing on their claims which in some cases will result in further hardship and business closures.*"

70 In my opinion, a reclassification of the Companies' creditors for the purposes of voting on the proposed Plan so that GE is in a separate class of creditors could potentially jeopardize a viable plan of arrangement. Bearing in mind that the object of the CCAA to facilitate reorganizations, if possible, I am attracted to the additional consideration referenced by Madam Justice Topoloniski in *San Francisco Gifts Ltd., Re*, supra, namely that in determining commonality of interests, the Court should also consider factors such as a plan's treatment of creditors, the business situation of the creditors and the practical effect on them of a failure of the plan. In my view, the practical effect in this case of a failure of the proposed Plan on the Companies' creditors, other than GE, would be significantly negative and adverse.

71 In my opinion, for these reasons, GE ought not to be placed in a separate class of creditors and accordingly this request is denied.

Disposition

72 For these reasons, the motion of GE is denied.

Motion dismissed.

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TAB 8

THE REMEDY OF SUBSTANTIVE CONSOLIDATION UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT: A CLOSER EXAMINATION OF DOMESTIC AND CROSS-BORDER ISSUES

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PART 1: INTRODUCTION

In Canada, it is a common occurrence for businesses to operate in enterprise groups.[1] These structures can result in various operational and financial benefits for the business as a whole.[2] Yet, in the case of severe financial distress or underperformance these business structures demand restructuring solutions that facilitate a swift recovery but also maximise value *en bloc*. This drives many to seek protection from the *Companies' Creditors Arrangement Act*[3] that enables financially troubled debtors the opportunity to restructure their affairs by developing a formal plan of compromise or arrangement with its creditors.

However despite the stark reality of enterprise groups, their restructuring can be both problematic and challenging in the current legal landscape. In Canada, corporations are considered distinct, each being a separate legal entity.[4] Hence, the restructuring of enterprise group structures is not expressly recognised under the *CCAA*. Nevertheless, in recent years the Canadian courts have been active in developing solutions to overcome the difficulties faced by

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[1] Enterprise group is defined as "two or more enterprises that are interconnected by control or significant ownership." The term "control" refers to "the capacity to determine, directly or indirectly, the operating and financial policies of an enterprise." These definitions are those endorsed in the *United Nations Commission on International Trade Law Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency*, pre-release July 2010: http://www.UNCITRAL.org/pdf/english/texts/insolven/pre-leg-guide-part-three.pdf, paragraph 4, [hereinafter, the UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency].

[2] The reasons why businesses use enterprise group structures is not the focus of this study. However, for a more detailed discussion on the issue see UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, paragraphs 17-25.

[3] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, [hereinafter, *CCAA*]. To qualify for relief under the *CCAA* the debtor must be a Canadian incorporated company or foreign incorporated company with assets in Canada or conducting business in Canada, be insolvent on a cash flow or balance sheet test and have in excess of $5 million in debt. Therefore the *CCAA* is restricted to larger corporations. Debtors who do not reach the $5 million threshold qualify for a Division 1 Proposal under the *Bankruptcy and Insolvency Act*, R.S. 1985, c. B-3, [hereinafter, *BIA*].

[4] *Canada Business Corporation Act*, R.S., 1985, c. C-44, section 15(1).

insolvent members of an enterprise group. The focus of this paper is the development and application of the equitable remedy of substantive consolidation under the *CCAA* framework in both the domestic and cross-border context.

The remedy of substantive consolidation, treating assets and liabilities of two or more enterprise group members as if they were part of a single insolvency estate, still appears to be in relative infancy in the context of the *CCAA*.[5] In the absence of codified provisions, substantive consolidation has leisurely evolved as a judicially-created remedy, courts relying upon their broad statutory authority to grant such orders.[6] In the last twenty years, there have only been six reported *CCAA* cases[7] that specifically analyze issues surrounding the doctrine in the domestic

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[5] M. B. Rotsztain and N. De Cicco, "Substantive Consolidation in *CCAA* Restructurings: A Critical Analysis," in J. P. Sarra, ed., *2004, Annual Review of Insolvency Law*, (Toronto: ThomsonCarswell, 2004), [hereinafter, Rotsztain and De Cicco].

[6] For a detailed discussion on the courts authority and interpretative tools see Justice G. R. Jackson and J. P. Sarra "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in J.P. Sarra, ed., *2007, Annual Review of Insolvency Law,* (Vancouver: Thomson Carswell, 2007).The authors suggest the courts should adopt a hierarchal approach to the interpretative tools – statutory interpretation, gap-filling, discretion and inherent jurisdiction. However, the case of *ATB Financial v. Metcalfe & Mansfield Alternative Investment II Corp.* 2008 ONCA 587 (Ont. C.A.) suggests it is not necessary to go beyond the general principle of statutory interpretation when the implicit language of the *CCAA* itself give the court such authority, hence there is no gap filling to be done and no need to fall back on inherent jurisdiction, see R. A. Blair J.J.A. at paragraphs 43-49.

[7] The six reported cases consist of both common law and civil law Canadian cases; *Northland Properties Ltd., Re*, 1988 CarswellBC 531, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, [1988] B.C.W.L.D. 2663, [1988] C.L.D. 1460, 11 A.C.W.S. (3d) 76, (B.C.S.C), [hereinafter, *Northland* Properties]; *Fairview Industries Ltd., Re*, 1991 CarswellNS 35, 11 C.B.R. (3d) 43, (sub nom. Fairview Industries Ltd., Re (No.2)), 109 N.S.R. (2d) 12, 297 (N.S.S.C. (Trial Division), [hereinafter, *Fairview Industries*]; *Lehndorff General Partner Ltd., Re,* 1993 CarswellOnt 183, 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 274 (O.C.J. [General Division – Commercial List]), [hereinafter, *Lehndorff*]; *Global Light Telecommunications Inc., Re,* 2004 CarswellBC 1249, 2004 BCSC. 745, 2 C.B.R. (5th) 210, 33 B.C.L.R. (4th) 155, (B.C.S.C.), [hereinafter, *Global Light*]; *PSINet Ltd., Re*, 2002 CarswellOnt 1261, 33 C.B.R. (4th) 284, 113 A.C.W. (3d) 760, (O.S.C.J. [Commercial List]), [hereinafter, *PSINet*]; *Re Atlantic Yarns Inc.,* 2008 CarswellNB 195, 2008 NBQB 144, 42 C.B.R. (5th) 107, 855 A.P.R. 143, 333 N.B.R. (2d) 143 (N.B.Q.B.) [hereinafter, *Atlantic Yarns*].

context.[8] Yet, the judicial dialogue that emerges from these cases reflects the pressing view of the United Nations Commission on International Trade Law Working Group V (Insolvency Law)[9]; the discussion in domestic law only concentrates on the circumstances in which it might be appropriate to consolidate insolvency estates. [10] Similarly, the small but valuable amount of scholarly literature in the domestic setting has focussed on examining the existing jurisprudence on the factors supporting consolidation.[11] Therefore, the objective of this paper is to go beyond the assessment already undertaken by other scholars by (a) gaining a deeper understanding of how substantive consolidation has evolved under the *CCAA* framework, (b) investigating whether the current legal landscape provides the most appropriate framework for dealing with the key issues relating to substantive consolidation in both the domestic and cross-border context, and (c) considering how, if necessary, the position could be enhanced or improved.

Accordingly, the rest of this paper proceeds as follows. Part 2 examines the current landscape in relation to the following key issues: (a) the factors supporting substantive consolidation, (b) the effect of substantive consolidation, (c) the multiple issues relating to the application for an order of substantive consolidation such as persons permitted to apply, timing of an application,

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[8] Rotsztain and De Cicco, *supra,* footnote 5, at page 343 note that despite the scarcity of case law on the doctrine of substantive consolidation under the *CCAA*, numerous consolidated plans of arrangement have been sanctioned by the courts.

[9] Hereinafter referred to as UNCITRAL Working Group V.

[10] UNCITRAL Working Group V, Note by Secretariat, Document A/CN.9/WG.V/WP.90, 9-13 November 2009, Vienna, paragraph 45.

[11] Rotsztain and De Cicco, *supra*, footnote 5; J. P. Sarra, "Corporate Group Insolvencies: Seeing the Forest and the Trees," (2008) 24(1) Banking and Finance Law Review 63. M. MacNaughton and M. Arzoumanidis, "Substantive Consolidation in the Insolvency of Corporate Group: A Comparative Analysis," in J. P. Sarra, ed., *2007, Annual Review of Insolvency Law* (Toronto: Thomson Carswell, 2007); B. Posno, "Substantive Consolidation in Canada," for full text see: *www.blakes.com/english/publications/RI/pdf/Paper102.pdf.*; M. MacNaughton, "Classification, Consolidation and Context: A Canadian Approach to Substantive Consolidation," (2009) 25 Banking and Finance Law Review 141; E. Hayes, "Substantive Consolidation under the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act," (1994) 23 Canadian Business Law Journal 444.

inclusion of a solvent group member and notice, and (d) the application of substantive consolidation in the cross-border context. Part 2 also looks towards the recent work of UNCITRAL Working Group V on substantive consolidation to propose an array of policy options for the application of the remedy under the *CCAA*. In doing so, it takes into account the scope of the *CCAA*, the balance between the need for flexibility and the demand for certainty in *CCAA* proceedings, what is desirable in practice and the nature of cross-border restructuring proceedings. Part 3, the concluding part of the paper, provides some overall conclusions.

PART 2: SUBSTANTIVE CONSOLIDATION UNDER THE *CCAA*

2.1 WHAT IS SUBSTANTIVE CONSOLIDATION?

Substantive consolidation is not defined by the statutory provisions of the *CCAA* or by the six reported cases[12] that specifically examine the doctrine. Therefore, it is important at the outset to identify what an order for substantive consolidation entails and how it differs from other forms of consolidation and remedies.

Substantive consolidation is the treatment of the assets and liabilities of two or more enterprise group members as if they were part of a single insolvency estate.[13] The practical effect of an order for substantive consolidation is that creditor claims are satisfied from a common pool of assets, inter-company transactions are extinguished and a levelling of creditor recoveries occurs by decreasing the recoveries of some creditors and increasing the recoveries of others.[14]

It is distinct from an order that grants procedural consolidation. Procedural consolidation[15] defines the situation whereby the court administers insolvency proceedings of multiple entities as one proceeding. Hence, the insolvency estates remain separate and distinct. The assets and liabilities are not treated as if they were part of a single insolvency estate.

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[12] Six reported *CCAA* cases, *supra*, footnote 7.
[13] UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, *supra*, footnote 1, page 4.
[14] UNCITRAL Working Group V, Report on Working Group V (Insolvency Law) on the work of its thirty-first session, Document A/CN.9/618, 11-15 December 2006, Vienna, paragraph 39.
[15] The term "procedural consolidation" is also referred to as "procedural coordination" in the UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, *supra*, footnote 1 at page 4, as "the coordination of the administration of two or more insolvency proceedings in respect of enterprise group members. Each of those members, including its assets and liabilities, remains separate and distinct."

In addition, the remedy of substantive consolidation should not be confused with the notion of lifting the corporate veil. In some instances, the law is prepared to disregard or look behind the corporate form and have regard to the realities of the situation.[16] Therefore, lifting the corporate veil, also known as piercing the corporate veil, involves treating the rights, liabilities or activities of the corporation as the rights or activities or liabilities of its shareholders.[17] The two doctrines appear similar since both ignore the orthodox principle of separate legal personality. However, there is a clear difference between them. Lifting of the corporate veil is a creditor's remedy against shareholders, disregarding the principle of limited liability. The doctrine of substantive consolidation, in principle, is a creditor's remedy against another creditor. There is a single insolvency estate where all assets and liabilities are pooled for all creditor claims.

2.2 FACTORS SUPPORTING CONSOLIDATION

There are six cases that have contributed to the development of the doctrine under the *CCAA* framework. The decision of the British Columbia Supreme Court in *Northland Properties*[18] was the first Canadian case to engage with the issue of substantive consolidation. In the case, the debtor companies sought, *inter alia*, an order merging and consolidating their reorganizations.

Due to the scarcity of Canadian cases dealing with the subject, Justice Trainor turned to United States jurisprudence that adopted a variety of approaches to determine the factors that support substantive consolidation in the domestic context. Justice Trainor accepted the analysis in *Snider*

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[16] L. Sealy and S. Worthington. *Cases and Materials in Company Law*. 8th ed. (Oxford, Oxford University Press: 2007), pages 51-70.
[17] *Ibid*, at page 51.
[18] *Northland Properties*, *supra,* footnote 7.

Brothers Inc. Re;[19] whereby the court held it must be clearly shown not only are the "elements of consolidation"[20] present but that the courts action is both necessary to prevent harm or prejudice and to effect a benefit generally. The approach taken was confirmed by the British Columbia Court of Appeal as the correct test for substantive consolidation.[21]

However, the four cases that followed on from *Northland Properties* failed to result in the development of significant additional jurisprudence,[22] creating a lacuna in the judicial reasoning as to the principles to be applied.[23]

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[19] *Snider Brothers Inc., Re*, 18. B.R. 230 (U.S. Bankr. Mass., 1982), [hereinafter, *Snider*].

[20] *Ibid.*, page 238. The seven "elements of consolidation" that were indentified in the case of *Vecco Construction. Industries Inc., Re*, 3 B.R. (Bankr. E.D. Va, 1980), as the difficulty in segregating assets; presence of consolidated financial statements; profitability of consolidating at a single location; commingling of assets and business functions; unity of interest in ownership; existence of intercorproate loan guarantees; and transfer of assets without observance of corporate formalities.

[21] *Northland Properties Ltd., Re*, (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195 (B.C.C.A.).

[22] In the case of *Fairview Industries* an application for substantive consolidation of six companies was brought before the Nova Scotia Supreme Court. The court held substantive consolidation was available in appropriate circumstances and given the interlocking of finances of the six debtor companies a consolidation order was appropriate.[22] In the case of *Lehndorff*, an application under the *CCAA* to file a consolidated plan of compromise was brought before the Ontario Court of Justice. The court held it was appropriate that a consolidated plan be approved. However, the court did not identify any judicial authority or cite the test that should be applied. In rendering the decision, Justice Farley looked towards significantly intertwined business operations that included multiple instances of inter-corporate debt, cross-default provisions and guarantees and a centralized cash management system. In the case of *Global Light* an application by the debtor companies for an order under the *CCAA* approving a plan of arrangement was brought before the British Columbia Supreme Court. Despite an objection from a creditor, the court granted the order. In considering whether to sanction a plan of compromise and arrangement, the court took into account four factors. Firstly, the objecting creditor had not previously opposed the plan despite having the opportunity to do so. Secondly, all creditors dealt with the parent company. Thirdly, the plan had been approved by a significant majority of creditors. Fourthly, the plan was fair and reasonable. Finally, in the case of *PSINet* the debtor companies brought a motion before the Ontario Superior Court to sanction a consolidated plan of compromise or arrangement. The court granted the order noting the consolidation plan avoided the complex and likely litigious issues surrounding the allocation of the proceedings from the sale of assets, reflected the intertwined nature of the business and in the circumstances was fair and reasonable. Yet, the court did not review the existing jurisprudence, such as Justice Trainor's approach in *Northland Properties*. Rather, Justice Farley simply noted that while consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect.

[23] Sarra, Seeing the Forest and the Trees, *supra*, footnote 11.

Nevertheless, the more recent case of *Atlantic Yarns* suggests there is a broad set of principles to determine the circumstances in which consolidation should be granted by the court. In the case of *Atlantic Yarns*, the debtors filed a consolidated plan of compromise and arrangement with the court under the *CCAA*. The plan encompassed two classes of creditors for the purposes of voting on the proposed plan; a secured class and an unsecured class. However, a motion was brought by a secured creditor asserting there should be no consolidation of creditors for voting purposes set out in the proposed plan. The issue before the New Brunswick Court of Queen's Bench was whether there should be a consolidated plan of compromise or arrangement in the circumstances.

In determining whether substantive consolidation should be granted, Justice Glennie firstly referred to the analysis given by Professor Sarra in *Rescue! The Companies' Creditors Arrangement Act*:[24]

> The court will allow a consolidated plan of compromise and arrangement to be filed for two or more related companies in appropriate circumstances...Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

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[24] J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, (Toronto: ThomsonCarswell, 2007) at page 242.

Guided by this analysis, Justice Glennie proceeded to review the "two-step" test taken by the court in *Northland Properties*. Firstly, there must be a balancing of interests, ensuring the creditors will suffer greater prejudice in the absence of consolidation than the debtors will suffer from its imposition. Secondly, the elements of consideration must be present. Finally, Justice Glennie referred to *PSINet* whereby Justice Farley noted whilst consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect.[25]

Hence, the approach of Justice Glennie can be formulated in three principles. Firstly, consolidation must be appropriate in the circumstances. The court must determine whether the elements of consolidation are present, such as the significant intertwining of assets and liabilities. Secondly, there must be a balancing of interests, ensuring the benefits will outweigh the prejudice to particular creditors if the debtor estates are consolidated. Thirdly, it is appropriate to look at the overall effect of consolidation. The court will consider whether consolidation is fair and reasonable in the circumstances of the case.[26]

The direction given by Justice Glennie in *Atlantic Yarns* is the most significant decision on the factors supporting substantive consolidation since the case of *Northland Properties*. For many years commentators have suggested the jurisprudence boasts inconsistent and fact specific judgements, failing to result in any meaningful guidance. However, *Atlantic Yarns* has confirmed that the questions to be asked in determining whether to grant consolidation are still the same as they were twenty years ago at the time of Justice Trainor's judgment in *Northland Properties*, only supplemented with the need to ensure the overall effect of consolidation is fair

[25] *PSINet*, *supra*, footnote 7 *per* Justice Farley at paragraph 11.
[26] Sarra, Seeing the Forest and the Trees, *supra*, footnote 11.

and reasonable. The current approach is both flexible and broad. It ensures the factors supporting consolidation can be applied in a variety of *CCAA* cases.

However, the case of *Atlantic Yarns* fails to indicate the standard to be applied in order to determine whether there is an intertwining of assets and liabilities. For example, should the test be that it is impossible to disentangle assets and liabilities or in the alternative that the unscrambling of assets and liabilities creates disproportionate additional expense or delay to the proceedings? The next section will explore this further.

2.2.1 SIGNIFICANT INTERTWINING

Three differing standards have been explored by Working Group V: (a) the "impossibility" of identifying the ownership of individual assets and responsibility for liabilities, (b) the ownership of assets and responsibility for liabilities cannot be identified "without undue cost and delay," and (c) the ownership of assets and responsibility for liabilities cannot be identified "without disproportionate expense or delay."

Initially it was proposed the standard to determine whether there was an intermingling of assets and liabilities should be the "impossibility to disentangle" the ownership of individual assets and responsibility for liabilities.[27] However, the Working Group noted the "impossibility" standard may create an extremely high threshold that in practice could be difficult to prove. Therefore, the Secretariat noted the approach maybe unworkable, requiring an alternative to the standard of "impossible to identify" to be considered.[28]

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[27] UNCITRAL Working Group V, Note by Secretariat, Document A/CN.9/WG.V/WP.76/Add.1, 14-18 May 2007, New York, paragraph 38.
[28] UNCITRAL Working Group V, Note by Secretariat, Document A/CN.9/WG.V/WP.80/Add.1, 3-7 March 2008, New York, paragraph 8.

The call for pragmatism led the discussions of Working Group V to a standard with a lower threshold: individual ownership of assets and responsibilities of liabilities cannot be identified "without undue cost and delay."[29] However, at its thirty-fourth session, Working Group V noted the meaning of the word "undue" was too uncertain and should be replaced with a concept of "disproportionality of expense and delay" to the amount that could be recovered for creditors or to the benefit to be derived from undertaking the identification.[30] Therefore, the Secretariat provided draft recommendations that reflected the standard of disproportionate expense or delay:[31]

> Where the court is satisfied that the assets or liabilities of the enterprise group members are intermingled to such an extent that the ownership of individual assets and responsibility for liabilities cannot be identified without disproportionate expense or delay.

However, further concerns were expressed about the scope of the standard of disproportionality. Firstly, it was suggested the term disproportionate was too vague[32] and the concept implied a comparison that was missing.[33] Nevertheless, the Working Group adopted the substance of the

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[29] *Ibid.*
[30] UNCITRAL Working Group V, Report of Working Group V (Insolvency Law) on the work of its thirty-fourth session, Document A/CN.9/647, 3-7 March 2008, New York.
[31] UNCITRAL Working Group V, Note by Secretariat, Document A/CN.9/WG.V/WP.82/Add.3, 17-21 November 2008, Vienna, paragraph 41.
[32] UNCITRAL Working Group V, Report of Working Group V (Insolvency Law) on the work of its thirty-sixth session, Document A.CN.9/671, 18-22 May 2009, New York, paragraph 104.
[33] UNCITRAL Working Group V, Report of Working Group V (Insolvency Law) on the work of its thirty-seventh session, Document A/CN.9/686, 9-13 November 2009, Vienna, paragraph 102.

draft legislative recommendations that employs the standard of" disproportionality of expense and delay."[34]

The Working Group V discussions are informative to the analysis of substantive consolidation under the *CCAA*. It signifies the need to rigorously examine the practical effects of any given approach and to ensure concepts used provide certainty and predictability. However, it is fundamental to situate the Working Group V findings within the framework of the *CCAA*.

Firstly, there is a difference in the terminology used in the Working Group V discussions and the jurisprudence on substantive consolidation under the *CCAA*. The Working Group V literature refers to the "intermingling of assets and liabilities" whilst the Canadian jurisprudence refers to the "significant intertwining of assets and liabilities." However, since the terms are analogous, the Working Group V discussions remain useful. Further, the "ownership" of assets and the "responsibility" of liabilities are not terms used in the Canadian jurisprudence. Nevertheless, it is clear the Canadian position would benefit from adopting this more defined approach.

Secondly, whilst the Canadian jurisprudence indicates the "intertwining of assets and liabilities" is a key factor Canadian courts look towards when determining to grant an order of substantive consolidation under the *CCAA*, other features of "intertwining" also appear relevant to the enquiry. In the case of *PSINet* Justice Farley referred to the "intertwined nature of the applicants and their business operations, which businesses in essence operated as a single business."[35] Furthermore, in the case of *Lehndorff*, his Honour noted the "business affairs of the applicants

[34] *Ibid.* The document does not reveal the reasons why Working Group V adopted the substance of the draft legislative recommendation.
[35] *PSINet*, *supra*, footnote 7 *per* Justice Farley at paragraph 2.

are significantly intertwined as there are multiple instances of inter-corporate debt, cross-default provisions, guarantees and a centralized cash management system."[36] Accordingly, these cases indicate whilst the Working Group V discussions centre on assets and liabilities, the approach under the *CCAA* is much broader. As a result, it is important to determine whether the same standard should apply to these additional factors or whether a separate standard should be adopted.

Finally, the three different standards presented by Working Group V each have to be examined in turn to ascertain what could be the most suitable approach for the scope of the *CCAA* framework. This paper suggests it would be wholly undesirable to impose an "impossibility" standard for identifying ownership of assets and responsibility of liabilities under the *CCAA* framework. In most cases, identification of ownership of assets and responsibility of liabilities can be obtained but it may result in a complex unravelling of financing transactions. Hence, the standard would impose a threshold that would be impractical to achieve. Further, should the standard apply to other features of intermingling, such as business functions and business operations the standard becomes even more redundant.

In contrast, the "without undue cost and delay" standard appears more suited to the *CCAA* framework. It recognises that in most cases, the identification of individual ownership of assets and responsibility for liabilities will inevitably generate additional costs and delays to the administration of the restructuring proceedings. Yet, the Canadian courts have suggested in the context of the *BIA* increasing administrative ease is not enough to counteract the possible

[36] *Lenhdorff*, *supra*, footnote 7 *per* Justice Farley at paragraph 2.

prejudice substantive consolidation can create for creditors.[37] As a result, although the "without undue cost and delay" approach provides a more practical threshold level in contrast to the "impossibility" approach, it fails to attach more importance to the possible potential prejudice to any creditor than the interests of time, expense and expediency.

Accordingly, with the need to ensure administrative ease is not the primary focus, it appears the standard of "without disproportionate expense or delay" is most suited to the scope of the *CCAA* framework and the existing jurisprudence on substantive consolidation. It reflects the notion that courts will undertake a balancing of interests exercise, assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. Further, should the standard be applied to other factors, such as business functions, it would be create an obtainable threshold.

However, in practice the intermingling of assets and liabilities can be hard to quantify. The courts will look towards fact specific information to determine the degree of intermingling, such as how assets were transferred and the manner the group operated financially. Therefore, even though it is fundamental to have a clear criterion which judges assess the relevant issues against, the many factors courts take into account may not be easily prescribed on paper. Nevertheless, this paper suggests the standard of "without disproportionate expense or delay" appears most suited to *CCAA* framework. It reflects the balancing of interests exercise Canadian courts undertake and provides a threshold that is practical.

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[37] See *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102, 1995 CarswellOnt 53 (Ont. Bktcy.) Whilst this case is governed by the *BIA*, it is informative to the discussion because it emphasises the courts reluctance to grant substantive consolidation on the grounds of expediency.

2.3 THE EFFECT OF CONSOLIDATION

The judicial dialogue has focussed on two common effects of consolidation. Firstly, the courts note consolidation has the potential to prejudice the rights of creditors stemming from the levelling of recoveries. In *Northland Properties*, Justice Trainor referred to the analysis given by the court in the case of *Snider*; "substantive consolidation, in all most all instances, threatens to prejudice the rights of creditors...this is so because separate debtors will almost always have different ratios of assets to liabilities. Thus the creditors of a debtor whose asset-to-liability ratio is higher than that of its affiliated debtor must lose to the extent that the asset-to liability ratio of the merged estates will be lower."[38] In *PSINet*, Justice Farley also noted that consolidation by its very nature will benefit some creditors and prejudice others.[39] Secondly, the courts have recognised the extinguishment of inter-company debts and obligations is an effect of consolidation. In *Global Light*, Justice Pitfield held the consolidated plan would deprive the creditor of the right to seek to recover on its guarantees.[40]

However, there are several effects of consolidation the courts have yet to discuss. These include: Should there be a combined meeting of creditors? Can certain assets or claims be excluded from the consolidation? The following section takes issue with these questions.

2.3.1 MEETING OF CREDITORS

Where a compromise or arrangement is proposed between the debtor and its creditors, section 4 and section 5 *CCAA* notes the court may order a meeting of creditors or class of creditors. At such meetings creditors are usually invited to vote on the proposed plan. In the case of

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[38] *Snider*, *supra*, footnote 19 at page 234.
[39] *PSINet*, *supra*, footnote 7 *per* Justice Farley at paragraph 11.
[40] *Global Light*, *supra*, footnote 7 *per* Justice Pitfield at paragraph 22.

proposing a consolidated plan, Working Group V suggests a single meeting would save time and costs.[41] This paper suggests this approach is both practical and workable for the *CCAA*.

2.3.2 EXCLUSIONS FROM AN ORDER OF CONSOLIDATION

The exclusion of certain assets or claims in an order for substantive consolidation may be advantageous in some *CCAA* cases. In particular, whereby a secured creditor's interest encumbers specific assets excluding them from the process of consolidation may ensure the interest does not extend to the whole of the consolidated estate.[42] The practical effect is that creditors with excluded claims are not entitled to vote at the creditors' meeting or receive any distributions from the consolidated plan of compromise or arrangement.

Yet, since the Canadian courts have suggested a key factor supporting consolidation is the intermingling of assets and liabilities, excluding such assets may require ownership of individual assets to be clearly identified.

Working Group V has suggested courts should be permitted to exclude specified assets and claims from an order for substantive consolidation and specify the circumstances in which those exclusions might be ordered.[43] However, since the *CCAA* is a flexible instrument, this paper suggests the approach should ensure exclusions can be applied in a variety of restructuring cases.

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[41] UNCITRAL Working Group V, *supra*, footnote 28 at paragraph 19.
[42] UNCITRAL Working Group V, *supra*, footnote 31 at paragraph 30-31.
[43] UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, *supra*, footnote 1 at paragraph 135-137.

2.4 APPLICATION FOR SUBSTANTIVE CONSOLIDATION

An application for substantive consolidation under the *CCAA* raises many questions. What parties are able to make an application? At what time in the proceedings can an application be made to the court? Is notice to affected parties a prerequisite requirement? Can a solvent group member of an enterprise group be included in an application for substantive consolidation? This section examines the current legal landscape and Working Group V discussions to find appropriate answers to these questions.

2.4.1 PARTIES PERMITTED TO MAKE AN APPLICATION

In most cases, the debtor makes an application for an order for substantive consolidation. In the cases of *Northland Properties* and *PSINet* a motion was brought by the debtor for an order that merged and consolidated their reorganisation for all purposes.[44] Similarly in the case of *Lehndorff*, the application for consolidation was brought by debtor companies for an order sanctioning a consolidated plan of compromise and arrangement that had been approved by creditors.[45] This finding is largely unsurprising. Sarra notes in most *CCAA* cases the debtor company proposes a plan of arrangement and compromise.[46] The debtor is well placed to discuss and negotiate with all creditors the terms of the substantive consolidation plan and propose it to the court.

The case of *Fairview Industries* also indicates the court will permit an application for substantive consolidation by creditors. In the case at hand, the issue of consolidation was raised by both the debtors and its creditors.[47] The case of *Atlantic Yarns* also suggests a creditor may bring a

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[44] *Northland Properties*, *supra*, footnote 7 *per* Justice Trainor at paragraph 27.
[45] *Global Light*, *supra*, footnote 7 *per* Justice Pitfield at paragraph 1.
[46] Sarra, Seeing the Forest and the Trees, *supra*, footnote 11 at page 233.
[47] *Fairview Industries*, *supra*, footnote 7 *per* Chief Justice Glube at paragraph 38.

motion challenging the application for substantive consolidation. A motion was brought by a secured creditor challenging the voting procedures set out in relation to the proposed consolidated plan of compromise and arrangement filed by the debtor companies. However, the existing case law fails to indicate whether an application can be brought by the monitor or whether the court is permitted to order consolidation on its own initiative.

2.4.1.1 MONITOR

As part of the initial order, the court will appoint a monitor to supervise the business and financial affairs of the debtor in the *CCAA* proceedings.[48] The monitor, as a court appointed officer, acts as "the eyes and ears" of the court. The monitor will oversee the ongoing operations of the debtor, assist with the filing and voting of the plan of compromise or arrangement and report to the court on the practicality of the plan. The monitor also acts independently and impartially in the interest of all stakeholders in the *CCAA* proceedings.

In practice, the role of the monitor has expanded in scope in recent years. Knowles notes the role of the monitor, now as a matter of course, goes beyond simply providing information to the court regarding the business and financial affairs of the debtor and providing recommendations to the court.[49] The role of the monitor can include reporting to secured creditors, selling assets with secured creditor approval and negotiating with various stakeholders.

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[48] *CCAA* section 11.7.

[49] See D. I. Knowles, "To liquidate or restructure under the *CCAA*? The Monitor's Conflicting Duties" in J.P. Sarra, ed., *2006, Annual Review of Insolvency Law* (Toronto: Carswell, 2006) at page 95 -100.

These basic duties are set out in the *CCAA*. Section 23 *CCAA* notes the monitor's duties include, *inter alia,* reviewing the company's cash flow statements,[50] filing a report to the court on the state of the company's business and financial affairs,[51] advising the company's creditors of the filing of the report[52] and advising the court on the reasonableness and fairness of any compromise or arrangement that is proposed between company and its creditors.[53] Further, section 23(1)(k) *CCAA* permits the monitor to carry out any other functions in relation to the company that the court may direct.[54] The broad and pragmatic scope of section 23(1)(k) *CCAA* recognises the need to ensure the monitor can continue to undertake any practical function that will add benefit to the restructuring process that lies in the interests of all stakeholders. Therefore, section 23(1)(k) *CCAA* appears to provide the gateway to permit the monitor to make applications for substantive consolidation in future *CCAA* proceedings.

In most *CCAA* cases the monitor will possess the most complete information regarding the restructuring of the debtor's affairs and issues that may arise in relation to it. Therefore, the advantage of the monitor being permitted to make the application for substantive consolidation stems from the monitor's ability to assess the appropriateness of such an order with an array of information available that may not be possessed by other parties privy to the proceedings.

When this issue was considered by UNCITRAL Working Group V the benefits of such an approach were clearly noted. At its thirty-third session, the Working Group suggested since it is

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[50] *CCAA* section 23(1) (b).
[51] *CCAA* section 23 (1) (d).
[52] *CCAA* section 23(1) (e).
[53] *CCAA* section23 (1) (i).
[54] *CCAA* section 23(1) (k).

often the insolvency representative[55] who would be in the best position to apply for a consolidation order, possessing the most complete information about the debtor companies necessary to assess the desirability of substantive consolidation, the insolvency representatives should be permitted to apply.[56] This view was later embodied in the draft legislative recommendations as follows:[57]

> *Persons permitted to apply*
>
> 223. The insolvency law should specify the persons permitted to make an application for substantive consolidation, which may include an enterprise group member, the insolvency representative of an enterprise group member or a creditor of any such group member.

Yet, despite the clear advantages of extending the role of the monitor to include bringing an application for substantive consolidation it is fundamental it does not create a conflict of interest. The monitor must remain independent and impartial throughout the *CCAA* process. In *Re Stokes Building Supplies Ltd*[58] the court noted since tremendous reliance is placed on the views and recommendations of the monitor in the *CCAA* process, it is vital neither shareholders nor creditors have any influence over the monitor. Further, in the case of *Siscoe and Savoie v. Royal*

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[55] The term "insolvency representative" is not defined in the UNCITRAL Working Group V literature. However, it is presumed for the purpose of this discussion the term would cover the role of the monitor under the *CCAA*.
[56] UNCITRAL Working Group V, Report of Working Group V (Insolvency Law) on the work of its thirty-third session, Document A/CN.9/643, 5-9 November 2007, Vienna, paragraph 82.
[57] UNCITRAL Working Group V, *supra,* footnote 10 at paragraph 15.
[58] *Stokes Building Supplies Ltd., Re* (1992), 13 C.B.R. (3d) 10 (Nfld. T.D.) at paragraph 15.

Bank[59] the New Brunswick Court of Appeal noted the monitor has a fiduciary obligation to ensure that one creditor is not given an advantage over any other creditor.

However the very nature of substantive consolidation, the pooling of assets and liabilities to create one single insolvency estate, may cast some doubt over the ability of the monitor to fulfill its duties without conflict. The monitor may be seen to be acting in the interests of only those creditors who gain an increase in recoveries over those who may see a diminished return.

Nevertheless, there are two principal safeguards against any potential conflict of interest issues. Firstly, section 6(1) *CCAA* provides a plan of compromise or arrangement has to be voted on by creditors prior to an application for court approval. Therefore, given in most cases an application for substantive consolidation is brought when asking the court to sanction the plan of compromise or arrangement, all creditors would have voted on such a proposal. As a result, it seems difficult to challenge the monitor's application on grounds of acting in the interest of one creditor over another. In practice, any contested issue regarding the plan of compromise or arrangement will centre on the fairness and reasonableness of the plan or the voting procedures used. This was demonstrated in the case of *Atlantic Yarns* whereby the secured creditor brought a motion challenging the application for substantive consolidation by the debtor companies on the basis that the voting procedure set out in relation to the plan was unfair and unreasonable. Secondly, section 23(1)(k) *CCAA* underlines the fact that the extension of the monitor's role is at the discretion of the court. Therefore, should the application jeopardise the monitor's ability to remain impartial and independent throughout the *CCAA* process, the court would not permit the monitor to carry out such a function.

[59] *Siscoe & Savoie v. Royal Bank* (1994), 29 C.B.R. (3d) 1 (N.B.C.A).

To this end, it appears advantageous to permit the monitor to make an application for substantive consolidation. The monitor is likely to possess the most complete information regarding the debtor companies necessary to assess the desirability of substantive consolidation. Furthermore, section 23(1)(k) *CCAA* makes clear the extension in the monitor's role is discretionary. The court will only allow the monitor to make an application on the basis that it does not create any conflict of interest.

2.4.1.2 THE COURT

The role of the court in *CCAA* proceedings is primarily supervisory in nature. The court serves to approve the framework for negotiation, determine matters that will facilitate the process and has overall responsibility to ensure the statutory requirements are met.[60] Yet, in recent years the courts have continued to make both substantive and procedural determinations regarding the restructuring process.[61] In doing so, it relies on section 11 *CCAA* to exercise its jurisdiction to make any order it considers appropriate in the circumstances. Therefore, should section 11 *CCAA* be relied upon in order to grant substantive consolidation?

When this issue was examined by UNCITRAL Working Group V, it was agreed the court should not be able to act on its own on such matters of gravity.[62] The key reason stemmed from the need to ensure parties had the opportunity to be heard and object to such an order.[63]

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[60] Sarra, Rescue, *supra*, footnote 24 at page 60.
[61] In recent years the courts have relied on section 11 *CCAA* to introduce debtor in possession financing and broaden the definition of insolvent.
[62] UNCITRAL Working Group V, *supra*, footnote 31 at paragraph 24.
[63] UNCITRAL Working Group V, *supra*, footnote 10 at paragraph 15.

The *CCAA* framework is focussed on providing a fair and equitable process with respect to devising a plan of compromise or arrangement between the debtor and creditors. Section 6(1) *CCAA* provides that in an order for compromises to be sanctioned by the court, creditors have to vote in favour of the plan in the requisite statutory amounts.[64] Section 6(1) *CCAA* requires the court to then critically examine whether there has been strict compliance with statutory requirements, all materials are filed and procedures carried out and whether the plan is fair and reasonable.

Therefore, this paper suggests although section 11 *CCAA* appears to provide an open door for courts to grant orders as it sees fit, it seems undesirable for the court to take such action in relation to substantive consolidation. The potentially drastic impact substantive consolidation can have on creditor's rights demand and fair and equitable process.

2.4.2 TIMING OF AN APPLICATION

In most *CCAA* cases an application for substantive consolidation is made *after* the initial order, at a subsequent hearing when the debtor is requesting the court to sanction a consolidated plan of compromise or arrangement.[65] However, in some cases it may be impossible to grant consolidation at a late stage in the proceedings when key matters may have been resolved, such as the sale or disposal of assets. Hence, the case of *Lehndorff* suggests an application for consolidation may be brought at the same time as a request for an initial stay of proceedings.

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[64] *CCAA* section 6(1).
[65] See *Northland Properties, Fairview, PSINet, Global Light* and *Atlantic Yarns.*

Therefore, the current approach appears to be flexible, taking into account the status of the administration in the particular case.

The key advantage to the current flexible approach to the timing of an application stems from its potential to ensure the remedy of substantive consolidation is widely available in a variety of restructuring cases. Yet some commentators argue a more rigid approach to the timing of an application for substantive consolidation is desirable. Rotsztain and De Cicco argue an application should be made no later than at the time of filing of the *CCAA* plan.[66] This would ensure the issue is adequately addressed prior to the debtor going to the expense of distributing the plan to creditors, convening a creditor's meetings to vote on the plan and avoiding the intense pressure to have the court approve the plan and permit its implementation.[67]

However, this paper argues a strict approach is not suitable for the *CCAA* for two key reasons. Firstly, as noted by UNCITRAL Working Group V, in some cases the factors supporting consolidation may not be certain or apparent at the time proceedings commence.[68] Therefore, a rigid approach can create a missed opportunity for employing a consolidated plan of compromise or arrangement. It has the potential to hinder the restructuring process by preventing a consolidated plan of compromise or arrangement to be devised between parties at the time of the proceedings where it may be the most suitable option in the circumstances.

Secondly, the statutory language of the *CCAA* acknowledges the need for flexibility. Section 6(2) *CCAA* permits creditors to modify the plan of compromise or arrangement *at the meeting of*

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[66] Rotsztain and De Cicco, *supra*, footnote 5.
[67] *Ibid.*
[68] UNCITRAL Working Group V, *supra*, footnote 10 at paragraph 155.

creditors to vote on the proposed plan. Section 7 *CCAA* notes where the change is made *after a meeting* at which creditors have voted on a plan, the court can proceed using its discretion to sanction the plan without creditors voting if it feels no party is adversely affected. Further, most plans of compromise or arrangement provide for a "comeback" clause, entitling the creditors or the debtor to return to court to modify an existing agreement.

Therefore, this paper argues a flexible approach to the timing of an application for substantive consolidation reflects the practical need to ensure the remedy is available at any given moment in the restructuring process. Restrictions on the timing of an application would negatively impact the core purpose of the *CCAA*; devising a plan of compromise or arrangement that enables the debtor to continue business but ensures its creditors receive some form of payment for the amounts owing to them.

2.4.3 NOTICE

As already noted, applications for a consolidated plan of compromise or arrangement usually occur *after* the debtor s have received an initial order from the court. In such cases, the issue of notice appears relatively straightforward; it is unlikely the court will approve a plan whereby the affected parties have not received notice of the application and not voted on the plan. However, the issue of notice becomes slightly less straightforward when the application for consolidation is brought at the *same time* as an initial order.

In some *CCAA* cases, applications for an initial stay order are brought by the debtor without notice, on an *ex parte* basis.[69] The practical reason for applying on an *ex parte* basis is that it prevents creditors from moving to realize on their claims.[70] This was the case in *Fairview Industries* whereby the six debtor companies expressed concern that if they were required to give notice of the application, it would give the secured creditor the opportunity to appoint a receiver, which could prevent the applicant from qualifying under the *CCAA*.[71] Therefore the inquiry in relation to consolidation becomes, will the court grant a consolidation order on an *ex parte* basis or in conjunction with an application for an initial order on an *ex parte* basis?

The only case that is relevant in answering this matter is *Lehndorff*. In the case an application for consolidated was brought at the same time as the application for an initial order for a stay of proceedings, with notice to the various creditors. However, Justice Farley noted the court will be concerned when major creditors have not been alerted even in the most minimal fashion.[72] Therefore, the current landscape suggests it is unlikely the courts will grant a consolidation order on an *ex parte* basis, or in conjunction with an initial order on an *ex parte* basis, due to the potentially drastic impact on creditor rights. It is vital creditors can review their position in light of the proposed consolidation that may be favourable or unfavourable depending on the levelling of recoveries that occur.

However, the relevant *CCAA* statutory provisions for most applications that alter the substantive rights of creditors state that notice only has to be provided to secured creditors. For example, section 11.2 *CCAA* provides an application by a debtor for interim financing must provide notice

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[69] Sarra, Rescue, *supra*, footnote 24 at page 55.
[70] *Ibid.*
[71] *Fairview Industries*, *supra*, footnote 7 *per* Justice Glube at paragraph 20.
[72] *Lehndorff*, *supra*, footnote 7 *per* Justice Farley at paragraph 3.

to secured creditors who are likely to be affected by the security or charge. Section 11.51(1) *CCAA* indicates an application by a debtor for security or charge relating to director's indemnification notice must be given to secured creditors who are likely to be affected by the security or charge.

However, in the case of an application for substantive consolidation, this paper suggests notice should be provided to all creditors groups for two reasons. Firstly, secured creditor claims are typically carved out and excluded from a consolidation order. Therefore, it is usually only the claims of priority and unsecured creditors that are the foundation of the consolidated insolvency estate. Secondly, even in cases whereby the encumbered assets of the secured creditor are needed for restructuring, the secured creditor can surrender its security interests following the consolidation and the debt can be paid by the consolidated insolvency estates.

The issue of notice to creditors of solvent entities also raises fundamental questions concerning the scope of the *CCAA*. On one hand, the case of *Stelco*[73] indicates the *CCAA* framework is only available to debtors that meet the definition of "insolvent," a debtor who is "reasonably expected to run out of liquidity within a reasonable proximity of time as compared with the time reasonably required to implement a restructuring."[74] Therefore, on this basis, the *CCAA* does not appear to envisage creditors of a purely solvent debtor to be provided notice. Further, providing notice of an application to the creditors of a solvent debtor could affect the commercial standing of that entity.[75] In practical terms, this may result in a lack of confidence by its investors and

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[73] *Stelco Inc., Re* (2004), 2004 CarswellOnt 1211 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]), [hereinafter, *Stelco*].
[74] *Ibid., per* Justice Farley at paragraph 40.
[75] UNCITRAL Working Group V, *supra*, footnote 57 at paragraph 85.

creditors, potentially resulting in further financial instability. Yet, on the other hand, providing notice to all creditors upholds the notion of equal treatment of creditors to solvent and insolvent entities.[76] Therefore, this paper suggests the discussion of notice to creditors of solvent entities requires careful consideration.

2.4.4 INCLUSION OF A SOLVENT GROUP MEMBER

To be granted relief under the *CCAA* a debtor must be insolvent having debts greater than $5 million.[77] Until recently, many believed the definition of insolvent under the *BIA* should be used in *CCAA* proceedings.[78] Section 2(1) *BIA* states:

> "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

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[76] *Ibid.,* at paragraph 85.

[77] Sarra, Rescue, *supra,* footnote 24 at page 6. Section 2 *CCAA*. Section 2 of the *CCAA* defines a "debtor company" as any company that:(a) is bankrupt or insolvent, (b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts, (c) has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act*, or(d) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent.

[78] R. Yalden *et al*, *Business Organizations: Principles, Policies and Practice*, (Toronto, Emond Montgomery Publication, 2008), page 1187.

> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

However, the Ontario Superior Court in the case of *Stelco* has stated 'insolvent' should be given an expanded meaning under the *CCAA*.[79] Justice Farley held a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within a reasonable proximity of time as compared with the time reasonably required to implement a restructuring."[80] Justice Farley acknowledged that under the "traditional" and more restrictive insolvency test in laid down in section 2(1) *BIA* the debtor in the case, Stelco, would not be 'insolvent.' Therefore, the new test laid down in *Stelco* indicates debtor companies can qualify for relief under the *CCAA* with a much wider and relaxed insolvency requirement.

To date there has not been a case that tests the scope of *Stelco* for the purposes of consolidation. However given the wider scope of the meaning of insolvency in *Stelco*, two assumptions can be made. Firstly, as DaRe notes, as long as there is at the time of filling, a "reasonably foreseeable expectation" of a liquidity problem,[81] it seems likely a debtor will fit under the *CCAA* insolvency umbrella for the purposes of consolidation. Secondly, despite the *CCAA* having a broad remedial purpose, it seems unlikely the courts will permit a solvent group member of an enterprise group to be included in an application or order for consolidation.

However, in cases where an insolvent debtor acts as one arm of the business operations and the solvent debtor acts as the other, consolidating the two entities can create financial stability and in particular prevent the liquidation of the insolvent debtor company. Therefore, including a

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[79] *Stelco, supra,* footnote 73 *per* Justice Farley at paragraph 25.
[80] *Ibid., per* Justice Farley at paragraph 40.
[81] V. DaRe, "Is 'Insolvency' Still a Prerequisite to Restructuring?" (2004) C.B.R. (4th) 163.

solvent group member in an application for substantive consolidation can help craft a successful restructuring plan that takes into account the *total* business operations of the group.

Yet, the inclusion of a solvent group member can have potentially drastic effects on creditors' rights. In the case whereby the solvent debtor has more assets than liabilities to contribute to the consolidated insolvency estate, it will create a deeper levelling of creditor recoveries by vastly varying the pool of assets available for distribution between creditors. It could decrease the recoveries of creditors of the solvent group member but increase the recoveries of other creditors, such as those of the insolvent group member. Therefore, creditors of the solvent group member may have particular concerns about these significant consequences of the consolidation. Therefore, it is important the consolidation order only extends to the net equity of the solvent group member in order to protect the rights of those creditors.[82] The practical effect is that certain encumbered assets may have to be carved out of the order or certain claims may have to be excluded from the consolidation. Therefore, although the inclusion of a solvent group member may appear to provide better financial stability to the total group operation, creditors of the solvent group member may be reluctant to participate in the consolidation without protection their position. As a result, a limited approach may have to be adopted.

Nevertheless, the broader definition of insolvent from the case of *Stelco* can be seen to provide the courts with a useful stepping stone. As long it can be proven at the time of filing, there is a "reasonably foreseeable expectation" of a liquidity problem[83] the debtor company could fit under the *CCAA* insolvency umbrella for the purposes of consolidation.

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[82] UNCITRAL Working Group V, *supra*, footnote 25 at paragraph 36.
[83] DaRe, *supra*, footnote 81.

2.5 SUBSTANTIVE CONSOLIDATION IN THE CROSS-BORDER CONTEXT

The issues surrounding an order for substantive consolidation in the cross-border context have yet to be addressed by the Canadian courts or the *CCAA* statutory provisions. The current *CCAA* cross-border provisions, modelled on the UNCITRAL Model Law on Cross Border Insolvency,[84] recognises the need to facilitate cross-border restructuring proceedings by offering various mechanisms and obligations to promote: cooperation between the courts, greater legal certainty for trade and investment, the fair and efficient administration of cross-border insolvencies that protects the interests of creditors and other interested persons, and those of debtor companies, the protection and the maximization of the value of debtor company's property and the rescue of financially troubled businesses to protect investment and preserve employment.[85] Firstly, a foreign representative[86] is permitted to apply to the Canadian court for recognition of a foreign proceeding.[87] Secondly, the concept of centre of main interests[88] has been adopted to determine main and non main proceedings.[89] Thirdly, where an order recognizing a foreign proceeding is made, there is an obligation on the courts to cooperate to the maximum extent possible, with the foreign representative and the foreign court involved in the foreign proceeding.[90] Finally, the

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[84] UNCITRAL Model Law on Cross-Border Insolvency Law 1997 into both *CCAA* and the *BIA*. .For full text of the Model Law see http://www.UNCITRAL.org/pdf/english/texts/insolven/insolvency-e.pdf. [hereinafter, UNCITRAL Model Law on Cross-Border Insolvency Law].

[85] *CCAA* section 44(1).

[86] *CCAA* section 45 A foreign representative is defined in Section 45(1) *CCAA* as defined as a person or body, including one appointed on an interim basis, who is authorized, in a foreign proceeding respect of a debtor company, to (*a*) monitor the debtor company's business and financial affairs for the purpose of reorganization; or (*b*) act as a representative in respect of the foreign proceeding.

[87] *CCAA* section 46.

[88] *CCAA* section 45(2). The centre of the debtors main interest is defined as in the absence of proof to the contrary, a debtor company's registered office is deemed to be the centre of its main interests.

[89] *CCAA* section 45(1). A foreign main proceedings means a foreign proceeding in a jurisdiction where the debtor company has the centre of its main interests. A foreign non main proceedings means a foreign proceeding other than a foreign main proceeding.

[90] *CCAA* section 52(1).

CCAA provisions expressly recognize multiple proceedings in order to facilitate coordination between local and one or more foreign proceedings and foster coordination of decision making.[91]

However, the *CCAA* cross-border provisions[92] wholly fail to address issues stemming from the financial distress of an enterprise group in the international context. Consequently, the application of substantive consolidation in the international context remains a challenge to be met. It appears the current *CCAA* cross-border provisions only apply in terms of facilitating cooperation after substantive consolidation has been achieved in a domestic context.[93] However, even this appears problematic. Since the Canadian court may not be dealing with the same debtor as the foreign court each proceeding may appear unconnected to each other, making cooperation seem unnecessary.

The application of substantive consolidation in the cross-border context is also strained by the difficulties posed by a cross-border case. In domestic *CCAA* proceedings where the debtor, creditors and all assets are within the territorial reach of the Canadian court, proceedings can be arguably straightforward and within the "comfort zone" of the court and parties privy to the proceedings. The mechanisms and remedies available to the debtor and its creditors under the *CCAA* are usually well understood.[94] However, if the debtor has assets or creditors in two or more jurisdictions, cross-border insolvency proceedings can become complex, generating various difficulties that may not occur in the domestic setting.

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[91] *CCAA* section 54 and 55. For a more detailed discussion on multiple proceedings see J. P. Sarra, "*Crossing the Finish Line: the Potential Impact on Business Rescue of Adoption of new Cross-Border Insolvency Provisions*. For full text see: http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02022.html.

[92] The UNCITRAL Model Law on Cross-Border Insolvency Law also fails to recognise the existence of enterprise groups.

[93] UNCITRAL Working Group V, Report on Working Group V (Insolvency Law) on the work of its thirty-fifth session, Document A/CN.9/666, 17-21 November 2008, Vienna at paragraph 96.

[94] L.J. Town, "A Banker's Perspective" in M. Bridge and R. Stevens, *Cross-Border Security and Insolvency* (Oxford: Oxford University Press: 2001).

The most noteworthy difficulty generated by a cross-border case is the differing attitudes to insolvency in various jurisdictions. Insolvency is commonly described as the inability of a debtor to command sufficient liquidity of resources to enable debts to be paid as they fall due.[95] The phenomena of insolvency has to be dealt with by any society that recognises the use of credit because as soon as society provides the ability to commit to future performance of an obligation, it provides the chance that performance will not be possible at that future time.[96] Therefore, there is always a degree of risk that those who are owed money by a firm will suffer because the firm may be unable to meet its debts on the due date.[97] In today's modern society, most jurisdictions possess a formal legal insolvency regime to tackle the inability of debtors to pay debts as they become due. However, the attitude and approach taken by the jurisdiction can and will vary the economic, legal and social consequences considerably. These differences can be rooted principles of law, such as how to balance the interests of the debtor, its creditors and the wider society. Differences can also be less obvious, such as questions of procedure or due process.

The practical effect on the application of substantive consolidation is twofold. Firstly, the remedy may not be widely accepted in all jurisdictions. Secondly, even in jurisdictions where substantive consolidation is available under domestic law, agreement by all concerned that particular group members should be consolidated on a cross-border basis may be absent or in question regarding various issues.

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[95] I. Fletcher, *Insolvency in Private International Law* (Oxford: Oxford University Press, 2005) at page 1. This is also known as the 'cash-flow' test of insolvency.
[96] F. M. Tomlie, *Corporate and Personal Insolvency,* (Routledge: Cavendish, 2003) at page 3.
[97] V. Finch, *Corporate Insolvency Law: Themes and Perspectives*, (Cambridge: Cambridge University Press, 2002) at page 1.

The approach to cross-border insolvency can also vary drastically in each jurisdiction. As a result, the literature indicates there are two key rival principles that dominate the approach towards cross-border cases; territorialism and modified universalism. The traditional approach of territorialism indicates the court in each jurisdiction where the debtor has assets is responsible for the distribution of those assets. This approach is also referred to as the "grab rule" – creditors being able to grab assets available in the local proceedings. The practical effect is parallel proceedings are usually initiated in each jurisdiction that the debtor has assets or creditors.

Lo Pucki argues the application of territorialism to multinational cases presents no serious problems,[98] and in fact can be seen to have advantages. Firstly, from the local creditors' perspective, there is a smaller pool of assets available that will be held only for their benefit. Secondly, from the perspective of all parties privy to the proceedings, the system appears clear and predictable. It is the location of the particular asset that determines the identity of the court and the law that will applied, the *lex situs*. The third advantage is an offspring of the second. Clearly identified forums and laws enable parties to act quickly and courts to be prompt.

The practical effect on substantive consolidation is that territorialism appears to only permit the insolvency estates in the reach of the local court to be consolidated. This can lead to two unfavourable outcomes. Firstly, should substantive consolidation be applied separately in multiple proceedings, it can create an inefficient administration of the enterprise group. Litigation costs can increase whilst the process of obtaining a timely resolution may be slower.

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[98] L. Lo Pucki, "The Case for Cooperative Territoriality in International Bankruptcy," (1999) 98 Michigan Law Review 2216 at page 2219. Also see L. Lo Pucki, "Global and Out of Control" (2005) 79 American Bankruptcy Law Journal 79; L. Lo Pucki, "Universalism Unravels" (2005) 79 American Bankruptcy Law Journal 143.

Secondly, the process lowers the overall value of the debtor's assets since the value of the whole debtor estate will always be greater than the sum of the constituent parts.[99]

On the other hand, the principle of modified universalism respects nation's domestic laws but provides for a single main proceeding in the debtor's home country and recognises the support of ancillary proceedings where assets are located or support from the local court is required.[100] Modified universalism is the foundation of the *CCAA* cross-border provisions. The practical effect on the application of substantive consolidation is it encourages courts to take a global view of the enterprise group.

Language barriers and imperfect or lack of information can also hinder the ability of parties privy to the proceedings to make fully informed decisions. For example, in the Nortel restructuring information concerning the financial position of each individual corporation and the debt structure of the global enterprise was hard to obtain.[101] Therefore, it may be difficult for parties to agree the debtor estates should be consolidated in the presence of asymmetric information.

In the recently published *Legislative Guide on Insolvency Law, Part Three: The Treatment of Enterprise Groups,* Working Group V proposes the first step to finding a solution to the problem of how to facilitate the global treatment of enterprise groups will be to ensure that existing

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[99] Justice Farley at the UNICITRAL 6th Multinational Judicial Colloquium, held in Sydney Australia 12-15th March 2005. For full text and comments made by Justice Farley see: http://www.UNCITRAL.org/pdf/english/news/SixthJC.pdf. Justice Farley was a former judge on the Ontario Superior Court, with extensive experience in corporate insolvency proceedings.

[100] J. Westbrook, "A Global Solution to International Default," (1997) 98 Michigan Law Review 2276 at pages 2292-97. For further commentary on the principle of universalism and modified universalism see: J. Westbrook, "Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation," (2002) American Bankruptcy Law Journal 1.

[101] D. C. Tay and J. L. Stam, "Challenges of Restructuring and Integrated International Business," in J. P. Sarra, ed., *2009, Annual Review of Insolvency Law 2009,* (Toronto: Carswell, 2009) at page 234.

principles for cross-border cooperation apply to enterprise groups.[102] Accordingly, various draft legislative recommendations have been proposed in order to promote cooperation in enterprise group situations. These include: ensuring foreign representatives and creditors have access to the courts for foreign representatives and the recognition of the foreign proceedings in respect to enterprise groups;[103] cooperation between the domestic court and foreign courts or foreign representatives;[104] cooperation to the maximum extent possible between courts;[105] the use of direct communication between the domestic court and foreign courts or foreign representatives;[106] cooperation between the insolvency representative and foreign courts;[107] cooperation between the insolvency representative;[108] communication between insolvency

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[102] UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, *supra,* footnote 1 at paragraph 7. .

[103] *Ibid.,* at paragraph 19. The recommended legislative provisions state the insolvency law should provide, in the context of insolvency proceedings with respect to enterprise group members, (a) access to the courts for foreign representatives and creditors; and (b) recognition of the foreign proceedings, if necessary under applicable law.

[104] *Ibid.,* at paragraph 40. The recommended legislative provisions state The insolvency law should permit the court that is competent with respect to insolvency proceedings concerning an enterprise group member to cooperate to the maximum extent possible with foreign courts or foreign representatives, either directly or through the insolvency representative or other person appointed to act at the direction of the court, to facilitate coordination of those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group.

[105] *Ibid.,* at paragraph 40. The recommended legislative provisions state the insolvency law should specify that cooperation to the maximum extent possible between the court and foreign courts or foreign representatives be implemented by any appropriate means.

[106] *Ibid.,* at paragraph 40. The recommended legislative provisions state the insolvency law should permit the court that is competent with respect to insolvency proceedings concerning an enterprise group member to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives concerning those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group to facilitate coordination of those proceedings.

[107] *Ibid.,* at paragraph 42. The recommended legislative provisions state the insolvency law should permit the insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to cooperate to the maximum extent possible with foreign courts to facilitate coordination of those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group.

[108] *Ibid.,* at paragraph 42. The recommended legislative provisions state the insolvency law should permit the insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to cooperate to the maximum extent possible with foreign representatives67 appointed to administer insolvency

representatives and communication between the insolvency representatives and the foreign courts;[109] and the appointment of a single or the same insolvency representative.[110]

Working Group V has also recognised the benefits of using cross-border protocols. Their use can effectively reduce the cost of litigation and enable parties to focus on the conduct of the proceedings, rather than upon resolving conflict of laws and other such disputes. Moreover, in addition to clarifying parties' expectations, these agreements can assist with preservation of the debtor's assets and maximization of value.[111] Therefore, Working Group V argues, it would be desirable that protocols continue to be used, authorising relevant parties to conclude cross-border agreements concerning different group members in different states and permitting courts to approve them and implement them, taking into account the group context.[112]

In recent years, the Canadian courts have shown a great willingness to take a global view of a debtor's financial distress by providing recognition to foreign proceedings and cooperation with foreign courts and insolvency representatives in order to facilitate successful restructurings. The various benefits derived from cross-border protocols have also been endorsed by the Canadian

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proceedings commenced in other States with respect to members of the same enterprise group in order to facilitate coordination of those proceedings.

[109] *Ibid.,* at paragraph 42.

[110] *Ibid.,* at paragraph 47. The recommended legislative provisions state The insolvency law should permit the court, in appropriate cases, to coordinate with foreign courts with respect to the appointment of a single or the same insolvency representative to administer insolvency proceedings concerning members of the same enterprise group in different States, provided that the insolvency representative is qualified to be appointed in each of the relevant States. To the extent required by applicable law, the insolvency representative would be subject to the supervision of each of the appointing courts.

[111] UNCITRAL Legislative Guide on Insolvency Law, Part Three; Treatment of enterprise groups in insolvency, *supra,* footnote 1 at paragraph 48.

[112] *Ibid.,* at paragraph 53.

courts.[113] Sarra notes that cross-border protocols have been approved by Canadian courts as a mechanism to facilitate cross-border proceedings involving multiple related corporate entities, creating a legal framework for the conduct of insolvency proceedings and coordination of administration of an insolvent estate in one state with administration in another.[114] For example, a cross-border protocol was used in the recent *CCAA* case of *Re AbitibiBowater Inc.* between the Superior Court of the Province of Quebec and the United States Bankruptcy Court for the District of Delaware.[115]

This paper suggests the *CCAA* framework would profit from adopting the legislative recommendations of Working Group V that promote cooperation in the context of enterprise groups. By doing so, it opens the door for courts to recognise substantive consolidation orders from foreign courts relating to debtors of the enterprise group. Nevertheless, the practical use of substantive consolidation in *CCAA* cross-border proceedings raises the question of whether there should be creditors' committees representing all creditors from the enterprise group members that will be consolidated. Sarra notes that the use of substantive consolidation in the cross-border context could create barriers to the participation of unsecured creditors where they are located in jurisdictions other than that of the main proceeding.[116] In particular, Sarra argues it may affect the ability of employees and pensioners to participate in workout proceedings, where the

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[113] American Law Institute, *Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases*, 2001. The Guidelines were developed by ALI during and as part of its Transnational Insolvency Project and are directed at facilitating communication between courts in multijurisdictional proceedings. For full text see: http://www.ali.org/doc/Guidelines.pdf.
[113] *CCAA* section 52(1) and *BIA* section 275(1).
[114] Sarra, *supra*, footnote 91.
[115] *Re AbitibiBowater Inc.*, 2010 CarswellQue 2338 (Quebec Superior Court).
[116] Sarra, *supra*, footnote 91.

enterprise group proceeding is not in their domestic jurisdiction.[117] However, whilst the Canadian courts will have to continue to ensure the substantive rights of creditors in Canada are protected, it is argued that the recognition of the enterprise group for the purposes of cooperation and continued use of cross-border protocols will foster greater participation of unsecured creditors.

To this end, linked to many of the issues relating to enterprise groups in the cross-border context, it appears the remedy of substantive consolidation continues to be problematic. The current landscape fails to recognise the existence of the enterprise group structure and does not facilitate the application of substantive consolidation on the international stage. However, the paper argues that the principle of cooperation could act as a bridge between various approaches and attitudes that can facilitate effective restructuring and maximisation of value of the debtors' estate *en bloc.*

[117] *Ibid.*

PART 3: CONCLUSION

This paper was an in-depth study on the equitable remedy of substantive consolidation under Canada's primary restructuring statute, the *CCAA*. By carefully examining how the remedy has evolved under the *CCAA*, the paper has critiqued the current legal landscape for failing to provide an appropriate framework for addressing various issues stemming from an order of substantive consolidation. In response to this perceived lack of guidance from the Canadian courts and statutory provisions, the paper looked towards the discussions of UNCITRAL Working Group V in order to suggest an array of policy options for the use of the remedy under the *CCAA*.

The paper indicated Canadian courts have pointed towards three circumstances that may support consolidation in the domestic context. Firstly, consolidation must be appropriate in the circumstances. The court must determine whether the elements of consolidation are present, such as the significant intertwining of assets and liabilities. Secondly, there must be a balancing of interests, ensuring the benefits will outweigh the prejudice to particular creditors if the debtor estates are consolidated. Thirdly, it is appropriate to look at the overall effect of consolidation. However, the paper argued there needs to be a suitable standard for determining whether there has been an intertwining of assets and liabilities. After considering the various standards proposed by UNCITRAL Working group V, the paper suggested the "without disproportionate expense or delay" approach is most suited to the *CCAA* framework.

The paper highlighted the current landscape fails to address the effect of consolidation on creditor meetings and exclusions from the order. The paper suggested a combined meeting of creditors is practical and in some cases excluding particular assets or claims from an order of

substantive consolidation may be desirable. However, in practice exclusions could be uncommon.

The paper argued the issues stemming from an application for substantive consolidation in the domestic context failed to be clearly addressed by the current legal landscape. The paper first examined the idea that parties should be able to bring an application to the court. It argued that whilst the current approach that permits both a debtor and creditor is satisfactory, monitors should also be able to bring an application before the court. The monitor usually possesses the most information regarding the financial affairs of the debtors. Further, any potential conflicts that arise from the extension in the monitor's role are limited by the discretion of the court.

To the contrary, the paper argued Canadian courts should not be able to grant an order for substantive consolidation on its own initiative. Given the potentially drastic effect substantive consolidation can have on creditors' rights, there needs to be a fair and equitable process whereby all parties' positions in respect of an order can be heard.

This paper noted it is unclear from the existing case law whether notice is a prerequisite to an application for substantive consolidation, particularly when the application is brought at the same time as an *ex parte* application for an initial stay of proceedings. However, this paper argued the potentially dramatic effect substantive consolidation has on creditor rights demands that notice of an application is provided to the creditors. Yet it appears notice to solvent group members would not be necessary since the *CCAA* framework only applies to insolvent debtors. Hence, the paper argued the remedy should not be available to solvent group members.

The paper argued the current flexible approach to the timing of an application continues to be the most appropriate. The approach recognises that in some *CCAA* cases the factors supporting

consolidation may not be certain or apparent at the time insolvency proceedings commence. As a result, the remedy will be available in a wide number of restructuring scenarios.

The paper identified cross-border substantive consolidation under the *CCAA* is not a common occurrence. The current *CCAA* cross-border provisions fail to address the notion of an enterprise group. As a result, it appears the obligation on Canadian courts to cooperate to the maximum extent possible with a foreign court that has granted an order for substantive consolidation has limited application. The court may be dealing with a different debtor than the foreign court, making cooperation seem unnecessary. Further, the difficulties generated by the varying approaches to the remedy and cross-border restructuring create further hurdles for its application. Informed by the discussions of UNCITRAL Working Group V, the paper suggested promoting the use of cooperation in the context of enterprise groups could facilitate the use of substantive consolidation more frequently in the cross-border context. Further the paper suggests the continued use of cross-border protocols in *CCAA* cross-border restructurings will assist in resolving the substantive and procedural issues stemming from an order of substantive consolidation.

In conclusion, an examination of the remedy of substantive consolidation under the *CCAA* framework reveals the need to carefully consider various issues that stem from such an order in both the domestic and cross-border context. This paper has attempted to tackle each in turn, taking into account the scope of the *CCAA*, the balance between the need for flexibility and the demand for certainty in *CCAA* proceedings, what is desirable in practice and the nature of cross-border restructuring proceedings. It is hoped legislators and future courts will recognise the need to address these issues in order to enhance the somewhat unfavourable position of the current law.

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c.C-36 AS AMENDED

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO **FRASER PAPERS INC./PAPIERS FRASER INC.**, FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LIMITED., FRASER PAPERS LIMITED AND FRASER N.H. LLC

Applicants

Court File No.: CV-09-8241-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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