File No. CI 20-01-26627

THE QUEEN'S BENCH
WINNIPEG CENTRE

IN THE MATTER OF: **THE APPOINTMENT OF A RECEIVER PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985 c. B-3, AS AMENDED AND SECTION 55 OF *THE COURT OF QUEEN'S BENCH ACT*, C.C.S.M. c. C280**

BETWEEN:

WHITE OAK COMMERCIAL FINANCE, LLC,

Applicant,

- and -

NYGÅRD HOLDINGS (USA) LIMITED, NYGARD INC., FASHION VENTURES, INC., NYGARD NY RETAIL, LLC, NYGARD ENTERPRISES LTD., NYGARD PROPERTIES LTD., 4093879 CANADA LTD., 4093887 CANADA LTD., and NYGARD INTERNATIONAL PARTNERSHIP,

Respondents.

MOTION BRIEF OF THE RECEIVER
(INKSTER APPROVAL AND VESTING ORDER)

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I. LIST OF DOCUMENTS

1. The First Report of the Receiver dated April 20, 2020;

2. The Supplementary First Report of the Receiver dated April 27, 2020;

3. The Second Report of the Receiver dated May 27, 2020;

4. The Supplementary Second Report of the Receiver dated May 31, 2020;

5. The Third Report of the Receiver dated June 22, 2020;

6. The Fourth Report of the Receiver dated June 27, 2020;

7. The Supplementary Third Report of the Receiver dated June 29, 2020;

8. The Fifth Report of the Receiver dated July 6, 2020;

9. The Sixth Report of the Receiver dated August 3, 2020;

10. The Seventh Report of the Receiver dated September 10, 2020;

11. The Supplementary Seventh Report of the Receiver dated September 14, 2020;

12. The Eighth Report of the Receiver dated September 28, 2020;

13. The Supplementary Eighth Report of the Receiver dated October 12, 2020;

14. The Ninth Report of the Receiver dated November 2, 2020; and

15. Notice of Motion of the Receiver dated October 26, 2020 with attached draft form of Inkster Approval and Vesting Order.

II. LIST OF AUTHORITIES

Tab

1. *Shape Foods Inc. (Receiver of), Re*, 2009 MBQB 171

2. *Redstone Investment Corp. (Receiver of), Re,* 2016 ONSC 4452

3. *Bacic v Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875

4. *PSINet Ltd., Re* (2002), 33 CBR (4th) 284 (Ont SCJ)

5. *A. & F. Baillargeon Express Inc., Re*, (1993) 27 CBR (3d) 36 (Que SC)

III. POINTS TO BE ARGUED

Introduction

1. On March 18, 2020, Richter Advisory Group Inc. was appointed receiver (in such capacity, the "**Receiver**") over all assets, undertakings and properties of the Respondents, Nygård Holdings (USA) Limited, Nygard Inc., Fashion Ventures, Inc., Nygard NY Retail, LLC, Nygard Enterprises Ltd. ("**NEL**"), Nygard Properties Ltd. ("**NPL**"), 4093879 Canada Ltd., 4093887 Canada Ltd., and Nygard International Partnership ("**NIP**", and collectively, the "**Debtors**") pursuant to an Order (the "**Receivership Order**") of this Honourable Court. The Receivership Order was subsequently amended by a General Order made on April 29, 2020, which limited the scope of the Receivership Order in relation to the property, assets and undertakings of the Debtors NEL and NPL.

2. The Receiver has now filed the Ninth Report of the Receiver, dated November 2, 2020 (the "**Ninth Report**"). Among other things, the Ninth Report provides this Honourable Court with an update as to the actions and activities of the Receiver since the filing of the Eighth Report of the Receiver dated September 28, 2020, including details of the Receiver's efforts to sell NPL's real property located at 1771 Inkster Boulevard, Winnipeg, Manitoba (collectively, the "**Inkster Property**"). The Ninth Report also contains the evidentiary basis for certain relief sought by the Receiver. In particular, the Receiver is now seeking an order (the "**Inkster Approval and Vesting Order**"):

(a) abridging the time for service of the Notice of Motion of the Receiver and the materials filed in support thereof, such that the motion is properly

returnable on the stated hearing date, and dispending with further service thereof;

(b) approving the terms of an accepted Agreement of Purchase and Sale (the "**Inkster Purchase Agreement**") dated May 21, 2020 (amended by separate amending agreements dated July 6, July 20, August 14, August 24, August 28, September 17, September 25 and September 30, 2020) between the Receiver and Eighth Avenue Acquisitions Ltd. ("**Eighth Ave",** or the "**Purchaser**") for the sale of the Purchased Assets (the "**Inkster Transaction**"), which is conditional upon the approval of this Honourable Court;

(c) vesting, upon the closing of the Inkster Transaction, all of NIP and NPL's right, title and interest in and to the purchased assets as described in the Inkster Purchase Agreement in favour of the Purchaser;

(d) sealing the Confidential Appendices to the Ninth Report, consisting of: (i) the "Offer Summary" relating to the Inkster Property; (ii) an appraisal report dated January 31, 2020 prepared by CBRE Limited relating to the Inkster Property; and (iii) an un-redacted copy of the Inkster Purchase Agreement; and

(e) approving the Ninth Report, the Receiver's updated interim statement of receipts and disbursements, and the conduct, activities and accounts of the Receiver and its counsel described therein.

3. This Brief is being filed on behalf of the Receiver so as to outline the legal basis for the requested Inkster Approval and Vesting Order, particularly in relation to the approval of the Inkster Purchase Agreement and the Inkster Transaction.

4. It is noted that the Receiver's motion seeking the Inkster Approval and Vesting Order is proceeding against the backdrop of a motion from the Debtors seeking an Order: (i) directing the Receiver not to proceed further with sale transactions relating to the Inkster Property and another property owned by NPL at 702 & 708 Broadway in Winnipeg, Manitoba (the "**Broadway Property**"); (ii) lifting the stay of proceedings under the Receivership Order for the purpose of permitting the Debtors (or any combination of them) to file a Notice of Intention to Make a Proposal pursuant to the *Bankruptcy and Insolvency Act* (the "**BIA**"); and (iii) an Order "discharging the Receiver".

5. In general, for reasons reflected in the Ninth Report, the Receiver's position in response to Debtors' motion is as follows:

(a) The Inkster Property is "Property" for the purposes of the Receivership Order and, pursuant to the Receivership Order, the Receiver is authorized to market and, subject to the approval of this Honourable Court, sell the Inkster Property;

(b) In accordance with the Reasons delivered by this Honourable Court on June 20, 2020 (p. T8, lines 9 – 17) in relation to the granting of the Landlord Charge: "The provisions of the credit agreement limit the priority of the lenders to proceeds of realization of NPL assets. If amounts in excess of U.S. $20 million plus costs are collected as a result of the sale of real property and the liquidation process, the funds realized would be available for other creditors

of NPL in accordance with the receivership order. If the proceeds exceed the limited recourse amount, the Receiver must determine what other debts and obligations are owed by the debtors, consider the priority of those claims, and seek further court authorization to use the balance of the proceeds of realization towards the satisfaction of the other debts and obligations."

(c) In the circumstances, the sale of the Inkster Property may contribute to the accumulation in the receivership of proceeds in excess of the amounts required to satisfy obligations ranking in priority to the claims of unsecured creditors, and therefore contribute to the accumulation of a pool of funds (the "**Unsecured Funds**") that may be available to unsecured creditors of the Debtors on a consolidated or other basis;

(d) It is the Receiver's understanding that key unsecured creditors, including landlords and certain suppliers, support the making of the Inkster Approval and Vesting Order and do not support returning the Inkster Property (or the Broadway Property) to the possession and control of the Debtors (outside of this Receivership), or any of them, or to Mr. Peter Nygard or any nominee of Mr. Nygard;

(e) It is not necessary at this stage for this Honourable Court to make any determination as to the manner in which any Unsecured Funds are to be treated, or as to whether the Debtors should be treated as a single consolidated entity for creditor purposes. It is sufficient as this stage for this Honourable Court to: (i) refuse to make an Order lifting the stay so as to enable the Debtors, or any combination of them, to pursue an "NOI

Alternative" or other alternative to this Receivership Proceeding; and (ii) refuse to make an Order discharging the Receiver. This will allow the Receivership Proceeding to continue and enable the Receiver to complete the numerous activities described in paragraph 64 of the Ninth Report (including the sale of the Inkster Property and, subject to the further approval of this Honourable Court, the Broadway Property), and such other activities as may be required by the Receiver to fully perform its duties under the Receivership Order; and

(f) The Receiver is an officer of this Honourable Court and is obligated to consider the best interests of all stakeholders, including the unsecured creditors. It is the Receiver's assessment, based on the information available, that it appears to be generally in the interests of stakeholders for the Inkster Property to be sold and for the Receivership Proceedings to continue. Among other things, this will facilitate the most efficient completion of the matters which remain to be addressed as part of the administration of the Receivership Proceedings.

6. With respect to ongoing concerns relating to documents and records of the Debtors, the Ninth Report reflects that the Receiver is proceeding diligently in regard to the preservation of such records, with a view to serving the interests of the broader community of stakeholders interested in the Receivership. Accordingly, the Receiver at this point is recommending that this Honourable Court make an Order authorizing and empowering the Receiver to, prior to the closing of the Inkster Transaction, enter into such arrangements as the Receiver considers appropriate for: (i) preservation of the

electronic records by means of a third party IT service provider, with a view to preserving, to the extent feasible, the functionality of the Debtors' IT system and electronic records stored therein; and (ii) storage of the physical records and dismantled electronic equipment at a third party storage location, to be identified by the Receiver.

Inkster Purchase Agreement / Inkster Transaction

7. Paragraph 5(b) of the Receivership Order permits the Receiver to market and pursue offers for the sale of the Debtors' property. In this case, the Receiver is obligated, under paragraph 6(m)(ii) of the Receivership Order, to obtain this Honourable Court's approval for any sale transaction in which the purchase price exceeds $250,000. Given the purchase price for the Inkster Property as set out in the Inkster Purchase Agreement, such approval is required.

8. The factors to be considered by this Honourable Court when assessing a proposed sale of assets by a court-appointed receiver were set by Menzies J. in *Shape Foods Inc. (Receiver of) , Re*, (citing *Crown Trust Co. v. Rosenberg*, (1986) 60 O.R. (2d) 87 (Ont. H.C.J.)):

(a) The court should consider whether the receiver has made a sufficient effort to get the best prices and has not acted improvidently;

(b) The court should consider the interests of the parties;

(c) The court should consider the efficacy and integrity of the process by which the offers are obtained; and

(d) The court should consider whether there has been any unfairness in the working out of the process.

Shape Foods Inc. (Receiver of), Re, 2009 MBQB 171 at para 20 [*Shape Foods*] [Tab 1]

9. Menzies J. went on in *Shape Foods*, (citing *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 (Ont. C.A.)), to summarize two principles that ought to be applied when a court is reviewing a receiver's conduction in relation to the sale of property. First, the court should place a great deal of confidence in the actions taken and the opinions formed by the receiver. Unless the contrary is shown, the court should assume that the receiver (its officer) is acting properly. Second, the court should be reluctant to second-guess, with the benefit of hindsight, the business decisions of the receiver.

Shape Foods, supra, at para 21 [Tab 1]

10. As noted in the Supplementary First Report of the Receiver, on April 21, 2020, the Receiver, the Applicant and Colliers International ("**Colliers**") entered into a listing agreement with respect to the real properties of the Debtor, NPL, located in Winnipeg, Manitoba, including the Inkster Property. The Inkster Property was subsequently listed on April 27, 2020 at a listing price of $8,500,000, with an open offer date.

11. The key aspects of the marketing process undertaken by Colliers with respect to the Inkster Property, and its results, are summarized in the Ninth Report. Those are as follows:

(a) on or about April 28, 2020, Colliers disseminated an email communication to its database of approximately 150 industrial clients from Manitoba and beyond to advise of the Inkster Property transaction opportunity. Given that the Inkster Property is a larger building on an 8.6 acre site, the marketing list

for the property was targeted towards Canadian investment and user communities;

(b) over the following weeks, the Colliers listing team began the process of direct communication to prospective users for the Inkster Property in which Colliers contacted over 100 companies located in Manitoba and beyond. The calls were primarily focused on users as Colliers was of the view that investors could be hesitant to acquire such a large single tenant property that would be vacant on closing. Of the 100 plus calls that Colliers made, the Receiver understands that the penetration rate was greater than 60%;

(c) nine of the parties contacted by Colliers, including the Purchaser, signed confidentiality agreements and accessed an electronic data room prepared by Colliers to provide interested parties with additional information on the Inkster Property;

(d) Colliers, with the assistance of the Receiver, facilitated due diligence efforts by, among other things, coordinating site visits to view and inspect the Inkster Property. Six parties attended the Inkster Property for a site tour; and

(e) on May 11, 2020, the Purchaser submitted a conditional offer to purchase the Inkster Property, which was at a discount to the listing price. The Receiver thereafter engaged in negotiations with the Purchaser, and the parties executed the Inkster Purchase Agreement on May 21, 2020, which included the following conditions for the benefit of the Purchaser:

(i) 45 days following the acceptance of the Inkster Purchase Agreement to review and approve the title to the Inkster Property and ascertain that the Inkster Property and its uses, included proposed uses, complies or will comply with all building, zoning and use restrictions affecting the Inkster Property (the "**City Clearance Condition**");

(ii) 20 days following the acceptance of the Inkster Purchase Agreement to complete and be satisfied with a physical and environmental inspection of the Inkster Property (the "**Inspection Condition**"); and

(iii) 45 days following the acceptance of Inkster Purchase Agreement to obtain financing satisfactory to the Purchaser in its sole discretion (the "**Financing Condition**").

(f) On May 25, 2020, the Purchaser delivered the initial deposit (the "**First Deposit**") to Thompson Dorfman Sweatman LLP.

12. As a part of the due diligence process, it was discovered that the Inskter Property had certain outstanding building permits that needed to be resolved with the City of Winnipeg (the "**City**") in order to proceed with a potential sale of the Inkster Property. In total, there were five open permits that required approvals from the City.

13. The Receiver and Colliers engaged in discussions with Sims & Associates Engineering Ltd. ("**Sims**") and Neil Cooper Architect Inc. ("**Cooper**") to understand the building permit issues and the options available to the Receiver to resolve these items and proceed with the potential sale of the Inkster Property. The Receiver, on behalf of the Debtors, subsequently retained Sims and Cooper to assist the Receiver with preparing

the necessary documentation and engaging with the City to find a resolution and obtain occupancy from the City for certain permits received by the Debtors in 2016 and 2018.

14. As a result of foregoing, on July 2, 2020, the Purchaser contacted the Receiver to request a two-week extension to the period to waive or satisfy the City Clearance Condition and the Financing Condition. On July 6, 2020, the Purchaser and the Receiver executed an amendment to the Inkster Purchase Agreement, which confirmed that the Inspection Condition had been satisfied and extended due diligence period for the City Clearance Condition and the Financing Condition from 45 days to 60 days.

15. Over the next two months, Sims and Cooper, on behalf of the Receiver, worked with the City to attempt to resolve the issues related to the outstanding permits. On August 10, 2020, the City issued an occupancy permit in connection with the 2016 Permits, at which point all open permits, other than the 2018 Permits, had been closed or the outstanding issues were substantially resolved. On the 2018 Permits, the City was of the view that since the work done at that time involved an increase in the building area of the Inkster Property, the entire building needed to comply with the current Manitoba Building Code (the "**Code**").

16. At issue was the fire rating resistance ("**FRR**") on the second level of the Inkster Property. The construction of this level was permitted under an older Code (1995), but was not longer Code compliant. In order to comply with the current FRR requirement, the entire second level of the Inkster Property would need to be upgraded or removed, which would result in significant time and expense. The FRR issue, which was not known

at the time of the listing of the Inkster Property, or when the Purchaser and the Receiver executed the Inkster Purchase Agreement, was a material defect in respect of the Inkster Property.

17. It was determined that the options available to the Receiver to address FRR issues were as follows:

(a) Upgrading the FRR on the second level of the Inkster Property, which would require extensive remediation work estimated to cost in excess of $1,000,000.00;

(b) Demolition of the second level of the Inkster Property, which would reduce the net rentable area of the Inkster Property by approximately 20% and have a corresponding impact on the valuation and purchase price; and

(c) De-construction of the work done to the Inkster Property in connection with the 2016 and 2018 permits, which would require extensive remediation work and was estimated to cost approximately $200,000.00 to $300,000.00 and would not address the FRR issue in its entirety. That is, a future occupant of the Inkster Property that intended to make any additions to the building area, change the occupancy type or demise the space for multiple tenants would still be required to address the FRR issue.

18. Throughout this process, the Receiver, through Colliers, Cooper and Sims, kept the Purchaser apprised of the status of discussions with the City on the building

permit issues in order to facilitate the waiver or satisfaction of the City Clearance Condition and the Financing Condition. During this period, the Purchaser and the Receiver executed the second amendment to the Inkster Purchase Agreement dated July 20, 2020, the third to the Inkster Purchase Agreement dated August 14, 2020, the fourth amendment to the Inkster Purchase Agreement August 24, 2020, and the fifth amendment to the Inkster Purchase Agreement dated August 28, 2020, each of which extended the due diligence period for the City Clearance Condition and the Financing Condition.

19. On or about August 28, 2020, the Purchaser advised the Receiver that notwithstanding the FRR issue, it was still interested in the Inkster Property but not at the purchase price contained in the Inkster Purchase Agreement signed on May 21, 2020. As such, throughout September 2020, the Receiver and Eighth Ave directly engaged in good-faith negotiations on a potential purchase price adjustment for the Inkster Property. During this period, the Purchaser and the Receiver executed the sixth amendment to the Inkster Purchase Agreement dated September 17, 2020 and the seventh amendment to the Inkster Purchase Agreement dated September 25, 2020, each of which extended the due diligence period for the City Clearance Condition and the Financing Condition, both of which were directly connected to the FRR Issue. On September 30, 2020, the Purchaser and the Receiver executed the eighth amendment to the Inkster Purchase Agreement, which made the following amendments to the original Inkster Purchase Agreement:

(a) confirmed that the City Clearance Condition and the Financing Condition had

been satisfied;

(b) the closing date for the Inkster Transaction would occur on the date (the "**Closing Date**") that is sixty (60) days from the date of the Inkster Approval and Vesting Order;

(c) in consideration of the implications of the FRR Issue, reduced the payment due on closing to reflect a purchase price reduction (the "**Purchase Price Reduction**") agreed to among the Receiver and the Purchaser; and

(d) extended the outside date for which the Receiver was required to obtain the Inkster Approval and Vesting Order to November 16, 2020.

20. The Purchase Price Reduction represents approximately 8% of the original purchase price offered under the Inkster Purchase Agreement. The Receiver is of the view that the Purchase Price Reduction is reasonable in the circumstances as it takes into account the costs that would be incurred by the Receiver to address the issues described above the Inkster Property, amounts what would likely need to be incurred by the Receiver in order to sell the Inkster Property to another potential purchaser. Additionally, the Purchase Price Reduction provides partial compensation to the Purchaser for the cost and risk that could be incurred by the Purchaser to resolve the FRR issue post-closing.

21. On October 2, 2020, Eighth Ave delivered the second deposit to TDS. Following waiver of the Purchaser's conditions, the Deposits were non-refundable unless the

Receiver failed to carry out its obligations under the Inkster Transaction, including obtaining the Inkster Approval and Vesting Order.

22. On September 22, 2020 an agent representing another prospective purchaser (the "**Second Offeror**") submitted an unsolicited conditional offer (the "**Second Offer**") for the Inkster Property. While the Second Offer was higher in value than that which was offered by the Purchaser, it included substantially all of the furniture, fixtures and equipment located at the Inkster Property, which the Receiver was marketing separately from the Inkster Property sale. It also contained a 60-day conditional period from acceptance of the Second Offer to complete significant due diligence, including the Second Offeror obtaining required financing and assessing building, zoning and use restrictions.

23. As the Second Offer was submitted with limited due diligence, was highly conditional and was not in accordance with the "Offer to Purchase" form included in the data room, the Receiver was concerned that the Second Offer had significant risk. Further the Inkster Purchase Agreement included a "no-shop" provision that prevented the Receiver from soliciting bids from other prospective purchasers while the agreement was in effect. In the circumstances, the Receiver instructed Colliers to contact the agent for the Second Offeror to disclose the FRR Issue, inquire as to whether the Second Offeror would be prepared to refine its conditions and reduce its due diligence period in order to determine whether a superior offer could be achieved in a timely manner without risking the loss of the Inkster Purchase Agreement.

24. Colliers did not ultimately receive a response from the agent for the Second Offeror in a timely manner. As such, the Receiver, in consultation with TDS and Colliers, determined that the Second Offer was not feasible and that further meaningful discussions with the Second Offeror were not justifiable. The Receiver understands that as at the date of the Ninth Report, the Second Offeror has not followed up with Colliers regarding the Second Offer or the status of the Inkster Property.

25. Based on the feedback received from prospective purchasers and its own assessment of the property, Colliers noted the following concerns / observations, separate and apart from the FRR issue, with respect to the Inkster Property:

(a) buildings of this size and price attract a small number of suitors in the Winnipeg market, particularly the Inkster Property as the majority of potential users and investors realized that the building was appropriate for the use it was configured for and that any conversion from that particular use would require significant capital expenditure;

(b) the configuration of the Inkster Property, which contained approximately 53,000 sqft of office and showroom space and only 70,000 sqft of warehouse space, was not ideal. The average industrial tenant requires approximately 5% of their total square footage dedicated to office and showroom space. The Inkster Property had a ratio of 43% of the total square footage dedicated to office and showroom. Colliers is of the view that the Inkster Property would have been more attractive to industrial users or investors if the building was an empty shell and/or demised into smaller units. Colliers received a Class

D estimate of $2 million to remove all interior improvements, deconstruct the second-floor office space leaving an approximately 100,000 sqft shell that would be then ready to lease to an individual tenant or demise into a multi-tenant facility;

(c) the building on the Inkster Property was built in the 1970s to a then high standard, however most users looking at 100,000 sqft facilities are now, at a minimum, requiring 28 ft clear ceilings in order to maximize pallet racking and their cubic storage volume. A 28 ft ceiling allows a user to stack approximately 5 pallets high. The Inkster Property features only 20-22 ft clear ceilings in which a user can only rack 3 pallets with standard pallet heights of 64 inches. Industrial users in Winnipeg looking for 100,000 sqft are choosing as their preference new facilities built to the modern minimum standard of 28 ft. The Inkster Property is not functionally obsolete, however, it is challenged in today's modern industrial real estate market; and

(d) the Fast Track System (as defined in the Ninth Report) was specifically built for the distribution of clothing and therefore would not be of use to any tenants not in that line of business. As such, there was not one single prospect that could use the warehouse space "as is", all would need to incur some costs to, at a minimum, remove and dismantle the Fast Track System, which would ultimately be reflected in the purchase price

26. The Receiver is of the view that the Inkster Transaction represents the best recovery for the Inkster Property, for the following reasons:

(a) the marketing process undertaken by the Receiver, with the assistance of Colliers, and the activities undertaken by the Receiver leading to the Inkster Transaction were designed to solicit interest from a number of *bona fide* parties that would be interested in and familiar with industrial real property assets;

(b) there is a limited market for the Inkster Property. The Inkster Property has been on the market since late 2020 and the market has been extensively canvassed in the process leading up to the Inkster Transaction and all likely bidders, including Mr. Nygard and the Gardena Landlords, have been provided with an opportunity to bid on the Inkster Property;

(c) the further marketing of the Inkster Property would, in the Receiver's view, not likely result in greater realizations and may put the Inskter Transaction at risk impairing recoveries;

(d) the Purchaser assumes the cost and risk of the FRR Issue and removal of the Fast Track System, which costs could be significant;

(e) the Inkster Purchase Agreement represents the only binding offer received for the Inkster Property;

(f) the Purchaser is able to close within 60 days of issuance of the Inkster Approval and Vesting Order, the proceeds of which would result in a meaningful recoveries for the unsecured creditors of the Debtors' estates.

27. In all the circumstances, the Receiver submits the Inkster Purchase Agreement and the Inkster Transaction satisfy the conditions for approval as set out in

the *Shape Foods* decision and therefore ought to be approved by this Honourable Court. In particular, the Receiver states that the process that it undertook with respect to the sale of the Inkster Property was commercially fair and reasonable, and was carried out with efficacy and integrity. The evidence provided indicates the Receiver made a reasonable effort to obtain the best price for the Inkster Property for the benefit of all stakeholders.

28. Further, there is no evidence that the Receiver acted improvidently in connection with efforts to sell the Inkster Property. In the absence of such evidence, it must be assumed that the Receiver acted properly, and there is no basis to second guess the business decisions of the Receiver.

Shape Foods, supra, at para 27 [Tab 1]

29. The draft form of Inkster Approval and Vesting Order also provides for the sealing of: (i) the "Offer Summary" relating to the Inkster Property; (ii) an appraisal report dated January 31, 2020 prepared by CBRE Limited relating to the Inkster Property, and (ii) the un-redacted Inkster Purchase Agreement. Relevant authorities relating to the sealing of confidential information in the context of insolvency proceeding were provided to this Honourable Court in the previous Motion Brief of the Receiver dated April 21, 2020 filed in connection with, *inter alia*, obtaining the Sale Approval Order.

30. For obvious reasons, the Receiver is of the view that if the Inkster Transaction does not close for any reason, efforts to re-market the Inkster Property may be significantly impaired if the documents referenced in the paragraph above are made public at this time. Thus, the Receiver submits that an order sealing these documents

(which are each attached as Confidential Appendices to the Ninth Report of the Receiver) ought to be granted.

Consolidation

31. As the Debtors have brought a motion seeking certain relief including, *inter alia*, the lifting of the stay of proceedings and the discharge of the Receiver for the purpose of initiating an "NOI Alternative" to the Receivership Proceedings, the Receiver, as an officer of this Honourable Court, intends to provide the Court with some authorities which may be of assistance in determining the best course of action going forward.

32. As at the date of this Brief, the Receiver has not been provided with any substantive information from the Debtors regarding the proposed "NOI Alternative" to the Receivership Proceedings, or some other alternative involving the Debtors or some combination thereof. Therefore, the Receiver is unable to provide specific commentary on such alternatives, and the proposed treatment of unsecured creditors thereunder.

33. As indicated in the Ninth Report, in the event that the Debtors do not present a credible and acceptable NOI Alternative, or other alternative, to the Receivership, it would be usual in the case of a receivership process which generates proceeds for unsecured creditors, for the Court to grant its receiver the authority to assign the receivership entities into bankruptcy, thus bringing to bear the provisions and processes of the BIA that are intended to address claims of unsecured creditors.

34. In this case, assuming that the Receiver is granted such authority, this Honourable Court may order the assignment of the Debtors into bankruptcy on a

consolidated basis, or may make a determination that the estates of the Debtors in bankruptcy ought to be consolidated. The Receiver also notes that a bankruptcy trustee can institute proposal proceedings on behalf of a bankrupt entity under the BIA.

35. In general terms, a key consideration in relation to the treatment of creditors in the context of a group of corporate debtors such as the Nygard Group, who in many respects have conducted business as a single enterprise, is whether assets and obligations to creditors will be dealt with on a consolidated or separate basis. That is, whether the Nygard Group is to be treated as if they were one entity, resulting in the 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, or whether assets and liabilities of each Debtor will be treated separately.

Redstone Investment Corp. (Receiver of), Re, 2016 ONSC 4452 at para 7 [*Redstone*] [Tab 2]

36. In this case, if the Debtors are to be treated separately for creditor purposes, complex matters such as the determination of accurate intercompany balances and the calculation of fair and appropriate allocations of the receivership proceeds and expenses would be critical, and would have to be undertaken by the Receiver.

37. In *Redstone Investment Corp. (Receiver of), Re*, 2016 ONSC 4452, the Ontario Superior Court of Justice undertook a comprehensive review the law as it relates to doctrine of substantive consolidation, finding:

> The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:

(i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?

(ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?

(iii) Is consolidation fair and reasonable in the circumstances?

Redstone, supra at para 78 [Tab 2]

38. In *Bacic v Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875, the Kane J. summarized the "elements of consolidation" as follows:

> The test as to substantive consolidation requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:
>
> (a) difficulty in segregating assets;
>
> (b) presence of consolidated Financial Statements;
>
> (c) profitability of consolidation at a single location;
>
> (d) commingling of assets and business functions;
>
> (e) unity of interests in ownership;
>
> (f) existence of intercorporate loan guarantees; and
>
> (g) transfer of assets without observance of corporate formalities
>
> in order to assess the overall effect of consolidation.

Bacic v Millennium Educational & Research Charitable Foundation, 2014 ONSC 5875 at para 113 [*Bacic*] [Tab 3]

39. Courts have repeatedly held that substantive consolidation is appropriate in circumstances where the affairs of the Debtors were conducted with a disregard for the "niceties of corporate identity and separate juridical personalities", assets were intermingled such that there was uncertainty of ownership, and where, due to the way the corporations were operated and the state of corporate records, the allocation of value and claims between the corporations would be burdensome.

See, *Bacic, supra* at para 100 [Tab 3]
PSINet Ltd., Re (2002), 33 CBR (4th) 284(Ont SCJ) [*PSINet Ltd.*] [Tab 4];
A. & F. Baillargeon Express Inc., Re, (1993) 27 CBR (3d) 36 at para 5 (Que SC) [*A. & F. Baillargeon Express Inc*] [Tab 5]

40. In *Bacic*, *supra* the Ontario Superior Court of Justice considered whether to implement a pooling/consolidated distribution, as recommended by the interim receiver. More specifically, whether a bankrupt foundation, which formed part of a larger group of bankrupt companies in receivership, should be isolated and removed from the pooled distribution scheme recommended by the interim receiver, which included both the foundation and certain other related bankrupt companies in receivership.

41. In determining that the consolidation of the estates of the bankrupt corporations, including the foundation, was appropriate in the circumstances, the Court relied upon the following facts:

(a) the presence of consolidated financial statements, which resulted in assets specific to one company being referred to in financial statements of other companies, including the foundation;

(b) the directing mind of the corporations and the foundation managed the

corporations and the foundation as a consolidated entity over eight years;

(c) any attempt to historically trace funding within the foundation would be inappropriate and financially impractical;

(d) any attempt to disengage and isolate the affairs and finances of only the foundation would be an artificial and impractical exercise; and

(e) the opinion of the interim receiver was that further tracing efforts would produce uncertain results and involve the expenditure of considerably more professional fees, which was to the risk of creditors of the bankrupt corporations, and not the foundation.

Bacic, supra [Tab 3]

42. In *PSINet Ltd., Re* (2002), 33 CBR (4th) 284(Ont SCJ), the Ontario Superior Court of Justice considered a consolidated plan of arrangement proposed by four applicant companies under the *Companies Creditors Arrangement Act*, RSC 1985, c C-36. In determining that the consolidated plan was appropriate, Farley J. stated:

> 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.

PSINet Ltd., supra at para 2 [Tab 4]

43. Moreover, Courts have considered the following facts as displaying "a total intermingling of assets, operations and liabilities" of related corporations:

(a) A group of debtor companies holding common bank accounts through which funds are funneled and distributed to pay the expenses and obligations of all of the companies regardless of which entity is legally entitled to the funds and/or responsible for the expense or obligation;

(b) The presence of intercorporate loans being made back and forth between related companies without the observance of typical corporate formalities (e.g. formal agreements for the repayment of debts as between companies);

(c) Records of debtor companies being so hopelessly confused that it is extremely difficult, if not impossible, to identify which fixed assets and records belong to each company;

(d) The existence of common head-offices shared by the group of debtor companies; and

(e) Each entity forming part of a larger group of companies being owned and controlled, either directly or indirectly, by one individual and having the same, or substantially the same, officers and directors acting as figureheads for the individual owner.

See, *Bacic, supra* at para 100 [Tab 3]
PSINet Ltd, supra [Tab 4];
A. & F. Baillargeon Express Inc., supra at paras 14-16 [Tab 5]

44. In order to provide this Honourable Court with the context in which the consolidation issue has arisen in the Receivership Proceedings, the Receiver has undertaken a review of the affidavit evidence filed by and on behalf of the Debtors in the course of the Receivership Proceedings, as well as the reports of the Proposal Trustee in connection with the "original" NOI Proceedings. A review of the Debtors' own evidence discloses a large number of references which either directly suggest that the business of the Debtors was carried on as a single enterprise, or assumes a single business. A summary provided of the evidence filed by or on behalf of the the Debtors and the elements of consolidation which are present in respect of such evidence is included for this Honourable Court's consideration at Appendix "F" to the Ninth Report.

45. As noted above, if the assets of the Debtors and liabilities to unsecured creditors are not to be addressed on a consolidated basis, then what may be a complex allocation process will need to be undertaken to determine the extent to which each of these obligations ought properly to shared and contributed to by proceeds of specific NPL assets, to ensure that stakeholders (including creditors) of other "contributors", such as NIP, are treated fairly.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 2nd day of November, 2020.

THOMPSON DORFMAN SWEATMAN LLP

Per: "Ross A. McFadyen"
G. Bruce Taylor / Ross A. McFadyen
Lawyers for Richter Advisory Group Inc.,
the Court-Appointed Receiver

2009 MBQB 171
Manitoba Court of Queen's Bench

Shape Foods Inc. (Receiver of), Re

2009 CarswellMan 312, 2009 MBQB 171, [2009] M.J. No. 240,
178 A.C.W.S. (3d) 570, 241 Man. R. (2d) 235, 54 C.B.R. (5th) 224

In the Matter of The Receivership of Shape Foods Inc.

And In the Matter of The Receivership of 0767623 B.C. Ltd.

Deloitte & Touche Inc. in its capacity as receiver and
manager of Shape Foods Inc. and 0767623 B.C. Ltd.

Menzies J.

Judgment: June 22, 2009
Docket: Brandon Centre CI 09-02-02233

Counsel: D. Swayze for Deloitte & Touche
B. Filyk for Vanguard Credit Union
W. Leslie for 884498 Alberta Ltd., Canrex Biofuels Ltd., Barry Comis, Ben Comis, Todd Hicks, Richard Brugger
J. Hirsch for 5842264 Manitoba Ltd. (watching brief)
R. Paterson for City of Brandon (watching brief)

Subject: Corporate and Commercial; Insolvency; Property; Intellectual Property

Headnote

Debtors and creditors --- Receivers — Conduct and liability of receiver — General conduct of receiver

Debtor defaulted on loan secured by assets of two corporations and receiver manager was appointed — Receiver obtained offer to purchase business interests — Receiver brought application for vesting order approving sale — Application granted — Receiver manager made reasonable efforts to achieve best deal and its recommendation should not be rejected — Fact that one potential bidder did not meet requirements or deadline did not mean sale was improvident — Process of sale was fair and receiver manager was able to obtain higher price than tender — Receiver manager made considered effort to obtain best price and sale was in best interest of interested parties.

Debtors and creditors --- Miscellaneous issues

Standing to oppose sale by receiver manager — Debtor defaulted on loan secured by assets of two corporations and receiver manager was appointed — Receiver obtained offer to purchase business interests — Receiver brought application for vesting order approving sale — Application granted — Unsuccessful purchasers did not have standing to oppose application — Prospective purchasers did not have rights in property — Minority shareholders did not have standing to oppose sale — Sale to another entity would not effect shareholder's capacity as unsecured creditors — Receiver manager made considered effort to obtain best price and sale was in best interest of interested parties.

Table of Authorities

Cases considered by *Menzies J.*:

Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 1986 CarswellOnt 235, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526, 67 C.B.R. (N.S.) 320 (note) (Ont. H.C.) — followed

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — followed

Selkirk, Re (1987), 1987 CarswellOnt 177, 64 C.B.R. (N.S.) 140 (Ont. S.C.) — considered

Skyepharma PLC v. Hyal Pharmaceutical Corp. (2000), 47 O.R. (3d) 234, 2000 CarswellOnt 466, 130 O.A.C. 273, 15 C.B.R. (4th) 298 (Ont. C.A.) — followed

Statutes considered:

Corporations Act, R.S.M. 1987, c. C225

s. 94 — referred to

APPLICATION by receiver manager for approval of sale of property.

***Menzies J.*:**

1 Shape Foods Inc. ('Shape') operated a food processing business in the City of Brandon. 0767623 B.C. Ltd. ('B.C.') was a related corporation which held ownership to the intellectual property (patents and trademarks) associated with Shape's food processing business. Both corporations executed a security agreement in favor of Vanguard Credit Union ('Vanguard') as security for a loan. The security agreement provided that in the event of default on the loan, Vanguard had the right to appoint a receiver-manager to realize on its security.

2 On October 23, 2008, Vanguard appointed Deloitte & Touche ('the Receiver') as receiver-manager of Shape Foods Inc.

3 Subsequently on December 10, 2008, Vanguard, appointed Deloitte & Touche receiver-manager of 0767623 B.C. Ltd.

4 On April 14, 2009, the Receiver accepted an offer to purchase the assets of Shape and B.C. in the amount of $5.1 million from 5842664 Manitoba Ltd. ('the purchaser'). A formal agreement was executed on May 6, 2009 which required the Receiver to provide a vesting order of the property in the name of the purchaser on or before June 5, 2009.

5 The Receiver-manager brought an application is for a vesting order to complete the transaction with the purchaser and for a declaration that the sale of the corporate assets is not reviewable by the remaining creditors of Shape or B.C. or by any subsequent trustee in bankruptcy.

The Standing of Parties on the Application

6 The application by the Receiver-manager is opposed by 884498 Manitoba Ltd., Canrex Biofuels Ltd., Barry Comis, Ben Comis, Todd Hicks and Richard Brugger. The Receiver-manager argues these parties do not enjoy standing before the court as they are not interested parties in the outcome of the application.

7 Before deciding the issue of standing, I allowed Todd Hicks on behalf of 884498 Manitoba Ltd. and Nick Mashin on behalf of Canrex Biofuels Ltd. to file affidavits as to their attempts to purchase the assets of Shape and B.C. My decision was based on the premise the evidence was relevant to the issue of the integrity of the Receiver-manager's actions taken to sell the security.

8 The Receiver-manager brought the application for the vesting order shortly before the closing date of June 5, 2009. A decision as to whether or not the vesting order would issue was required in a timely fashion or the sale agreement would be in jeopardy. With some misgivings, I reserved my decision on the issue of standing and heard the arguments of the opposing parties to allow the ultimate application to proceed. While this is not the best procedure in which to consider an application, the process did allow me to render a decision on the issue of the vesting order within the time constraints of the purchase agreement.

Interested Parties

9 884498 Manitoba Ltd. and Canrex Biofuels Ltd. attempted unsuccessfully to purchase the assets of Shape and B.C. from the Receiver-manager. Barry Comis, Ben Comis, Todd Hicks and Richard Brugger are shareholders of 884498 Manitoba Ltd.

10 I have concluded an unsuccessful purchaser does not have standing to challenge a proposed sale. In coming to this conclusion I rely upon the reasons of O'Connor J. A. of the Ontario Court of Appeal in *Skyepharma PLC v. Hyal Pharmaceutical Corp.*, [2000] O.J. No. 467, 47 O.R. (3d) 234 (Ont. C.A.) beginning at para 25:

> There are two main reasons why an unsuccessful prospective purchaser does not have a right or interest that is affected by a sale approval order. First, a prospective purchaser has no legal or proprietary right in the property being sold...The duties of the receiver and the court are to ensure that the sales are in the best interests of those with an interest in the proceeds of sale. There is no right in a party who submits an offer to have the offer, even if the highest, accepted by either the receiver or the court: *Crown Trust v. Rosenberg* (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H. C. J.).
>
> Moreover, the fundamental purpose of the sale approval motion is to consider the best interests of the parties with a direct interest in the proceeds of sale, primarily the creditors. The unsuccessful would be purchaser has no interest in this issue. Indeed, the involvement of unsuccessful prospective purchasers could seriously distract from this fundamental purpose by including in the motion other issues with the potential for delay and additional expense.
>
> In making these comments, I recognize that a court conducting a sale approval motion is required to consider the integrity of the process by which the offers have been obtained and to consider whether there has been unfairness in the working out of the process: *Crown Trust v. Rosenberg*, supra; Royal *Bank of Canada v. Soundair Corp.* (1991), 4 O. R. (3d) 1, 83 D. L. R. (4th) 76 (C. A.). The examination of the sale process will in normal circumstances be focused on the integrity of that process from the perspective of those for whose benefit it has been conducted. The inquiry into the integrity of the process may incidentally address the fairness of the process to prospective purchasers, but that in itself does not create a right or interest in a prospective purchaser that is affected by a sale approval order.
>
> [para. 29] In limited circumstances, a prospective purchaser may become entitled to participate in a sale approval motion. For that to happen, it must be shown that the prospective purchaser acquired a legal right or interest from the circumstances of a particular sale process and that the nature of the right or interest is such that it could be adversely affected by the approval order. A commercial interest in not sufficient.

11 As prospective purchasers, none of the opposing parties have a legal right or interest in the assets arising out of the circumstances of the sale process. Although I have considered their evidence in assessing the integrity of the sale process, they are not interested parties merely due to their status of unsuccessful purchasers.

12 Barry Comis and Ben Comis claim standing as interested parties by virtue of being shareholders of Shape. Richard Brugger and Todd Hicks claim standing as shareholders of Falcon Creek Holdings Inc., a corporation which is a shareholder in Shape. The extent of their holdings in Shape were not disclosed except to the extent of an admission by their counsel that they are minority shareholders in Shape. They were not appearing on behalf of Shape, but simply in their capacity as minority shareholders.

13 Ben Comis also claims status as an interested party by virtue of being a creditor of Shape in the amount of $6,300.00.

14 I am not satisfied that the status of shareholder, in and of itself, or the status of creditor gives one the status of an interested party. In my opinion, more is required. In this case the assets of Shape and B. C. are secured by three secured creditors. Vanguard is the first secured creditor. As of May 19, 2009, Vanguard was owed $4,711,865.50

with daily interest accruing at the rate of $822.26. The Manitoba Development Corporation ('MDC') is the second secured creditor. The debt owed to MDC as of May 1, 2009 was $4,145,541.82 with interest accruing at the daily rate of $868.14. In addition, MDC had guaranteed repayment of Vanguard's debt. The third debtor is RAB Special Situation (Master) Fund Ltd. with a debt in the approximate amount of $2,000,000.00.

15 The completion of the agreement between the Receiver and the successful purchaser will result in Vanguard being paid in full and MDC receiving only partial payment. In addition, MDC will be relieved of any obligation under its guarantee of the Vanguard debt.

16 The two prospective offers not accepted by the Receiver will result in Vanguard being paid in full, and MDC receiving an increased partial payment on its debt. The acceptance or the rejection of the Receiver-manager's recommended sale in favor of one of the unsuccessful purchasers will not affect the position of Ben Comis, Barry Comis, Todd Hicks or Richard Brugger in their capacity as minority shareholders or Ben Comis in his capacity as an unsecured creditor.

17 As receiverships often affect numerous parties, I am of the opinion that a party requesting to appear to oppose a proposed sale by a receiver-manager must minimally show an interest to the extent that any alleged failure of the receiver-manager to act in a commercially reasonable manner may affect their interests in a material fashion.

18 I am not satisfied that 884498 Manitoba Lyd., Canrex Biofuels Ltd., Barry Comis, Ben Comis, Todd Hicks or Richard Brugger have proven they are interested parties to this application.

The Duty of the Receiver

19 S. 94 of *The Corporations Act* (Manitoba) provides that a receiver or receiver-manager of a corporation appointed under an instrument shall act honestly and in good faith; and deal with any property of the corporation in his possession or control in a commercially reasonable manner.

20 On considering a proposed sale of a debtor's property by a receiver-manager, there are four criteria for the court to consider. (See: *Crown Trust Co. v. Rosenberg*, supra; Bennett on Receiverships, (2nd Ed.) (1999) Carswell at p. 251 et seq.)

> 1) The court should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
>
> 2) The court should consider the interests of the parties.
>
> 3) The court should consider the efficacy and integrity of the process by which offers are obtained.
>
> 4) The court should consider whether there has been unfairness in the working out of the process.

21 In *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1, 4 O.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321 (Ont. C.A.), the Ontario Court of Appeal outlined two principles for a court to consider in reviewing a sale of property. The first principle is that a court should place a great deal of confidence in the actions taken and the opinions formed by the receiver-manager. Unless the contrary is clearly shown, the court should assume that the receiver-manager is acting properly. The second principle is a court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions of the receiver-manager. I will now consider the relevant criteria in this transaction.

Did the Receiver Make a Sufficient Effort to Get the Best Price and Did It Act Providently?

22 In this instance the Receiver-manager was appointed to take control of the assets of Shape in October 2008. The Receiver-manager advertised the sale of the assets of Shape and B. C, by way of tender with the advertisements

being published in the Brandon Sun, the Winnipeg Free Press and the Globe and Mail on November 26, 2008. Tenders closed on December 17, 2008 with the highest bid being in the amount of $750,000.00.

23 Following the attempt to sell by tender, a sales and information package was distributed to potential purchasers and interested parties on April 16, 2009. By March 31, 2009, the Receiver-manager had received five additional proposals with the highest being $4.5 million.

24 The Receiver-manager advised the interested parties to reconsider their bids and that no bid under $5 million would be considered. The Receiver-manager maintains that all parties were advised that bids would require either a deposit or a letter from a financial institution confirming financing.

25 Two bids were received which complied with the conditions as set out by the Receiver-manager. The highest bid was received from the purchaser and was accepted.

26 The evidence establishes the Receiver-manager put considerable effort into obtaining the best price for the assets of Shape and B. C.

27 The real issue to be determined is whether the Receiver-manager acted improvidently. I am guided by the comments of Anderson J. in the decision of *Crown Trust Co. v. Rosenberg*, supra, at p. 112 [O. R.]:

> Its decision was made as a matter of business judgment on the elements then available to it. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.
>
> If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made on the motion for approval.

28 I repeat that a court should be reluctant to reject the recommendation of the Receiver-manager based upon information which comes to light after the decision was made. Evidence as to the value of competing bids was placed before me on this application. This evidence is relevant only to the extent it allows me to evaluate the reasonableness of the price obtained by the Receiver-manager. (See: *Crown Trust Co. v. Rosenberg*, supra)

29 Evidence of the value of competing bids was considered by McRae J. in *Selkirk, Re* (1987), 64 C.B.R. (N.S.) 140 (Ont. S.C.), at 142:

> Only in a case where there seems to be some unfairness, in the process of the sale or where there are substantially higher offers which would tend to show that the sale was improvident will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

30 The evidence alleging improvident behavior on behalf of the Receiver-manager comes from two sources. One such source is the affidavit of Nick Mashin, the President of Canrex Biofuels Ltd, who submitted a proposal of $6.25 million for the assets of Shape and B.C. In brief, the evidence of Mashin was that although he forwarded the proposal to the Receiver-manager on March 13, 2009, he was not prepared to provide either a deposit or a letter of commitment for financing by the date on which the Receiver-manager accepted the purchaser's offer. These allegations do not amount to evidence of improvident behavior by the Receiver-manager.

31 The other source is the affidavit of Todd Hicks. According to Hicks, 884498 Alberta Ltd. submitted a proposal in the amount of $6.51 million on April 9, 2009. On April 14, 2009, Hicks was advised that a 7% deposit

and a letter of commitment for financing would need to be provided to the Receiver-manager by 1:00 p.m. that day. Hicks forwarded the letter confirming financing to their Manitoba lawyer but instructed him not to forward it on to the Receiver-manager until he received further instructions.

32 At 3:04 p.m. on April 14, 2009, the lawyer for 884498Alberta Ltd. emailed the Receiver advising that his client was aware the confirmation of financing letter must be provided and that the 7% deposit was being raised. This was two hours after the deadline as advised by the Receiver. On April 15, 2009, the Receiver advised 884498 Alberta Ltd. that another offer had been accepted.

33 Hicks provides much evidence as to conversations he had with respect to the purchase of the property. However, Hicks knew of the April 14, 2009 at 1:00 p.m. deadline and did not meet it. There is no evidence of a request for an extension of time to raise the deposit. The letter of commitment for financing was available but not forwarded until after the deadline.

34 Business negotiations take many interesting and varied approaches. 884498 Alberta Ltd. decided not to forward the available letter of commitment for financing which is their right to do. However, as of April 14, 2009 at 1:00 p.m., the Receiver did not have a deposit or a letter of commitment of financing to back up the offer of $6.5 million. The Receiver-manager, with the information it had, made his decision. He accepted the purchaser's proposal. I am not persuaded the Receiver-manager acted improvidently.

The Interests of the Parties

35 No one appeared on behalf of Shape and B. C. on this application.

36 There are three major creditors holding security against the assets the Receiver-manager proposes to sell. The first secured creditor in priority is Vanguard who as of May 19, 2009 was owed $4,711,865.50 with interest continuing to accrue at the per diem rate of $882.26.

37 The second secured creditor in priority is MDC. As of May 1, 2009, MDC was owed $4,145,541.82 with interest accruing at the rate of $868.14 daily. In addition to its own loan to Sharpe and B.C., MDC has guaranteed the loan held by Vanguard.

38 The third secured creditor in priority is RAB Special Situations (Master) Fund Ltd. whose loan is in the approximate amount of $2,000,000.00. This creditor took no part in these proceedings.

39 Vanguard supports the Receiver-manager's proposal in favor of the purchaser. Vanguard will be paid in full by the Receiver-manager's proposal.

40 MDC also supports the Receiver-manager's proposal. With the closing of the transaction with the purchaser, Vanguard will be paid off and MDC will be released of any liability under their guarantee. It is anticipated that there will also be some monies available to reduce the amount of indebtedness on the MDC loan. RAB will get nothing.

41 MDC does not support the position of 884498 Manitoba Ltd. Although 884498 Manitoba Ltd.'s bid exceeds the purchaser's offer by $1.5 million, the bid is subject to the completion of a due diligence review. It is not a guaranteed transaction. MDC supports the Receiver-manager's proposal as it is to close imminently.

42 Neither scenario will result in MDC being paid in full. RAB will not receive any payment on account of their debt no matter which proposal is accepted.

43 It is in the interests of the interested parties that approval to the Receiver-manager's proposal be given.

Consideration of the Efficacy and Integrity of the Process

44 It is important that the potential purchasers in a receivership situation have confidence that if they act in good faith, undertake bona fide negotiations with a receiver-manager and enter into an agreement for purchase of the assets that a court will not lightly interfere with the negotiated agreement. Potential purchasers must have some degree of confidence in the efficacy and integrity of the process. The comments of Saunders J. in *Re: Selkirk*, supra, at p. 246 [C. B. R.] are of assistance:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J. A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of N. S.* (1981), 38 C. B. R. (N. S.) 1, 45 N. S. R. (2d) 303, 86 A. P. R. 303 (C. A.), where he said at p.11:
>
> > In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard — this would be an intolerable situation.

45 Hicks and Mashin attack the process used by the Receiver-manager in their affidavits. They claim they were unable to obtain information in a timely manner and their bids were made subject to conditions that the ultimate purchaser did not have to comply with, notably the provision of a deposit. I do know that the purchaser did ultimately provide a deposit but I do not know when and under what circumstances. Although their allegations raise some concern, I am unable to adjudicate if the procedures required of Mashin or Hicks were substantially different than the procedure for the purchaser based solely on the affidavit evidence before the court.

46 It is true that there were strict timelines under which parties were expected to comply with conditions of the receiver's process, but that does not affect the integrity of the process.

47 As far as efficacy of the process, the Receiver-manager began with a tendering process which resulted in an offer of $750,000.00 and was able to negotiate a proposal from the purchaser in the amount of $5,100,000.00. The efforts of the receiver-manager obtained positive results for the debtor and creditors. As was stated earlier in the *Skyepharma* decision, supra, the integrity of the process should be analyzed from the perspective of those for whose benefit it has been conducted. In that regard, the proposal accepted by the Receiver-manager was considerably higher that the initial tenders at the beginning of the process.

Consideration of Unfairness in the Process

48 The Receiver-manager undertook to sell the assets with a tendering process which was unsuccessful. The Receiver moved on to a second bidding process which once again was unsuccessful. Finally the Receiver followed up with who he considered to be serious buyers and accepted a proposal from the purchaser. All parties were provided with notice of what constituted an acceptable tender by the Receiver and all potential bidders were aware of the time guidelines. The only unfairness alleged is that the conditions of a tender were not the same for all parties. As I have already said I am unable on the evidence before me to conclude whether this allegation has been made out or not. However, other that that one allegation, the process undertaken was a fair process to all concerned.

Decision

49 The court should accept the recommendation of the Receiver except in circumstances where the necessity of rejection of the Receiver-manager's recommendation is clear (See *Crown Trust and Rosenberg*, supra.).

50 Receiver-manager has made a considered effort to obtain the best price and has not acted improvidently. In light of the position of MDC, I have no hesitation in finding that the approval of the proposed sale to the purchaser would be in the best interests of the interested parties.

51 I am unsure if there has been any unfairness in the working of the process with respect to the conditions imposed on the final purchase bids on the property. The evidence is somewhat contradictory and I am unable to resolve the credibility issues on the basis of affidavits alone. However, a decision was required as of the date of the hearing or the sale agreement with the purchaser would have been breached.

52 Due consideration must be given to preserving the efficacy and integrity of the sale process undertaken by the Receiver-manager.

53 After consideration of all the criteria set out in the case law, I have concluded the proposed sale should be approved as requested by the Receiver-manager. To not do so would put any potential sale of the assets at jeopardy and place the parties back into a situation of uncertainty.

54 The vesting orders as requested by the Receiver will be granted.

55 Because I was unable to resolve the issue of unfairness with any degree of certainty, I am not prepared to grant the declaratory relief as requested by the Receiver and that portion of the application is dismissed.

Order accordingly.

End of Document

2016 ONSC 4453
Ontario Superior Court of Justice

Redstone Investment Corp. (Receiver of), Re

2016 CarswellOnt 15863, 2016 ONSC 4453, 271 A.C.W.S. (3d) 248, 40 C.B.R. (6th) 181

IN THE MATTER OF THE RECEIVER OF REDSTONE INVESTMENT CORPORATION AND REDSTONE CAPITAL COROPRATION

AND IN THE MATTER OF A MOTION PURSUANT TO SECTION 101
OF THE COURTS OF JUSTICE ACT, R.S.O. 1990, c. C.43, AS AMENDED

G.B. Morawetz J.

Judgment: October 5, 2016 *
Docket: CV-14-10495-00CL

Counsel: Ian Aversa, Jeremy Nemers, for Grant Thornton Limited., in its capacity as Receiver and Manager of Redstone Investment Corporation, Redstone Capital Corporation and 1710814 Ontario Inc. o/a Redstone Management Services
Justin Fogarty, Pavle Masic, for RIC Investors
Grant Moffat, Kyla Mahar, for RCC Investors
Harvey Chaiton, Doug Bourassa, for RMS Investors

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Miscellaneous

Substantive consolidation — Court appointed receiver over three corporate entities, RI Co., RC Co. and 171 Inc. — Received assigned RI Co. and RC Co. into bankruptcy — RC Co. Investors had priority for any receivership funds over RI Co. Investors by virtue of agreement under which RC Co. was secured creditor of RI Co. — Receiver brought motion to determine whether estates of three companies should be substantively consolidated — Motion dismissed — Extraordinary remedy of substantive consolidation was not appropriate — Elements of consolidation were not present — Assets were held separately — Audited financial statements existed for RI Co. and RC Co. — Governing loan documents clearly set out that companies were separate and that obligations of RI Co. to RC Co. were subject to general security agreement — There was no unity of interest in ownership — Creditor's motivation for investing is not relevant to considerations set out in test for substantial consolidation — There would be significant financial prejudice to creditors of RC Co. if substantive consolidation were ordered.

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Generally — referred to
Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

Words and phrases considered:

substantive consolidation

Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the 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.

MOTION by receiver to determine whether three corporate entities should be substantively consolidated.

***G.B. Morawetz J.*:**

Introduction

1 This motion seeks a determination of whether the estates of three corporate entities — Redstone Investment Corporation ("RIC"), Redstone Capital Corporation ("RCC"), and 1710814 Ontario Inc. o/a Redstone Management Services ("RMS") — should be substantively consolidated.

2 The motion was brought by Grant Thornton Limited in its capacity as court-appointed receiver ("GTL" or the "Receiver") of the property, assets and undertakings of RIC, RCC, and RMS (collectively "Redstone").

3 To facilitate the determination of this issue, Newbould J. granted an order, which, among other things, appointed representative counsel ("RIC Representative Counsel") to represent the interests of parties who hold promissory notes issued by RIC (the "RIC Investors"), representative counsel ("RCC Representative Counsel") to represent the interests of all parties who hold bonds issued by RCC (the "RCC Investors"), and representative

counsel ("RMS Representative Counsel") to represent the interests of all parties who invested money with RMS ("RMS Investors").

4 The order of Newbould J. provides that any RIC Investor, RCC Investor, and RMS Investor who is not represented by their respective Representative Counsel will nonetheless be bound by the decision made in respect of this motion.

5 In the absence of substantive consolidation of RIC, RCC, and RMS, the RCC Investors have priority for any receivership funds over the RIC Investors by virtue of an inter-corporate agreement under which RCC is a secured creditor of RIC.

6 The RIC and RMS Investors argue in favour of substantive consolidation; the RCC Investors oppose substantive consolidation; the Receiver put forward an independent legal opinion that it is unlikely substantive consolidation would be ordered in this case.

What is Substantive Consolidation?

7 Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the 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. See: Janis Sarra, *"Corporate Group Insolvencies: Seeing the Forest and the Trees"* (2008) 24 B.F.L.R. 63, at. p. 8.

8 The authority for substantive consolidation of bankrupt estates in Canada lies under the equitable jurisdiction of the Superior Court of Justice granted by s. 183(1) of the *Bankruptcy and Insolvency Act* ("BIA"). See:*A. & F. Baillargeon Express Inc. (Trustee of), Re* [1993] Q.J. No. 884 ("Baillargeon"), at para. 23); *Nortel Networks Corp., Re*, 2015 ONSC 2987 (Ont. S.C.J. [Commercial List]), at para. 216 and *Bacic v. Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875 (Ont. S.C.J.) .

Background

Procedural History

9 On March 24, 2014, RIC and RCC commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), with GTL appointed as Monitor.

10 On August 8, 2014, the CCAA proceedings were converted to receivership proceedings and GTL was appointed as Receiver of the property, assets and undertakings of RIC and RCC.

11 On August 12, 2014, the Receiver assigned RIC and RCC into bankruptcy. GTL was appointed trustee in bankruptcy of each estate.

12 On September 17, 2014, the receivership proceedings were expanded, on motion by the Receiver, to include RMS.

13 A *Mareva* injunction has been in place since April 4, 2014, restraining RMS and Mr. Edmond Chin-Ho So, the founder of the Redstone group of companies, from encumbering the assets of RMS (the "Mareva Order").

Redstone Incorporation and Ownership Structure

14 RMS was incorporated on September 19, 2006, and it is wholly-owned by Mr. So. RMS was used to process loans until the establishment of RIC. Starting March 14, 2012, RMS provided administrative services to RIC and RCC through a Management Services Agreement (the "MSA"). The services provided to RIC included

seeking out borrowers, reviewing suitability for investment, carrying out due diligence, and maintaining a register of outstanding RIC Notes.

15 RIC was incorporated in Ontario on September 25, 2009, and is also extra-provincially registered in Alberta. RIC was wholly-owned by Mr. So until January 28, 2014, when he transferred 60% of the shares to Mr. Eric Hansen. RIC carried on business as a commercial lender to Canadian small to medium-sized businesses and entrepreneurs seeking capital on a short-term basis. Loans ranged from $250,000 to $2,000,000 and were payable within 30 days to one year. RIC financed its lending activities by way of a continuous offering of unsecured promissory notes ("RIC Notes") distributed under exemptions from the prospectus requirement.

16 RCC was incorporated on December 15, 2011, for the purpose of raising registered funds that would be transferred to RIC. RCC is owned 40% by Mr. So and 60% by Target Capital Inc. ("TCI"). RCC ownership was set up with TCI in voting control so that investments in RCC would qualify as a "deferred plan investment" under Canadian income tax legislation, making it eligible for registered savings plans.

17 RCC raised capital through a continuous offering of unsecured fixed rate bonds ("RCC Bonds") under the same exemptions from the prospectus requirement as the RIC Notes. RCC would then transfer the capital it obtained from investors to RIC so that RIC could use the amounts to fund new loans to third parties.

Leadership and Business Operations of Redstone

18 Mr. So created the Redstone group of companies with the aim of providing short-term high-interest loans to small and medium-sized Canadian companies. Borrowing clients came to RIC directly, through a referral, or from a bank or accounting firm. After conducting due diligence consisting of an assessment of their financial position and financing needs, loans would be arranged.

19 Mr. So is an experienced and educated participant in securities' markets. His formal education includes completion of three and a half years of a Bachelor of Commerce program at the King's University in Alberta. Upon leaving university, he joined a boutique corporate finance firm, Harris Brown, where he started as a research analyst and ultimately moved into the role of Manager of Finance and Administration. Throughout his employment, he researched target companies, worked in debt lending, and liaised with clients looking for debt or equity financing.

20 Mr. So was the president and chief executive officer ("CEO") of RIC and RCC until January 28, 2014, when he resigned from these roles following his incarceration for unrelated criminal charges. At that time, Mr. Hansen — who had been a consultant providing marketing and investor relations to the Redstone companies since the summer of 2011 — became the sole director and officer of RIC and RCC, until his own resignation on August 8, 2014, when Redstone entered receivership.

21 RIC and RCC shared the same registered office, located at 101 Duncan Mill Road, Suite 400, Toronto, Ontario. Though it had another registered office, RMS used Duncan Mill Road as its principal address.

22 Mr. So had sole signing authority for transfers between the three Redstone entities, though he contends that Mr. Chris Shaule and Mr. Karim Habib, both of whom had acted under him as portfolio analysts for the Redstone companies under contract, did as well. Mr. Shaule was responsible for maintaining the books and records of RIC and RCC. Mr. So himself maintained the books and records of RMS.

23 Mr. Hansen, together with Mr. Shaule and Mr. Habib, engaged in a review of the Redstone companies' financial position starting January 2014. Various financial irregularities came to light, so the Redstone companies and GTL on March 17, 2014, with a view to potentially acting as a court-appointed monitor in a CCAA filing.

The RCC — RIC Loan Agreement and General Security Agreement

24 To facilitate the transfer of funds, RCC and RIC entered into a loan agreement dated January 23, 2012 (the "Loan Agreement"), which provided for a loan between $250,000 and $25,000,000 that would be drawn upon with RCC's pre-approval. The agreement was signed by Mr. So on behalf of both companies. RCC lent RIC approximately $14.5 million under the agreement.

25 As part of this lending arrangement, RIC granted RCC a security interest over all of its property via a General Security Agreement (the "GSA").

26 Mr. So explained on cross-examination that, though he now understands that RCC is the first-ranking secured creditor of RIC due to the GSA, he did not appreciate that the GSA would have this effect until Redstone commenced proceedings under the CCAA in March 2014. This is a point to which I will return later in these reasons.

27 On March 14, 2014, in anticipation of the CCAA proceedings, Mr. Hansen performed a search under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") over each of RIC and RCC. The RIC search revealed that RIC had no secured creditors other than TD Bank. The RCC search showed a registration in favour of RIC. Mr. Hansen caused the discharge of the RIC entry against RCC and filed a registration against RIC in RCC's favour. This registration was made prior to the CCAA proceedings.

Redstone Offerings

The Subscription Process

28 RIC Notes and RCC Bonds were issued under a continuous offering made pursuant to exemptions from the prospectus requirement of securities legislation in British Columbia, Alberta, and Ontario. Both RIC and RCC obtained investors under Offering Memoranda ("OM") — documents provided to investors in exempt distributions that set out the business of the company, including liabilities and risk factors. Neither RIC nor RCC are registered in any capacity with securities regulatory authorities.

29 As part of the subscription process, investors acknowledged receipt of the OM and were advised of the risky nature of the investment in the form of a Subscription Agreement delivered to RIC [1] or RCC, [2] depending on the product to which the investors subscribed (i.e., RIC Notes or RCC Bonds). The investors also provided a Representation Letter, in which the investor set out how they qualified for the exemption used to make the purchase. In addition, RCC Investors provided a specific release for TCI. The Subscription Agreement provides, among other information, that "the Subscriber has received and reviewed the Offering Memorandum" in connection with the purchase of the notes.

30 Each one of the RIC and RCC OM contain a section describing risk factors — "ITEM 8 — RISK FACTORS" — that includes the following statements, respectively:

> The purchase of the [RIC Notes] offered hereby is suitable only for sophisticated investors of adequate financial means who can bear the risk of loss associated with an investment in the Company and who have no need for liquidity in this investment. Prospective investors should give careful consideration to the following risk factors in evaluating the merits and suitability of an investment in the Company. The following does not purport to be a comprehensive summary of all the risks associated with an investment in the Company. Rather, the following are only certain particular risks to which the Company is subject. Management urges prospective

> The purchase of [RCC Bonds] pursuant to this Offering should only be made after consulting with independent and qualified sources of investment and tax advice. Investment in the Bonds at this time is highly speculative. The Corporation's business involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Purchasers of Bonds must rely on the ability, expertise, judgement [sic], discretion, integrity and good faith of the management of the Corporation. This Offering is suitable for investors who are willing to rely solely

investors to discuss such risks and other potential risks in detail with their professional advisors prior to making an investment decision.

upon the management of the Corporation and who could afford a total loss of their investment.

The RIC Offerings

31 RIC issued seven OMs between 2010 and 2013 for the purpose of obtaining investments and one non-offering OM to amend a prior memorandum for deficient disclosure of the Loan Agreement.

32 The four OMs issued prior to the Loan Agreement advised that RIC may subsequently enter loans that could supersede the RIC Notes. These OMs state, "The [Notes] are unsecured, and as a result (i) are subordinate to any secured debt which the Company now has or may hereafter incur, and (ii) purchasers will have no direct recourse to the assets of the Company or any other collateral."

33 However, the April 2012 OM failed to disclose the Loan Agreement entered earlier that year as a material contract. The non-disclosure contravened the requirements for a distribution under the s. 2.9 OM exemption that had been used to make distributions in Alberta and British Columbia. This led the securities regulators of those two provinces to issue deficiency letters to RIC with respect to the April 2012 OM, as well as make cease trade orders.

34 RIC settled with the securities regulators by issuing a non-offering OM on August 30, 2012 (the "Rescission OM"), which included and disclosed the RCC Loan and gave RIC Investors who subscribed under distributions based on the April 2012 OM the opportunity to rescind their investments. One investor accepted the rescission offer and the investment was repaid. The correction brought RIC in compliance with the s. 2.9 requirements. The cease trade orders were revoked by both the Alberta and British Columbia securities commissions in October 2012. [3]

35 The amended April 2012 OM and the two subsequent OMs disclose the Loan Agreement and the GSA under material contracts. They also outlined risks related to the notes, including that "[t]he present and after acquired personal property of the Company is secured in favour of RCC pursuant to the terms of the RCC Loan Agreement."

36 Since its inception, RIC has issued 925 notes raising $65,474,000. As of February 28, 2014, approximately $23,340,145 of this is outstanding to RIC Investors.

The RCC Offerings

37 RCC issued two OMs, one in 2012 and the other in 2013. [4] The Loan Agreement is discussed in both OMs: the 2012 OM indicates that RCC intends to enter a loan agreement with RIC and the 2013 OM indicates the agreement has been executed.

38 Both OMs include a summary of loan terms and advise of the risks pertaining to the loan. They indicate that the loan would "be secured by way of a General Security Agreement securing all present and after acquired personal property of RIC in favour of [RCC]." In terms of investment risk with respect to RIC, the OMs indicate that "[a] return on investment for a Subscriber under this Offering is dependent upon RIC's ability to meet its obligations of principal and interest pursuant to the RIC Loan." Further, the risks section explains that "[t]here is no assurance or guarantee that [RCC] will be repaid the RIC Loan in accordance with its terms, if at all, and any failure of RIC pursuant to its payment obligations will directly affect the ability of [RCC] to pay interest and redeem the Bonds."

39 The 2013 RCC OM appends the RIC OM issued March 1, 2013, and advises RCC Investors to review it as it details the risk factors that pertain to RIC's business.

40 Since its inception, RCC has issued 710 bonds raising $16,486,000. All of the bonds were issued after the Loan Agreement was executed. As of February 28, 2014, approximately $16,317,602 of this is outstanding to RCC Investors.

41 It is of note, though perhaps not of consequence, that the RIC and RCC OMs which reference the Loan Agreement misstate the minimum loan amount as $150,000, when the agreement actually provides that the minimum loan amount is $250,000.

Receivership: Redstone Assets and Claims

42 Each of RIC, RCC, and RMS maintained separate financial records and bank accounts. Transfers between the companies have been consistently recorded in their respective books. The Receiver undertook an examination of each company's assets.

43 The assets of RIC as of February 28, 2014, consist of its lending portfolio, which includes 35 accounts with loans totaling approximately $24,648,000. The loans are generally secured against the assets of the borrowers and personal guarantees from their respective shareholders. The sole material asset of RCC is its loan to RIC, which totals $14,260,116. According to the Receiver's investigation, RIC and RCC are owed $8,344,714 by RMS. [5]

44 The claims against each corporation and the Receiver's realizations for each estate as of June 2015 are as follows:

Entity	Claims accepted	Total claim amount	Estate amount
RIC	501	$23,434,146	$16,886,899
RCC	683	$15,849,360	$273,129
RMS	9	$9,854,219	$169,279

45 After disbursements, the Receiver holds $13,776,924. If the priority of RCC Investors is recognized, they would recover approximately 86% of their claims, and the other investors would obtain minimal, if any, recovery. If the Redstone estates are consolidated and the funds divided equally, each investor would recover approximately 28% of their claim.

Law and Argument

46 The RIC and RMS Investors ask me to exercise my equitable discretion and substantively consolidate the estates. The RCC Investors oppose consolidation. Before turning to the parties' interpretation of the facts and their respective arguments, I provide a brief overview of the law surrounding substantive consolidation in Canada and the United States, followed by a description of each party's characterization of the key facts.

47 In determining the appropriateness of substantive consolidation, all counsel referenced *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affir'd *Northland Properties Ltd., Re*, [1989] B.C.J. No. 63 (B.C. C.A.), where the court stated that in determining whether to impose substantive consolidation, the court must balance the economic prejudice to the creditors resulting from continuing corporate separateness against the economic prejudice caused by consolidation. To establish that substantive consolidation is warranted, it must be shown that the "elements of consolidation" are present, and that the consolidation would prevent a harm or prejudice or would effect a benefit generally. The "elements of consolidation" adopted in *Northland* from United States case law were as follows:

(i) difficulty in segregating assets;

(ii) presence of consolidated financial statements;

(iii) profitability of consolidation at a single location;

(iv) co-mingling of assets and business functions;

(v) unity of interests in ownership;

(vi) existence of inter-corporate loan guarantees; and

(vii) transfer of assets without observing corporate formalities.

Substantive Consolidation in the United States: Three Approaches to Assessing What is Just and Equitable in the Circumstances

48 A brief overview is included to contextualize the approach Canadian courts have adopted thus far, given the relatively limited treatment of this concept in Canada, before addressing the parties' arguments on the application of substantive consolidation to their dispute.

49 In the United States, the determination is made under the courts' equitable jurisdiction, similar to Canada. American courts have taken divergent approaches that has led to the articulation of several tests, the first regarding retaining flexibility but recently indicating that orders should be limited to very specific circumstances.

50 The power of U.S. courts to order substantive consolidation is derived not from explicit statutory provisions but rather from the Bankruptcy Court's general powers in s. 105(a) of the *Bankruptcy Code* "to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the *Bankruptcy Code*]". Substantive consolidation has been recognized by the Supreme Court as a power under this section in *Sampsell v. Imperial Paper & Color Corp.* [6] Given its foundation upon an equitable basis, in determining whether to order substantive consolidation courts are guided by what is just and equitable in the circumstances. Three leading approaches led to the evolution of this determination.

First Approach: Three-Part Test

51 In *In re Auto-Train Corp., Inc.*, [7] the Court of Appeals for the District of Columbia Circuit moved away from relying on a list of factors to ascertain whether there has been an abuse of the corporate form and instead adopted a three-part test for determining whether or not to grant a substantive consolidation request:

1. Is there a substantial identity between the entities to be consolidated? [8]

2. Is consolidation necessary to avoid some harm or to realize some benefit?

3. If a creditor objects and demonstrates that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation, will the demonstrated benefits of consolidation heavily outweigh the harm to the objecting creditor?

Second Approach: Two-Part Test with a Focus on Reliance

52 In *In re Augie/Restivo Baking Co., Ltd.*, [9] the Court of Appeals for the Second Circuit departed from previous cases where determinations were made without regard for creditor reliance and were only based on corporate veil principles pertaining to respecting corporate separateness, [10] and instead set a two-part approach with a focus on reliance:

1. Have creditors dealt with the entities as a single economic unit rather than relying on their separate identities in extending credit?

2. Are the affairs of the debtors so entangled that consolidation will benefit all creditors?

Third Approach: Stricter Focus on Prepetition and Postpetition Consequences of Consolidation

53 In *In re Owens Corning*,[11] the Third Circuit elected to set out a stricter approach, rejecting *Auto-Train* as creating "a threshold not sufficiently egregious and too imprecise for easy measure" and disapproving of the checklist approach used in assessing corporate separateness, holding instead that substantive consolidation is appropriate only when an applicant proves either that:

1. Prepetition, the entities for whom consolidation is sought disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or

2. Postpetition, their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

54 Interestingly, all three approaches referenced above focus on the administrative costs of separating the entities with consequent detrimental effect on all creditors. In the case at bar, this is not a factor as the assets are held separately and the books and records, although they may not be pristine, are such that the Receiver can identify the creditors of each entity.

55 I now return to the investors' key positions on this issue in the context of Redstone's receivership.

Credibility, Relevance and Findings of Facts

RIC Investors

56 In support of their submission that consolidation is appropriate, counsel for the RIC Investors contends that the Redstone companies operated as a single entity that shared business functions, resources, personnel, and cash flow, and whose assets are intermingled due to inaccurate recordkeeping. RIC Representative Counsel further highlights the following facts:

• Redstone operates a centralized cash management system, with no protocol of any kind regarding the movement of monies between RCC, RIC or RMS — even though the companies have separate bank accounts, the funds flowed between entities to serve operational needs without having any rules, policies or regulations in place in respect of recording inter-company transfers;

• Evidence by Redstone staff that they saw no distinction between how funds were advanced between RCC and RIC or RMS and RIC, and that they treated the companies interchangeably;

• Redstone personnel discovered millions of dollars of unexplained transactions, bearing the hallmark of fraudulent activity;

• The Receiver discovered an error in the RCC accounting ledger — namely, RCC bond purchases between June and September 2012 totalling $713,722 that were not recorded in the RCC accounting ledger, but the funds from which were paid to RCC and then transferred to RIC — that renders unreliable the Receiver's assertion in its Fourth Report that "transfers between bank accounts were recorded in great detail in the books of records of each of RIC and RCC";

• According to the terms of the MSA, all expenses were to be borne by RMS, but in practice RIC generally held the bulk of cash and covered expenses incurred for the benefit of all three companies, such as fees for any market dealers involved in facilitating the sale of RIC Notes or RCC Bonds, accounting and legal fees or salaries for staff;

• Mr. So's evidence that only in 2013 were attempts made to improve recordkeeping within Redstone. Further, the records before late 2013 are not accurate and make it impossible to know the true inter-company balances;

• The RMS books were never subject to an audit, and though Mr. So employed "auditors" in respect of RIC and RCC, no evidence has been produced as to the quality or assurance level of the audits, nor are any reports or working notes included in the record;

• Mr. So's evidence that he viewed the companies as a single entity, which is how he represented them to investors, and he in fact intended, in late 2013, to amalgamate RIC and RCC and wind down RMS, as a part of which the RIC Notes and RCC Bonds would be exchanged for a new and identical security;

• The representations by Mr. So and Redstone personnel to the Exempt Market Dealers (EMD) who promoted Redstone products were that investments in each company would be treated equally. The marketing materials for RIC and RCC distributed to investors were virtually identical, both describing the same investment terms, interest rates, and risks, and both failing to reference any priority for RCC Investors;

• Evidence of investors that they were led to believe RIC, RCC and RMS were interchangeable, and most investors were never informed of the Loan Agreement and GSA.

RMS Investors

57 Counsel to RMS Investors supports the position of the RIC Investors. In particular, RMS points to evidence by RMS and RIC Investors that they were led to believe there was no distinction between RIC and RMS or RIC and RCC. Further, RMS notes that there is no evidence that the RCC Investors relied on their priority position in making their purchases. Counsel also points to the evidence of various Redstone investors and others, who swore they made investments in Redstone and were led to believe that there was no distinction between RIC and RMS. Additionally, some of these investors swore that they were not told that RCC had a priority position and that they either did not receive an OM or only received one after the investments were made. Further, RMS Representative Counsel highlights the following evidence:

• Mr. Farouk Haji, whose affidavit detailed the process an Exempt Market Dealing Representative is required to follow prior to a client undertaking a new trade in an exempt market product, did not discuss whether he advised any clients of the priority position of RCC over RIC;

• There is no evidence from any RCC Investor that they relied on the priority position in making their investments;

• Ms. Cynthia Lewis' second investment in RIC, made in February 2011 in the amount of $540,000, was not treated in accordance with the OM in place at the time: she was first assigned RIC security against the ultimate borrower that was discharged in 2011 without her knowledge, and when her promissory note from RIC matured and rolled over in the February 16, 2012, after having already rolled over a number of times, the replacement note was issued by RMS rather than RIC but the language of the note nonetheless required interest payments from RIC. Ms. Lewis advises that Mr. So explained the rollover to RMS as due to RMS being for "friends and family";

• Mr. Chad MacDonald received a promissory note from RMS and RMS agreed to assign him a portion of the security it obtained from the ultimate borrower, Green Dot Finance Inc. However, the Green Dot loan, which formed the security for the investment and which appeared to be an asset of RIC, was sold for full face value to Maple Brook.

RCC Investors

58 RCC Representative Counsel contends that consolidation would unduly prejudice the RCC Investors' interests as this is not a case where corporate formalities were not maintained or the liabilities were not readily identifiable. They point to the following in support of this position:

- The creditor pools of RIC and RCC are different, the creditors invested in each entity based on distinct OMs prepared on a single-entity basis, and the creditors of each entity are identifiable;

- RIC, RCC and RMS each maintained separate bank accounts. The evidence available to the Receiver and its consultants indicated that Mr. So did not treat each of these as one bank account. Transfers between bank accounts were recorded with great detail in the books and records of RIC and RCC;

- On cross-examination, Mr. So's evidence was that he assumed inter-company transfers were recorded in the books of the respective corporations as either receivables or payables. In addition, he advised staff to make best efforts to ensure the transactions pertaining to an entity stay within that entity and be processed through the correct account. He also advised them to record inter-company transfers where necessary. It was his belief and/or hope that this was undertaken properly;

- The assets of each Redstone corporation are different and identifiable. RIC's assets as of February 28, 2014, consisted of its lending portfolio which included 35 accounts with loans totaling approximately $24.648 million. The loans were all secured against the assets of the underlying borrower, and typically were supported by personal guarantees from shareholders where the borrower was a corporation. RCC's sole material asset is the loan receivable from RIC, on a secured basis in the amount of $14,260,116. The assets of RMS are identified by Mr. So in his sworn affidavit as several loan receivables, office furniture and the like, which he valued at $4,706,510. The assets and liabilities of RMS have been the subject of a forensic review undertaken by GTL in its capacity as Monitor and Receiver;

- RIC and RCC had separate audited and unaudited financial statements and did not prepare consolidated financial statements. The most recent audited financial statements for RIC and RCC were dated August 31, 2012. RMS also maintained separate financial records;

- Note 6 of the audited and unaudited financial statements of RCC attached to the RCC 2013 OM states that the loan from RCC to RIC is secured by way of a GSA on all present and after-acquired property of RIC.

Mr. So's Evidence on Cross-Examination

59 As articulated above, counsel to RCC relies on the evidence of Mr. So to support its position. I have reviewed the affidavits and the transcript of Mr. So's cross-examination and have come to the conclusion that his evidence is unreliable and should be disregarded.

60 In many cases, the answers provided by Mr. So on cross-examination belie the fact that he is highly educated and very experienced in the financial field. Mr. So was asked about the inter-company transfers between each of RMS, RIC and RCC. Mr. So answered that when such inter-corporate transfers occur, there would be an appropriate entry, whether a receivable or payable, in the relevant books and records of those companies.

61 Mr. So was also asked about the Cease Trade Order that related to RCC and RIC. He was asked how the issue was resolved. Mr. So answered as follows:

> While Craig Betham took . . . you know, reformatted both OMs for us. And one of the things at that time was that . . . the original RCC OM was a separate OM that was created. Then, what the regulators wanted us to do, because these two companies are basically the same company, or related companies, they wanted us to do a wrapper, a wrap-around OM, so that the RIC OM had to be included in the RCC OM. That was done. Then, the second thing was we had to offer rights of rescission to all investors that invested in the previous OM, so

that they had the proper information to decide if they were going to rescind or remain in the company. And then once those two things were done, we were restored back into good standing with the regulators.

62 In addition, Mr. So was asked whether he had certain friends and family who are RIC Investors. He answered in the affirmative. He also understood that if the RIC Investors were successful on this substantive consolidation initiative, it would be reflected in the ultimate distribution to the investors.

63 Mr. So was asked questions with respect to the GSA provided by RIC to RCC, executed January 23, 2012.

Question 518: Can you tell me, in your own words, what you think this document purports to do?

Answer: I remember that this was when we created Redstone Capital. It was what . . . I believe the lawyers, for Craig Skauge . . . I can't remember who at that time had told us that it was to be put in place in order to make RCC RSP eligible or something of that sort, that there had to be a securities agreement in place into RIC. But one of the things that I wanted to add, was that I had always spoken to him about, that this was, is in *pari passu* with all RIC Investors . . .

Question 528: So it's your evidence today that starting from your years at Harris Brown and subsequently your years at Redstone, where your primary function was to lend money to entities to take security for those loans, that you did not understand what this general security agreement did?

Answer: I understood that RCC was taking a GSA at RIC. Yes, I understood that.

Question 529: So we'll start again. When you executed this document in January 2012.

Answer: Yes.

Question 530: [D]id you understand that the effect of this document would be to grant a security interest in and to RCC, with respect to RIC's assets?

Answer: I understood that it would be granting a security interest. Yes I did . . .

Question 531: Okay.

Answer: My understanding . . . and which is why all marketing material, and the way that Redstone has always been presented to all investors and EMDss, was that everything was *pari passu*. The only difference between RCC and RIC was RCC was registered funds and RIC were non-registered.

Question 532: I understand that, but I guess. I just want to make sure I understood what you're saying to me. We have established that you understand what a general security agreement is.

Answer: Yes.

Question 533: And what a general security agreement does? And the effect of a general security agreement.

Answer: Yes.

Question 534: And you agree that this document has the effect of a typical general security agreement?

Answer: Yes.

Question 535: And you agree that you have executed this document.

Answer: Yes.

> Question 536: But you're telling me that you always had the impression that RIC and RCC would be treated on a *pari passu* basis. I have a hard time how that holds together.
>
> Answer: Well because that's what I had spoken to the lawyers about when we were creating the RCC OM and everything. That it was . . . everyone was always to be *pari passu*. And we were never told differently and that is. Mr. Hansen was even involved in that, when we were creating RCC. I never once told that RCC has a priority over RIC. . . .

64 The foregoing interchange establishes, in my view, that Mr. So's evidence is completely unreliable. It is inconceivable that an individual with a background education in commerce and finance, followed by a lengthy career in the financial industry, could make the statements that Mr. So did. He understands the effect of a GSA, which is that one party is granted security over its assets in favour of another party (the secured party). This is a fundamental and elementary financing concept. I fail to understand how Mr. So can appreciate the effect of a GSA in situations where a Redstone entity is lending money to a borrower, yet fail to understand the effects of the same type of agreement when granted by RIC in favour of RCC. It is impossible to reconcile these positions.

65 I find that Mr. So's attempt to explain this anomaly arose *ex post facto*. Mr. So arrived at his *pari passu* understanding not at the time of granting the security, but subsequent to the collapse of Redstone and the initiation of these proceedings in an attempt to justify that the three entities in question should be consolidated for distribution purposes. The fact that substantive consolidation, if granted, favours his family and friends, cannot be overlooked.

66 I am satisfied that Mr. So knew that RCC was created in order that it could attract eligible funds for registered investors; that RIC was a separate entity from RCC; that RIC granted a security agreement in favour of RCC; and that the effect of granting such a security agreement resulted in RCC being a secured party holding a security interest in the assets of RIC and, therefore, having priority over RCC.

67 The evidence of Mr. So is replete with contradictions. I find his evidence to be unreliable in all respects, such that I have disregarded it in its entirety. Obviously, this finding is extremely detrimental to the position put forth by counsel on behalf of both RIC Investors and RMS Investors. RMS Investors, to the extent they rely on the evidence of Mr. So.

Investor State of Mind

68 Counsel for the RMS Investors also pointed to evidence of a number of RMS and RIC Investors who claimed they were led to believe that there was no distinction between RIC and RMS or RIC and RCC, and further that there was no evidence that RCC Investors relied on their priority position in making their purchases. In support of this argument, the RMS Investors highlighted the evidence of Cynthia Lewis, Chad MacDonald, Nick DeCesare, Robert Dodd, Dario Mirabella and Ronald Smithers. In my view, the evidence of these individuals carries little weight.

69 Their evidence has to be discounted because it is subjective evidence provided today about their state of mind and knowledge at the time they made the investment a number of years ago. Their evidence is also at odds with the language contained in the loan agreement and OMs. The evidence is suspect as these parties are aware that it is in their best financial interest to take the position that they were led to believe there was no distinction between RIC, RMS and RCC. Indeed, it would be surprising if they did not take such a position. Investors in RIC and RMS stand to receive nominal distribution unless there is substantive consolidation. This is in contrast to a projected distribution of 28% if there is substantive consolidation.

70 A review of the authorities also convinces me that their evidence is of very limited utility and is largely irrelevant. The "elements of consolidation" adopted from U.S. case law were referenced in *Northland*, supra.

Absent from this list, and for good reason, is the knowledge or state of mind of the investor or creditor at the time that investments were made or credit was advanced.

71 In my view, a creditor's motivation for investing is not relevant to any of the considerations set out in the test for substantial consolidation. I considered this issue in a preliminary motion, indexed as *Redstone Investment Corp., Re*, 2016 ONSC 513 (Ont. S.C.J.), at paras. 11 — 15:

> [11] RCC Representative Counsel submits that the evidence in the Bach Affidavit is relevant as it shows Mr. Bach's motivation for investing in RCC and the actual prejudice he will suffer in the event of substantive consolidation.
>
> [12] The test for substantive consolidation was recently summarized in *Bacic v. Millennium Educational and Research Charitable Foundation*, 2014 ONSC 5875, 19 C.B.R. (6th) 286 at para 113.
>
> It requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:
>
> a) Difficulty in segregating assets;
>
> b) Presence of consolidated Financial Statements;
>
> c) Profitability of consolidation at a single location;
>
> d) Commingling of assets and business functions;
>
> e) Unity of interests in ownerships;
>
> f) Existence of intercorporate loan guarantees; and,
>
> g) Transfer of assets without observance of corporate formalities.
>
> in order to assess the overall effect of the consolidation. (*Atlantic Yarns Inc., Re*, 2008 NBQB 144 (N.B. Q.B.); *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affirmed in *Northland Properties Ltd., Re* (1988), [1989] B.C.J. No. 63 (B.C. S.C.) and *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]).
>
> [13] In *PSINET*, *supra*, Farley J. held, at para. 11 that consolidation by its very nature will benefit some creditors and prejudice others and, as a result, it is appropriate to look at the overall general effect. This approach was affirmed in *Atlantic Yarns*, *supra*. In *J.P. Capital Corp.*, Re (1995), 31 CBR (3d) 102 (Ont. S.C.) Chadwick J. expressed concern about the consolidation of actions without knowing the effect it will have on all creditors. Chadwick J. wrote, "Although expediency is an appropriate consideration, it should not be done at the possible prejudice or at the expense of any particular creditor." In considering the relevance of *JP Capital* to this matter, I note that the *J.P. Capital* involved an "extremely complex bankruptcy" touching on a number of companies and assets, the parties were in the midst of cross-examination, and there were issues raised with respect to the actual corporate structure of the various companies and the tracing of the assets in relationship to the parties (para.17)."
>
> [14] In my view, Mr. Bach's motivation for investing in RCC is not relevant to any of the considerations set out in the test for substantive consolidation. As a result, in determining the overall general prejudice to both sets of creditors, it seems to me that if the evidence is not relevant, refusing leave cannot be prejudicial to Mr. Bach, as an individual creditor. The second part of the Rule 39.02(2) is not applicable as no cross-

> examination took place and since I have determined that the content of the affidavit is not relevant to the determination of the Substantive Consolidation Hearing, the fourth part of the test need not be considered.
>
> [15] Accordingly, since I have concluded that the Bach Affidavit does not meet the relevance criteria of the Rule 39.02(2) test, the motion seeking leave to deliver the Bach Affidavit as evidence in the Substantive Consolidation Hearing is dismissed.

72 There is a great danger to placing any weight on the state of mind of the investor or creditor in the substantive consolidation analysis. Human nature is such that individuals would be far more likely to recite or recall a fact situation, which, if acceptable, puts them in a better financial position. All that is required would be for the individual to take the position that a number of the RIC Investors and RMS Investors are taking in these proceedings, namely, that they did not know that RCC had priority. This presupposes that the investors did not read the governing documents. It presupposes that the EMDs either did not read the governing documents or did not advise the Investors of the contents of the governing documents.

73 To recognize state of mind would result in an unacceptable level of commercial uncertainty where written contracts could be overridden by parties who voluntarily choose not to read the governing documents.

74 Counsel acknowledges that the consolidation of bankrupt estates was recently authorized in *Bacic*, supra and *D'Addario v. Ernst & Young Inc.*, 2014 ABQB 474 (Alta. Q.B.). In both cases, the assets of the corporations, business functions and financial statements were all co-mingled. However, in deciding to consolidate the estates, the court in each decision explicitly noted that consolidation would not be to the prejudice or expense of a particular creditor. In particular, the court in *D'Addario* found that "no creditor would benefit from consolidation at the expense of any other". That is clearly not so in this case. The projected distribution for RCC Investors would be reduced from 86% to 28%.

Legal Argument

75 Counsel to RMS Investors referenced the text of Dr. Janis Sarra, *Rescue: The Companies' Creditors Arrangement Act*, 2d ed (Toronto: Carswell, 2013), where the author explains the process to be followed in assessing whether to consolidate estates:

> 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 to be 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.

76 Based on the jurisprudence canvassed above, there are two related streams of case law in Canada on the issue of substantive consolidation in either a restructuring or a bankruptcy situation: First, the *Northland* line of cases involving analysis of: (i) the elements of consolidation; and (ii) whether consolidation would prevent a harm or prejudice or would effect a benefit generally. Second, there is a more ad hoc approach involving fact-based analysis guided by the equities.

77 In this case, the essential effect of consolidation would be to avoid the priority arrangement purportedly created by the loan documents, resulting in moderate recoveries to the investors in each of the Redstone entities. Absent consolidation, RCC Investors will receive a projected 86% recovery. RCC Investors and RMS Investors would receive a nominal recovery at best.

78 The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:

(i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?

(ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?

(iii) Is consolidation fair and reasonable in the circumstances?

79 Based on the foregoing — and knowing that the evidence of Mr. So carries no weight and that the evidence of the investors is of very limited import — the analysis of the *Northland* factors supports maintaining the status quo.

(i) Difficulty in Segregating Assets

80 The assets of each of RIC, RCC and RMS are easily identifiable, are not difficult to segregate, and have been segregated as is demonstrated by the Receiver's Statement of Receipts and Disbursements.

(ii) Presence of Consolidated Financial Statements

81 RIC, RCC and RMS did not prepare consolidated financial statements. All financial statements, audited and unaudited, were prepared on an entity-by-entity basis. The financial statements of RIC and RCC were audited. This factor supports maintaining the status quo.

(iii) Co-mingling of Assets and Business Functions

82 The only material asset of RCC is the secured inter-company receivable from RIC, which is not co-mingled with any assets of RIC or RMS. To the extent that any business functions were co-mingled, this can be explained by the MSA between RMS and RIC and the terms of the OMs that confirm that RIC was liable for all costs incurred by RCC relating to RCC's Offering. As such, this factor supports maintaining the status quo.

(iv) Unity of Interests in Ownership

83 There is no unity of interest in ownership. RIC, RCC and RMS have different ownership structures. RIC is owned 60% by Mr. So and 40% by Mr. Hansen. RCC is owned 60% by TCI and 40% by Mr. So. RMS is wholly-owned by Mr. So.

(v) Existence of Inter-Corporate Loan Guarantees

84 There are no inter-corporate loan guarantees of any third party financing. This factor supports maintaining the status quo.

(vi) Transfer of Assets Without Observance of Corporate Formalities

85 While there is evidence of transfers of assets without observance of corporate formalities, the preponderance of evidence relates to transfers from RIC/RCC to RMS. Prior to the CCAA filing, it was determined that RMS received significant unauthorized cash transfers from RIC estimated to be approximately $8.5 million. The Receiver completed an investigation and prepared an analysis relating to the source and uses of funds relating to RMS. As a result of the analysis, the Receiver determined that there is a total of approximately $8.3 million due from RMS to RIC and RCC. As such, in my view, this factor supports maintaining the status quo.

Prejudice to Creditors

86 In addition to a review of the factors set out above, the court will consider the relative prejudice to creditors that will result from substantive consolidation. In this case, substantive consolidation eliminates the secured inter-company receivable, while it is the only material asset of RCC. The result is, therefore, from an objective

standpoint, extremely prejudicial to the RCC Investors as their recoveries (based on available information in the Receiver's Fourth Report) would go from 86% in a status quo scenario to 28% in a substantively consolidated estates scenario. Conversely, the RIC Investors and RMS Investors benefit from the consolidation from effectively no recovery in a status quo scenario to a 28% recovery in a substantively consolidated scenario.

87 Investors in RCC and RIC took calculated risks based upon OMs that disclosed the RCC GSA and RIC loan. The RIC Investors acknowledge that these were risky investments and that they may not recover their investments. Now, facing the very risk they previously acknowledged, the RIC Investors seek to ameliorate the prospect of a negligible recovery against RIC to the prejudice of RCC Investors.

88 As Trainer J. explained in *Northland*, "it would be improper for the court to interfere with or appear to interfere with the rights of the creditors," and that such an appearance would be created if the estates are ordered merged for all purposes. This caution rings true in this case. To order substantive consolidation would require me to ignore written contracts and rely on subjective *ex post facto* evidence.

Conclusion

89 Substantive consolidation is an equitable remedy. The primary aim of this extraordinary remedy is to ensure the equitable treatment of all creditors. It is recognized that as consolidation effectively redistributes wealth among creditors of the related entities, individuals will invariably realize asymmetric losses or gains (see: M. MacNaughton and M. Arzoumanidis*, "Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis*" (2007), ANNREVINSOLV 16, at p. 3).

90 In this case, I have concluded that it is not appropriate to invoke this extraordinary remedy. The assets are held separately and audited financial statements exist for RIC and RCC. The governing loan documents clearly set out that the corporations are separate and that the obligations of RIC to RCC are subject to a GSA. Referencing *Northland*, the "elements of consolidation" are not present. Furthermore, there would also be significant financial prejudice to creditors of RCC if substantive consolidation were ordered.

91 In the result, an order shall issue that the three corporate entities are not be to substantially consolidated.

Costs

92 The parties have previously provided costs outlines to the court, which should be incorporated into a draft order for my review.

Motion dismissed.

Footnotes

* A corrigendum issued by the court on October 17, 2016 has been incorporated herein.

1 The RIC OMs state that the subscription documents have to be delivered to RIC at its Duncan Mill Road address for all except subscriptions under RIC's first two OMs: the July 8, 2010 OM directs that forms be sent to Harris Brown & Partners Ltd. as RIC's agent, and the January 20, 2011 OM directs that forms be sent to Sterling Grace as RIC's agent. On February 20, 2014, the registration of Sterling Grace was suspended by the Ontario Securities Commission for several failures, including with respect to acting as an exempt market dealer facilitating subscriptions to Redstone Investment Corporation.

2 The RCC OMs state that the subscription documents be sent to RCC at its Duncan Mill Road address.

3 The cease trade orders were issued on June 7, 2012 in BC and June 15, 2012 in Alberta. The orders were fully revoked on October 4, 2012 in BC and October 10, 2012 in Alberta.

4 The RCC OMs are dated April 3, 2012 and March 1, 2013.

5 As a result of the *Mareva* order, the Monitor undertook a forensic review of two of RMS's bank accounts at the TD Bank. RMS also maintains an account with National Bank. The Receiver also completed an investigation and prepared completed an analysis relating to the sources and use of funds relating to RMS. As a result of this analysis, the Receiver determined that there was a total of $8,344,714 due from RMS to RIC and RCC.

6 313 U.S. 215 (U.S. Sup. Ct. 1941).

7 810 F.2d 270, Bankr. L. Rep. P 71, 618 (U.S. Ct. App. 1987). This test has been adopted by the D.C. Circuit and the Eleventh Circuit: see *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, Bankr. L. Rep. P 74, 055 (U.S. C.A. 11th Cir. 1991). The necessity of consolidation requirement follows from *Snider Brothers Inc., Re*, 18 B.R. 230 (U.S. Mass. 1982) and the balancing of interests element flows from *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987).

8 This is a typical *alter ego* inquiry made in corporate veil cases and generally involves consideration of the seven factors set out in In re Vecco Construction Industries, Inc., 4 B.R. 407 (Bankr. E.D. Va. 1980): 1. Difficulty in segregating assets; 2. Presence of consolidated financial statements; 3. Profitability of consolidation of a single location; 4. Comingling of assets and business functions; 5. Unity of interests in ownership; 6. Existence of inter-corporate loan guarantees; and 7. Transfers of assets without observance of corporate formalities.

9 860 F.2d 515, Bankr. L. Rep. P 72, 482 (U.S. C.A. 2nd Cir. 1988). This test has been adopted by the Second and Ninth Circuits and followed by the Fourth Circuit.

10 For example, in *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (U.S. C.A. 2nd Cir. 1964), the Second Circuit Court of Appeals focused the inquiry on corporate veil-based principles and specifically looked to whether there was an abuse of the corporate form or structure, including whether the companies at issue operated a single business, had the same directors, shareholders, and staff, or shared accounting records. In *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. C.A. 2nd Cir. 1966), 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.

11 419 F.3d 195, Bankr. L. Rep. P 80, 343 (U.S. C.A. 3rd Cir. 2005).

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2014 ONSC 5875
Ontario Superior Court of Justice

Bacic v. Millennium Educational & Research Charitable Foundation

2014 CarswellOnt 14545, 2014 ONSC 5875, 19 C.B.R. (6th) 286, 246 A.C.W.S. (3d) 751

In the Matter of an Application Pursuant to Section 101 of the Courts of Justice Act, R.S.O. 1990, c. C.43, as Amended

In the Matter of Section 248(3)(b) of the Ontario Business Corporations Act, R.S.O. 1990, Chapter B.16

In the Matter of Section 241(3)(b) of the Canada Business Corporations Act, R.S.C. 1985, c. C-44

In the Matter of Section 253(3)(b) of the Canada Not-for-Profit Corporations Act, S.C. 2009, c.23

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Lily Bacic, Ronald Ayoub, Sandra Ayoub, Donald Hutchinson, Gloria Hutchinson, Kim Kruk, Dale Hein, Pamela Stone, Caroline Lewandowsky, Lim Lewandowsky, Anne Lefier, Gary McGinn, David Hamilton, James Miller, Helene Lamadleine, Mary Lou Fisher, Allan Brett, Richard Melcer, Stephen Caldwell, Wendy Caldwell, Barry Doucette, Colleen Moore, Michelle Vezeau, David Kornelsen, Kevin Harsh, Luc Maltais, Colleen Maltais, Bob Mech, A.A.N.T. Software Corporation, Terrance Finnigan, James Joss, David Wiskowski, Moe Litwack, Tomy Issa and George Boszormeny, Applicants and Millennium Educational & Research Charitable Foundation (formerly the Thomas C. Assaly Charitable Foundation), Assaly Investment Program Corporation, Assaly Financial Corporation, Act 1 Corp. and Millennium Springs Development & Construction Corp. (aka Millennium Springs Properties Ltd.) Thomas G. Assaly, Karen Floyd-Assaly, and Frank H. Fee, III, Respondents

In the Matter of the Bankruptcy of Millennium Educational & Research Charitable Foundation (formerly the Thomas C. Assaly Charitable Foundation) a registered charity carrying on business in the City of Ottawa, in the Province of Ontario (the “Foundation”)

In the Matter of the Bankruptcy of Assaly Financial Corporation, of the City of Ottawa, in the Province of Ontario, Assaly Investment Program Corporation, of the City of Ottawa, in the Province of Ontario and Act 1 Corp., of the City of Ottawa, in the Province of Ontario (collectively the “Bankrupt Respondent Corporations”)

Kane J.

Heard: June 17, 18, 2014
Judgment: October 17, 2014
Docket: Ottawa 13-57904, 33-165343, 33-165372, 33-165369, 33-165370, 33-165371

Counsel: Martin Black, for Estate of Thomas C. Assaly (the “Estate”)
Jason Dutrizac for Doyle Salewski Inc., court appointed Interim Receiver of the Foundation, Receiver and Manager of the respondent corporations in the Receivership Action, other than the Millennium Educational & Research Charitable Foundation (”Foundation”), and Trustee in the Bankruptcy of the Foundation (the “Trustee”)
Justin R. Fogarty for Applicants in the Receivership Action and Applicants in the Bankruptcy Action

Subject: Corporate and Commercial; Estates and Trusts; Insolvency; Property

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — Appeal from disallowance — Grounds
Settlor established charitable foundation in 1989 — Settlor became incapacitated by 2006 — Foundation was essentially controlled by son and his wife — Objects of foundation were changed in 2006, when foundation had $3,813,507 in assets — Foundation and settlor's group of companies became bankrupt — After settlor died, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation in amount of $3,813,507 — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging settlor's gifts had failed and must be returned to his estate in priority to foundation's creditors and other claimants — Appeal dismissed — Estate failed to establish any error by trustee — Even if son and his wife misappropriated funds from foundation, settlor's gift could not be undone — Nothing indicated settlor imposed any reversionary or residual rights to receive back any portion of foundation's assets — Foundation continued to distribute some money for charitable purposes from 2006 to 2011 so total amount claimed was incorrect — Further, investment funds from various creditors had been channelled through foundation so estate would not have been able to obtain blanket priority — Inherent jurisdiction of court to regulate charities should not be used to achieve such purpose — There was no evidence settlor ever intended to establish trust — Treating group of companies and foundation as consolidated bankrupt was justified — Son had intermixed funds within group of companies and foundation since 2006.

Estates and trusts --- Charities — Nature of gift — Miscellaneous
Settlor established charitable foundation in 1989 — Foundation was essentially controlled by settlor's son and his wife after settlor became incapacitated — Objects of foundation were changed in 2006 — Foundation and settlor's group of companies became bankrupt — After settlor passed away, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging that gifts made by settlor to create foundation and advance its stated objects had failed and must therefore be returned in first priority to his estate — Appeal dismissed — Estate failed to establish any error by trustee — Even if son and his wife misappropriated funds from foundation, settlor's gift could not be undone — Nothing indicated settlor imposed any reversionary or residual rights to receive back any portion of foundation's assets — Foundation continued to distribute some money for charitable purposes from 2006 to 2011 so total amount claimed was incorrect — Investment funds from various creditors had been channelled through foundation so estate would not have been able to obtain blanket priority — Inherent jurisdiction of court to regulate charities should not be used to achieve such purpose — There was no evidence settlor ever intended to establish trust.

Bankruptcy and insolvency --- Property of bankrupt — Miscellaneous
Consolidation or pooling of assets — Settlor established charitable foundation in 1989 — One of settlor's sons worked within settlor's group of companies — Foundation was essentially controlled by son and his wife after settlor became incapacitated — Objects of foundation were changed — Foundation and settlor's group of companies became bankrupt — After settlor died, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging settlor's gifts had failed and must be returned to his estate in priority, without allowing any pooling or consolidation of group of companies and foundation's estates, assets or liabilities — Appeal dismissed — Substantive consolidation of assets of bankrupt estate, including foundation, was authorized — Treating group of companies and foundation as consolidated bankrupt was justified — Son had intermixed funds within group of companies and foundation since 2006 and it would be burdensome to allocate value and claims among them.

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J.P. Capital Corp., Re (1995), 1995 CarswellOnt 53, 31 C.B.R. (3d) 102 (Ont. Bktcy.) — considered

Jardine v. Jardine (2002), 2002 CarswellOnt 3602 (Ont. S.C.J.) — 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.) — referred to

Northland Properties Ltd., Re (1989), *(*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, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122, 1989 CarswellBC 334 (B.C. C.A.) — referred to

PSINET Ltd., Re (2002), 33 C.B.R. (4th) 284, 2002 CarswellOnt 1261 (Ont. S.C.J. [Commercial List]) — considered

Richert v. Stewards' Charitable Foundation (2005), 2005 BCSC 211, 2005 CarswellBC 315, 15 E.T.R. (3d) 92, 2005 D.T.C. 5647 (Eng.), [2006] 4 C.T.C. 67 (B.C. S.C.) — referred to

Singh Estate (Trustee of) v. Shandil (2005), 2005 CarswellBC 2466, 2005 BCSC 1448, 20 E.T.R. (3d) 106 (B.C. S.C.) — referred to

Singh Estate (Trustee of) v. Shandil (2007), 2007 CarswellBC 1322, 68 B.C.L.R. (4th) 108, *(*sub nom. *Singh Estate v. Shandil)* 243 B.C.A.C. 148, 32 E.T.R. (3d) 206, [2007] 10 W.W.R. 84, *(*sub nom. *Singh Estate v. Shandil)* 401 W.A.C. 148, 2007 BCCA 303, 32 E.T.R. (3d) 207 (B.C. C.A.) — referred to

Victoria Order of Nurses for Canada v. Greater Hamilton Wellness Foundation (2011), 2011 CarswellOnt 12086, 2011 ONSC 5684, 75 E.T.R. (3d) 161, 94 B.L.R. (4th) 246 (Ont. S.C.J.) — considered

Women's Christian Assn. of London v. McCormick Estate (1989), 34 E.T.R. 216, 1989 CarswellOnt 533 (Ont. H.C.) — considered

Young v. Young (1958), 15 D.L.R. (2d) 138, 1958 CarswellBC 193 (B.C. C.A.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 50.1 [en. 1992, c. 27, s. 19] — considered

s. 51(1)(e) — considered

s. 65.2(4) [en. 1992, c. 27, s. 30] — considered

s. 66.14(b) [en. 1992, c. 27, s. 32(1)] — considered

s. 67(1) — considered

s. 67(1)(a) — considered

s. 81.2(1) [en. 1992, c. 27, s. 38(1)] — considered

s. 81.3(8) [en. 2007, c. 36, s. 38] — considered

s. 81.4(8) [en. 2007, c. 36, s. 38] — considered

s. 102(2) — considered

s. 124(2) — considered

s. 128(1) — considered

s. 135 — considered

s. 135(2) — considered

s. 135(4) — considered

s. 183(1) — considered

Canada Not-for-Profit Corporations Act, S.C. 2009, c. 23
s. 22 — referred to

Charities Accounting Act, R.S.O. 1990, c. C.10
Generally — referred to

s. 4 — considered

s. 4(j) — considered

s. 10(1) — considered

APPEAL by estate from disallowance of claim by trustee in bankruptcy.

***Kane J.*:**

1 This is a motion by the Estate:

> (1) Appealing the Notice of Disallowance by the Trustee dated May 8, 2014 of the Proof of Claim of the Estate dated April 22, 2014 for an unsecured claim in the amount of $3,813,507 (the "Claim").
>
> (2) For an order declaring the Estate has a first priority claim to the assets, funds and receipts of the Foundation, to the extent of its claim of $3,813,507, in priority to the claims of the Applicants and other creditors of the Foundation.
>
> (3) For an order declaring that the Applicants and other creditors of the Bankrupt Respondent Corporations in the Receivership Action and of the Bankrupt Respondent Corporations, are not to share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.

2 The Estate submits that:

> (1) Based on s. 135 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "*BIA"*), the gifts and settlements made by the late Thomas C. Assaly to create the Foundation and advance its stated objects have failed and must therefore be returned in first priority to his Estate in priority to the Foundation's creditors and other claimants without allowing any pooling or consolidation of other Respondents' or Bankrupts' estates, assets or liabilities.
>
> (2) As the Settlor of the capital monies of the Foundation, TCA if alive, would have a claim to the assets under receivership on the basis that the purposes of his gift to the Foundation were subject to a condition subsequent that the monies be used for the express purposes of the Foundation.
>
> (3) Gifts of money or property can be made subject to a condition subsequent after the gift has taken effect. Non-fulfillment of the condition subsequent will put an end to the gift whereupon the property reverts to the original owner.
>
> (4) The rights and obligations of the deceased succeed to the Estate Trustee and because the Settlor is entitled to a return of the monies, so is the Estate Trustee.
>
> (5) The position of the Settlor, and therefore his Estate, take priority over claims of any investor in the Bankrupt Respondent Corporations who were defrauded by Thomas G. The Applicants should only have resort to the assets of the corporations in which they invested, not the assets of the Foundation; unless there are funds surplus to the Estate's claim, but only if it can be precisely established what monies, if any, were illegally transferred from the various entities to the Foundation.
>
> (6) The Applicants and other creditors of the Bankrupt Respondent corporations, other than the Foundation, may not share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.
>
> (7) In the alternative, the monies held in the Foundation as at the date of the Guardianship Order, namely $3,817,000, are trust property by virtue of the provisions of the *Charities Accounting Act* (the "*CAA"*).
>
> (8) In the further alternative, the Estate is entitled to participate in the monies available for

distribution in this proceeding.

3 The Receiver and Trustee submits that the issues in this appeal are:

(1) Whether the Receiver erred in disallowing the Proof of Claim filed by the Estate of TCA.

(2) If the Receiver erred in disallowing the Proof of Claim, whether the monies held by the Foundation are trust properties by virtue of the *Charities Accounting Act*, Reg. 4/01 ("*CAA*").

(3) Whether, by operation of s. 67(1) of the *Bankruptcy and Insolvency Act* (the "*BIA"*) and after the *CAA*, the Estate of TCA is entitled to payment to the extent $3,813,507 in priority over the claims of the Applicants in the within application and other creditors of the Foundation.

(4) Whether the pooling distribution scheme as recommended by the Interim Receiver, should be implemented and form part of the Claims Bar Order yet to be issued and entered.

Background

4 The Claim was submitted by Robert Assaly, trustee on behalf of the Estate of Thomas C. Assaly ("TCA" or the "Estate") pursuant to the Claims Bar Process created pursuant to s. 50.1, subsections 65.2(4), 81.2(1), 81.3(8), 81.4(8), 102(2), 124(2), 128(1) and paras. 51(l)(e) and 66.14(b) of the *BIA* and the order of this Court dated December 23, 2013.

5 The Estate claims $3,813,507 of assets of the Foundation which were misappropriated by Thomas G. Assaly ("Thomas G.") and his wife Karen Floyd-Assaly ("Karen FA").

6 Prior to his death, TCA, through corporations, developed and controlled considerable corporate real estate assets.

7 Robert Assaly and Thomas G. are each sons of the deceased TCA.

8 Thomas G. worked for his father in one or more of the real estate or development corporations operated by TCA. Theirs was a tumultuous relationship. On occasion, Thomas G. had his employment terminated by his father, or resigned or disappeared from the Assaly corporate activities for periods of time.

1989

9 On July 6, 1989, TCA caused the incorporation of the Thomas C. Assaly Charitable Foundation. The applicants for incorporation were TCA, his two lawyers and his four children.

10 The parties agree that TCA was its sole settlor by way of causing a transfer of assets to the Foundation having an estimated value of some $5 million.

11 There is no evidence whether some or all of that $5 million came from TCA personally or via corporations he controlled. The issue before this Court is whether TCA or his Estate is entitled to assets now in the Foundation.

12 As incorporated, the objects of the Foundation included the following:

(a) To hold, manage, and administer the property of the Corporation for such charitable purposes as

> may seem expedient from time to time to the board of directors within the scope of the following more particular objects.
>
> (b) To acquire by way of grant gift or purchase, but without public appeal, real and personal property of every class, and to use and apply the principal and income thereof exclusively for the legally charitable purposes herein after mentioned.
>
> (c) To expend by way of grant or gift and to contribute any kind of property and assistance whether by the erection of buildings or other structures, to all matter of legally charitable organizations in Canada for such of their objects as are legally charitable.
>
> (d) To do and to cause to be done all such acts and things as are necessary or incidental to such purposes and objects.
>
> (e) As authorized by by-law:
>
> > (i) To borrow money and issue debentures and securities of the corporation.
> >
> > (ii) To pledge or sell such debentures and securities.
> >
> > (iii) To secure such borrowings, debentures and securities by mortgage or charge of the real and personal property of the corporation.

1999

13 By Supplementary Letters Patent, dated January 13, 1999, the name of the Foundation was changed to Thomas C. Assaly Charitable Foundation. The original objects of the Foundation continued and included "to hold, manage and administer the property of the Corporation for such charitable purposes as may seem expedient from time to time by the Board of Directors ...".

2000 to 2006

14 TCA was diagnosed with Parkinson's disease.

15 TCA and the Foundation at some point after 2000, commenced litigation against his three sons and Karen FA. TCA swore an affidavit in that action indicating that Thomas G. had been problematic in his employment with his father's corporations and that they had had a falling out regarding the affairs of the Foundation resulting in the departure of Thomas G. and his non-involvement in the Foundation, allegedly since 2002.

16 Guardianship proceedings were commenced as to TCA. The court therein appointed legal counsel to represent TCA. Ultimately, legal guardianship of TCA was ordered.

17 The court appointed legal counsel of TCA, by letter dated April 7, 2006, states that as of that date, TCA was neither a member nor a director of the Foundation.

18 Thomas G. continued as a member and Director of the Foundation and in fact controlled it after his father ceased participation in the Foundation. Karen FA replaced TCA in becoming a member and Secretary of the Foundation.

19 The objects of the Foundation were changed by Supplementary Letters Patent dated August 21, 2006. Object "B" above was amended to state that funds held and/or acquired were to be used to "fund scholarships

and/or bursaries and for research into neurological diseases ... substantially directed to Parkinson's Disease, followed, in priority by Alzheimer's, Multiple Sclerosis and Muscular Dystrophy."

20 As of September 12, 2006, the funds being administered by the Foundation allegedly totalled $3,813,507. This is the amount and the 2006 source of the present claim by the Estate put forward by Robert Assaly.

21 The court notes that Robert Assaly and Thomas G. are potential beneficiaries of any assets flowing from the Foundation into the Estate of their late father.

22 The Estate alleges that after September, 2006, all expenditures from the Foundation were made for the personal benefit of Thomas G. and Karen FA and their children. Such expenditures include the Foundation's purchase and renovation of a residence in the State of Florida ("Canada House") in which Thomas G., Karen FA and their children resided at the time of these proceedings.

23 The Estate acknowledges that the applicants or creditors have been defrauded by Thomas G. but stress that the applicants have never been members of the Foundation.

2007

24 Further Supplementary Letters Patent were issued on September 20, 2007, changing the name of the Foundation to Millennium Educational and Research Charitable Foundation.

Standard of Review

25 Section 135(2) of the *BIA* empowers a trustee to disallow any claim in whole or in part. Any such disallowance is final and conclusive unless appealed pursuant to s. 135(4) of the *BIA* as has occurred in the present case.

26 The Standard of Review on an appeal is correctness where the trustee's decision involves a question of law. (*Business Development Bank of Canada v. Pinder Bueckert & Associates Inc.*, 2009 SKQB 458 (Sask. Q.B.) at para. 20).

Estate's Claim to the Assets of the Foundation

27 The 2006 Supplementary Letters Patent amending the objects of the corporation directed that the properties of the Foundation be used to fund scholarships and research into specified neurological diseases.

28 The Estate submits that these amended objects are an implied condition subsequent and because the condition became incapable of being fulfilled due to the misappropriation of funds of the Foundation by Thomas G., the gift fails and must be returned to the Settlor, or his Estate.

29 There are a number of problems in the argument advanced by the Estate as to this first issue.

30 Subject to conditions, a gift, once complete, cannot be undone: *Richert v. Stewards' Charitable Foundation*, 2005 BCSC 211 (B.C. S.C.), at para 18; *Jardine v. Jardine* [2002 CarswellOnt 3602 (Ont. S.C.J.)], 2002 CanLII 2749, at para 23; and *Singh Estate (Trustee of) v. Shandil*, 2005 BCSC 1448 (B.C. S.C.) at para 19; aff'd 2007 BCCA 303 (B.C. C.A.).

31 There is no evidence of TCA imposing any reversionary or residual rights to receive back any portion of any monies he donated directly or caused to be donated to the Foundation, at any point in time.

32 The Estate advances its claim on the presumption that the $3,813,507 that existed in 2006 is the then

residue of the $5,000,000 donation caused to be made in 1989 by TCA.

33 "[T]he relevant time to assess donative intent is the time of the transfer of property from one party to another" (*Campbell v. MacKenzie*, 2003 ABPC 203 (Alta. Prov. Ct.), at para 6 ("*Campbell*")). As such, the relevant time to assess TCA's intent with respect to any conditions is when he transferred the funds to the Foundation.

34 There is no evidence as to the source of the $5,000,000 which TCA caused to be donated or funded into the Foundation in 1989. The present claim by the Estate is on behalf of the deceased TCA and his Estate. It is the claim of the deceased in his personal capacity.

35 There is no evidence as to any express conditions in 1989.

36 There is no issue that TCA in 1989 caused that funding to flow into the Foundation. The source and therefore the original ownership thereof however are not in evidence. What is known is that the deceased was a very successful developer and owner of real estate and he caused funding of $5,000,000 to be made to the Foundation in 1989.

37 The Estate filed as part of its claim, a 2006 Charity Information Return which shows that the Foundation in 2006 had assets in the amount of the Claim, namely, $3,813,507. Those assets include an account receivable of $885,000 as well as long-term investments in the amount of $2,893,382.

38 Pursuant to line 4,250 of the 2006 return, the $2,893,382 was "not used in the charitable program."

39 A considerable portion of the original $5,000,000 caused to be donated to the Foundation in 1989, had already been expended according to a full and final release between and executed on September 16, 2005, by TCA, Thomas G. and the Foundation. That release records funding provided to the Foundation in 1998 by TCA in the amount of $2,858,329, which is above the $5,000,000 funding in 1989. Combined, these two donations to $7,858,329. Eight years later, there is a maximum of $3,813,507 in the Foundation.

40 As to this 1998 funding of 2.8 million dollars, the release records that the Foundation is irrevocable beneficiary thereof. Pursuant to this release, TCA and Thomas G. forever released each other from any claims and agree not to allow the Foundation to pursue any claims against TCA for any dealings on behalf of the Foundation, provided that all loans to TCA have and will be repaid by him. There appears to have been an issue involving TCA and the Foundation.

41 The objects of the original Foundation in 1989 are broadly stated and provide that the Foundation is to use its principal and income exclusively for legally charitable purposes. The Foundation however is permitted to borrow money, issue debentures, provide security for repayment of such debt and to construct and own real property.

42 The August 21, 2006 Supplementary Letters Patent creating more specific charitable objectives, namely scholarships and research into neurological diseases but repeat the other above earlier general objects.

43 TCA was neither a member nor Director of the Foundation at the time of these 2006 Supplementary Letters Patent. These amended subsequent objects are not conditions associated with or imposed by TCA or his Estate. They are amended objects enacted by the Foundation subsequent to TCA's involvement in the Foundation. These specific neurological objects are not conditions subsequent of TCA.

44 In its present claim of $3,813,507, being the total assets declared in the Information Return in 2006, the Estate disregards all events involving the Foundation during the next eight years.

45 The Estate of TCA incorrectly assumes a freeze was or should be imposed on funds of the Foundation in 2006.

46 The financial records of the Foundation in the years 2006 through 2008, indicate that it continued to distribute some money for charitable purposes.

47 James Meuse was examined under oath by the Receiver on April 29, 2013. Mr. Meuse was a Director of the Foundation from 2008 until February, 2013. Mr. Meuse resigned because expenditures were being made from the Foundation at the direction of Thomas G., for the benefit of Mr. Thomas G.'s children and/or their education.

48 Mr. Meuse states that the charitable donations made by the Foundation stopped in approximately October of 2011 and that no charitable donations were made between then and the time that he resigned in February of 2013.

49 Charitable donations continued to be made by the Foundation after 2006 and it is therefore artificial to state that the Estate has a claim to the extent of the amount of the 2006 listed assets, including the $2.893 million listed as not used for charitable purposes.

50 The combination of: (a) the final release signed by TCA in 2005 evidencing irrevocable donation to the benefit of the Foundation 2.8 million dollars, some or all of which, must be included in the 2006 statement of assets, (b) the opinion of the court appointed solicitor of TCA in 2006 that TCA had no right or interest in and to the Foundation's assets as of that point in time, and (c) the ongoing charitable donations between 2006 and 2011; directly contradicts the position that TCA or his Estate is entitled to payment of the 2006 value of the Foundation in priority to all other claims.

51 The claim by the Estate further ignores the fact that Thomas G. undertook a program in which he systematically transferred assets belonging to other respondent corporations, including investment funds from the Applicants advanced to fund real property developments into the Foundation. The Estate now claims title to such investment funds diverted to the Foundation.

52 Thomas G. operated the respondent corporations as departments of one commercial enterprise.

53 There are affidavits filed by former employees including accountants within the respondent corporations, which indicate that Thomas G. intentionally inter-mingled monies and paid expenses without respecting the separate corporate identities amongst the respondent corporation.

54 The 2007 financial statements of the Foundation indicate that the receipts for that year totalled $1,298,292, of which $1,120,163 is listed as the Enduring Properties. The Enduring Properties are defined under the Foundation's Minutes dated June 24, 2008; as the Florida property in the amount of $725,000, the Donnelly mortgage in the amount of $200,000 and the 1003-Whitney Road property outside of Ottawa of some 148 acres.

55 The Whitney Road property was part of the Nature Walk development set up by Thomas G. under a separate respondent corporation, in which some of the investors were directed to pay their investment funds to the Foundation, which in fact occurred.

56 The Whitney Road property originally was owned by Thomas G. Through a number of inter-corporate investment-related transactions, he sold the Whitney property for $1,500,000 to the corporation he set up to develop that property. Thomas G. received at least partial payment of this sale by the transfer of investment funds from the Applicants who were investing in his proposed real property developments. The Applicants invested the monies to finance the construction of the condominium units and a golf course in this Ontario development which was not built.

57 The Florida property, Canada House, is a large residential home in the State of Florida which was purchased by Thomas G. and Karen FA as their residence, using monies obtained from the Foundation

according to the Receiver/Inspector and the examination of Thomas G. and Karen FA.

58 The Minutes of Settlement between the Applicants, the Receiver and Thomas G. and Karen FA, estimates the realization to the Receiver of a low of $1,851,000 and a high of $2,801,000. Of that amount, Canada House has an estimated low value of $1,200,000 and an estimated high value of $1,400,000.

59 Thomas G., Karen FA and their children resided continuously in Canada House in Florida since approximately February of 2013. Prior to that date, they transferred title of Canada House to the Foundation and established a tax scheme by which seven individuals invested hundreds of thousand dollars for which they received tax benefits as well as a life interest in Canada House.

60 The Receiver determined that since the transfer of Canada House to the Foundation, extensive renovations have been carried out on that property at a cost of some $774,000. The Receiver determined that $380,000 of those renovation costs came from the Foundation. $263,000 and $131,000 of those renovation costs however came from the respondent bankrupt corporations, Assaly Financial Corporation and Assaly Investment Property Corporation respectively.

61 The renovation costs of Canada House have largely been paid by investors who advanced monies intended for development of Ontario projects which never proceeded and then the subsequent transfer of those investment monies from the respondent corporations to the Foundation.

62 In an attempt to distance the assets of the Foundation from these proceedings, Thomas G. and Karen FA, at that point being the only remaining Directors of the Foundation, transferred title of Canada House from the Foundation to themselves in May of 2013. This couple subsequently quit claimed any interest in Canada House to the Receiver on April 3, 2014.

63 The Receiver determined that the investment by the Applicants in Nature Walk occurred in 2009 and the investment by the Applicants in Villa Montague occurred in 2010.

64 The Receiver determined that the residual assets of the Assaly group of companies, including the respondent corporations other than the Foundation, were transferred to the Foundation in the years 2011 and 2012.

65 The Receiver determined that on December 15, 2009, $159,000 was transferred from the respondent Millennium Springs Development Construction Corp. (”MSDC”) and invested on behalf of the Foundation. On January 31, 2011, $80,000 was paid by MSDC for “Florida House office expenses”. On May 9, 2009, $54,000 was transferred to the Foundation.

66 The transfer of assets from the respondent corporations to the Foundation includes the transfer of monies and shares of MSDC and Assaly Financial Corporation, Act 1 Corp. “(AFC”), with a value of approximately $348,000.

67 The Inspector previously reported to this Court that between September, 2011 and February, 2013, Thomas C. authorized the transfer of substantial assets owned by the Assaly Group of respondent corporations to the United States totalling a minimum of $806,564. The documentation disclosed to the Inspector appears to indicate that assets of an even higher value were transferred to the United States during this period of time. Specifically, all investment accounts of MSDC, AFC and AIPC were transferred to the Foundation in 2011.

68 Mr. Thomson on behalf of TD acknowledged on his examination that multiple transfers between the respondent corporate accounts, including the Foundation were common practice as directed by Thomas G.

69 Mr. Thomson acknowledged that at some point by February of 2013 all of the assets of the respondent corporations were consolidated into the Foundation and then moved to Florida.

70 The purchase and establishment of assets by the Foundation in some of its subsidiary corporations derives at least partially from investment monies paid by the applicants or from transfer of their investment monies in some of the respondent corporations to the Foundation.

71 This Court on April 18, 2013, determined that:

> (a) All investment accounts of MSDC, AFC and Assaly Investment Program Corporation "(AIPC") were transferred to the Foundation in 2011.
>
> (b) That on the instructions of Thomas G., all residual funds in the bank accounts of the Foundation were transferred from Canada to the United States on February 8, 2013.
>
> (c) The Foundation is a body corporate affiliated to and controls MSDC.
>
> (d) The Foundation is one of the Assaly Group of companies.
>
> (e) The Foundation, MSDC and AIPC are affiliated body corporations under s. 22 of the *Canada Not-For-Profit Corporations Act.*

72 The Receiver has traced the transfer and payment of funds from the respondent corporations as follows:

> (a) $463,000 to Thomas G.
>
> (b) $221,000 to Karen FA.
>
> (c) $680,000 to the above couple.
>
> (d) $423,000 for payment against credit cards of the above couple.

73 MSDC, Assaly Investment Program Corporation, C. Assaly Financial Corporation and Act 1 Corporation made an assignment in bankruptcy on September 11, 2013.

74 The Foundation, under the direction of Thomas G., was conducting commercial activity. It did so in the form of the life interest it sold in Canada House. It did so in the form of its majority ownership of the shares in several of the respondent development corporations, all of which Thomas G. controlled.

75 The present assets of the Foundation incorporate the transfer to it of monies and assets belonging to the respondent corporations which were commercial corporations and not charities.

76 It is now highly artificial to attempt to impose a financial silo around each of the respondent corporations, particularly the Foundation, when the directing mind of those corporations carried on business as if each corporation was only a department of one commercial entity.

TCA and Estate's Claim

77 The 2006 Supplementary Letters Patent creating objects of research into neurological diseases originated from Thomas G., after the departure of TCA, cannot be relied upon now as conditions by the Estate requiring that the remaining donation revert to the Estate. The Estate is incorrect in this argument.

78 The Estate is further incorrect as, (a) simple mathematics indicate the vast majority of the original 1989 $5,000,000 donated had been spent by 2006, (b) there is no evidence who specifically donated the $5,000,000,

and (c) TCA made an irrevocable donation to the Foundation of $2,858,000 in 1998.

79 There are no express terms as was contained in the will in the case of *Women's Christian Assn. of London v. McCormick Estate*, 1989 CarswellOnt 533 (Ont. H.C.), and relied upon by the Estate in this case.

80 Case law, for the most part, stands for the principle that powers of revocation must be express: *Child v. Chase*, 1980 CarswellSask 161 (Sask. Dist. Ct.), at para 5; *Eberwein Estate v. Saleem*, 2012 BCSC 250 (B.C. S.C.) ("*Eberwein*") at para 19. As stated in *Young v. Young* (1958), 15 D.L.R. (2d) 138 (B.C. C.A.), at 139 -40 (cited with approval by the Ontario Court of Appeal in *Berdette v. Berdette* (1991), 3 O.R. (3d) 513 (Ont. C.A.) at p. 518 ("*Berdette*")):

> Nothing is clearer than that a gift thus made cannot be revoked unless an express power of revocation is preserved. None can be implied no matter how natural such an implication might be. Here, no matter what the plaintiff's expectations were, no power to revoke the gift to the defendant was reserved; so that was the end of the matter.

81 The Estate, in terms of the decision in *Victoria Order of Nurses for Canada v. Greater Hamilton Wellness Foundation*, 2011 ONSC 5684 (Ont. S.C.J.), is eight years late in seeking the present remedy. As acknowledged in that decision, the Court has jurisdiction under s. 4 of the *CAA* to require that the executor or trustee of the charity pay into court any funds in their hands. Any such order now however would involve payment of substantial and non-traceable amounts of money misappropriated from the applicants or derived from their investment in other for-profit corporations which assets Thomas G. later caused to be transferred to the Foundation which is now bankrupt.

82 The Estate in this argument is attempting to do exactly what it correctly faults Thomas G. for doing, namely ignoring the separate legal entities of these corporations in arguing conditions subsequent entitle the Estate to reimbursement of these 2006 assets.

83 In the face of the irrevocable release signed by TCA in 2005, the Estate cannot now argue there was a condition subsequent to the 1998 funding by TCA that the deceased or his estate is entitled to a refund of any remaining assets of the Foundation because the general charitable objects of the Foundation were, with exceptions, not complied with since 2006 or 2011.

84 The Receiver determined that the donations to the Foundation over the years include donations from parties other than TCA. In that way, the Estate is also attempting to establish priority ahead of those other donors.

85 At one point in time, Robert Assaly was a member of the Foundation's Board of Directors. His involvement in the Foundation and the acrimony, including litigation between Robert, and his brother, Thomas G., must have created knowledge in Robert of the inappropriate manner in which Thomas G. was administering the affairs of the Foundation. It is too late now to apply the stamp of charitable objects to the remaining inter-mingled money and assets within the Foundation which last made a charitable donation in 2011.

86 The provisions of the *CAA* do not provide specifically for the return of an absolute gift to a donor upon a charity's directors non-adherence to the corporate objects. Such remedy however could be available under sections 4(j) and 10(1), as well as under the Court's inherent jurisdiction to regulate charities.

87 That jurisdiction should not be exercised on the facts in this case.

88 The directing mind of a charity cannot improperly divert monies belonging to others into a charity and thereupon use the *CAA* as a shield to defeat creditors who can trace the misappropriation of their investment into a charity. A substantial portion of the assets in the Foundation are monies misappropriated from the Applicant investors or the assets they invested in.

89 The assets of a charitable corporation are not held by it as trustee for its charitable objects but rather are owned by that corporation beneficially, to be used in a fashion consistent with its objects. It is now generally accepted that unrestricted property of a charitable corporation is not to be construed as trust property held by a charitable corporation. As such, a charity may use an unrestricted gift to the full extent of its charitable objects based upon its corporate authority as a legal entity without the involvement of a charitable purpose trust. (*Christian Brothers*, *supra*, 390-91, 701-702 and *Terrence S. Carter*: "Donor-Restricted Charitable Gifts: A practical overview revisited II" September, 2003, at pp. 7-8).

90 The Estate is incorrect in asserting that it has a priority to the remaining assets presently located within the Foundation in priority to the claims of the Applicant creditors.

91 The Appellants are not entitled to money misappropriated from others because the wrongdoer deposited it in a charity.

92 TCA and the Estate have no claim or priority to the assets in the Foundation.

Trust

93 A charity is not immune from liability to those who suffered at its hand. Assets of the charity, owned beneficially or in trust, are available to respond to those liabilities. *Christian Brothers of Ireland in Canada, Re* (2000), 47 O.R. (3d) 674 (Ont. C.A.). The applicants have numerous potential claims against the Foundation which include misappropriation and conversion of their money.

94 As to the argument that TCA intended by his donations to create a trust, the Receiver has determined that no tax returns were ever filed on behalf of any alleged trust nor are there any documents reflecting the creation or the intention to establish such a trust.

95 Such misappropriated assets belonging to the Applicants are, within the meaning of s. 67(1)(a) of the *BIA*, held by the bankrupt in trust for the Applicants.

96 The evidence establishes a lack of certainty of intention and objects as considered in *Christian Brothers of Ireland in Canada, Re* (1998), 37 O.R. (3d) 367 (Ont. Gen. Div. [Commercial List]).

97 The Appellants have failed to establish an error by the Receiver based on trust law.

98 The Estate is not a simple creditor. The deceased caused or donated to the Foundation. The deceased acknowledged the irrevocable nature of the 1998 second donation seven years later in September of 2005.

99 The Estate is not a creditor of the Foundation or other corporate respondents. It has no equal right to share in the consolidated remaining assets in the Foundation.

Consolidation or Pooling

100 As noted by Justice Farley in *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) "... consolidation by its very nature will benefit some creditors and prejudice others ..." The rationale for consolidation of assets between corporations in the present case is justified because the businesses were intertwined, were operated as a single business and the allocation of value and claims between the businesses would be burdensome).

101 The Foundation's business was not since 2006 separate and distinct from the business activities of the other respondent corporations. As previously determined, the activities of the respondent corporations, including the Foundation, since 2006 was operated as part of one business enterprise. That business enterprise misappropriated investors' money and is indebted to the Applicants in an amount which far exceed the best

realizable value of the amalgamated assets of such enterprise.

102 Extensive professional fees have been incurred to date in the inspection, receivership, and bankruptcy proceedings involving this Assaly group of companies, including the Foundation, in Canada and the United States. The Appellants' argument that further assets should be expended in an attempt to historically trace funding within the Foundation is inappropriate and financially impractical given the extent to which existing claims far exceed assets.

103 Even if the monies and assets of the Foundation are trust monies, like the decision in *Christian Brothers*, such trust monies in the Foundation are not held in priority to the Foundation, but are available to the claims of creditors.

104 The 2008 Board of Directors' Minutes of the Foundation demonstrates that the Foundation was carrying on business and was not restricting its activities to charitable purposes.

105 The Foundation's Board of Directors' Minutes dated June 24, 2008, reflect that the transfer of the majority of the shares of Millennium Springs Properties Ltd. and Assaly Investment Program Corporation are transferred to the Foundation. The ownership of the majority control of these corporations, combined with the 2007 financial statements of the Foundation showing the value of the 1003 Whitney Road property and the Donnelly mortgage, both derived from respondent corporations, confirms the commercial business activities and integration of all the respondent corporations into one combined business enterprise in the Foundation, of which Thomas G. was the directing mind.

106 A June 24, 2008 Directors' meeting refers to the Foundation's two new corporations being Millennium Springs Properties Ltd. and Assaly Investment Program Corporation. Millennium Springs Properties Ltd. is also known as Millennium Springs Development & Construction Corp. or MSDC.

107 As to consolidating the bankrupt estates of several parties, the Court has jurisdiction at law and in equity to exercise original, auxiliary and ancillary jurisdiction in bankruptcy pursuant to s. 183(1) of the *BIA*.

108 Substantive consolidation is appropriate where the directing mind of the bankrupt estates has conducted the affairs of the bankrupt with the total disregard for the niceties of corporate identity and separate juridical personalities.

109 In *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (C.S. Que.) para. 5, the corporate records were so hopelessly confused or non-existent that it was next to impossible to know which fixed assets belonged to which of the respective bankrupt company.

110 Notwithstanding the absence of a statutory provision in the *BIA* in empowering the court to consolidate such bankrupt estates, the courts in Canada and the United States have relied upon their inherent jurisdiction to do so, where to do otherwise would be impractical given the intermingling and difficulty in separating access, transactions, and finances between the bankrupt estates. (*A. & F. Baillargeon Express Inc., Re*, *supra*, para. 21 as well as *Associated Freezers of Canada Inc., Re* (1995), 36 C.B.R. (3d) 227 (Ont. Bktcy.)).

111 Intermingling and uncertainty of ownership of assets or supports substantive consolidation. (*Associated Freezers of Canada Inc., Re*, *supra*, para. 5.)

112 Substantive consolidation in this case if permitted, is not to the "prejudice or expense of a particular creditor" namely the Estate, as per *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Bktcy.).

113 The test as to substantive consolidation requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:

(a) difficulty in segregating assets;

(b) presence of consolidated Financial Statements;

(c) profitability of consolidation at a single location;

(d) commingling of assets and business functions;

(e) unity of interests in ownership;

(f) existence of intercorporate loan guarantees; and

(g) transfer of assets without observance of corporate formalities

in order to assess the overall effect of consolidation.

(*Atlantic Yarns Inc., Re*, 2008 NBQB 144 (N.B. Q.B.), paras. 33-34 and *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affirmed in *Northland Properties Ltd., Re*, [1989] B.C.J. No. 63 (B.C. C.A.) and *PSINET Ltd., Re*, *supra*, at para. 11)

114 The above analysis of the facts establishes the difficulty in segregating the assets, the commingling of assets and business functions and the transfer of assets regardless of corporate identities. The facts establish the presence of consolidated financial statements to the extent that assets consisting of some of the developments are specifically referred to in the financial statements of the Foundation.

115 This Court must be cognizant of the Receiver's opinion that further tracing efforts will produce uncertain results and involve the expenditure of considerably more money which is to the risk of the creditors of the bankrupt corporations and not the Foundation.

116 Thomas G. directed and managed the respondent corporations, including the Foundation, as a consolidated commercial entity over eight years. It is artificial and impractical at this point to attempt to disengage and isolate the affairs and finances only of the Foundation.

117 For the reasons stated, substantive consolidation of the assets of the bankrupt Estate, including the Foundation, are hereby authorized.

Conclusion

118 For the above reasons, the appeal of the Estate from the disallowance of its proof of claim is hereby dismissed.

Costs

119 Any party seeking costs shall provide the court with brief written submissions within 30 days. Any reply thereto shall be submitted within 21 days thereafter.

Appeal dismissed.

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2002 CarswellOnt 1261
Ontario Superior Court of Justice [Commercial List]

PSINet Ltd., Re

2002 CarswellOnt 1261, [2002] O.J. No. 1156, 113 A.C.W.S. (3d) 760, 33 C.B.R. (4th) 284

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

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

Headnote

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.

Table of Authorities

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.

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1993 CarswellQue 49
Quebec Superior Court, Bankruptcy and Insolvency Division

A. & F. Baillargeon Express Inc., Re

1993 CarswellQue 49, 27 C.B.R. (3d) 36

Re bankruptcy of each of A. & F. BAILLARGEON EXPRESS INC., WESTERN CRATING & MOVING LIMITED, KENWOOD'S MOVING & STORAGE (1986) INC., A. & F. BAILLARGEON EXPRESS (CANADA) INC., and BORISKO BROTHERS MOVING INC. (debtors); RICHTER & ASSOCIATES INC. (trustee-petitioner)

Greenberg J.

Judgment: May 28, 1993
Docket: Docs. S.C. Montreal 500-11-000476-933, 500-11-000519-930, 500-11-000520-938, 500-11-000477-931, 500-11-000478-939

Counsel: *Mark Schrager*, for trustee-petitioner.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Headnote

Bankruptcy --- Administration of estate — Trustees — Legal proceedings by trustee

Practice — Consolidation of administration of bankrupt estates — Twenty-six companies forming highly complex group and intermingling assets, operations and liabilities as though they were one company — Five companies in group being bankrupt — Practical approach being appropriate — Expenses of bankruptcy likely to increase if trustee required to administer each of five companies separately — Consolidation of administration of bankrupt estates ordered.

Procédure — Consolidation de l'administration des actifs de sociétés faillies — Vingt-six sociétés formant un regroupement complexe et confondant leurs actifs, opérations et responsabilités comme s'il ne s'agissait que d'une seule compagnie — Cinq sociétés faillies au sein du groupe — Approche pratique étant appropriée — Frais de la faillite susceptibles d'augmenter si le syndic est tenu d'administrer chacune des cinq sociétés séparément — Consolidation de l'administration des actifs des sociétés faillies ordonnée.

The appellant was appointed trustee for each of the five bankrupt companies, as well as interim receiver for 21 other companies. All those companies formed a highly complex group. The five bankrupt companies operated as if they were one, with no distinction as to their customers, banks and assets, and with total disregard for corporate identity and separate judicial personalities. The 26 companies held only four operating bank accounts and one concentration account into which all moneys funnelled through other accounts. There was a total intermingling of assets, operations and liabilities. As interim receiver, the trustee was responsible for collecting the receivables of the 21 non-bankrupt companies.

The trustee brought motions seeking the consolidation of the administration of the five bankrupt estates. The registrar dismissed the motions and the trustee appealed.

Held:

The appeal was allowed.

The concept of protection incorporated into Canadian bankruptcy law in the recent major amendments to the *Bankruptcy and Insolvency Act* (the "Act") justified the court to refer to, and to some extent rely upon, American jurisprudence and authorities, as opposed to the traditional reference to British bankruptcy law and authorities.

In that context, the following statement must be considered in consolidation matters: "If the relationships between affiliates are so obscured that it is impossible to disentangle their affairs, of course their bankruptcy proceedings should be consolidated. In such a situation, even a simplistic reliance argument could not seriously be advanced."
The trustee testified that the records had become hopelessly confused and in many instances were non-existent, so that it was impossible to identify which fixed assets belonged to which of those companies. Also, the customers were billed by whichever company management deemed would be the most expedient.
It was extremely unlikely that there would be any dividend for ordinary creditors but, to the extent that there was any possibility, it was important that the secured creditors realize the maximum possible on their claim. Therefore, if the trustee was required to perform a separate body of work in respect of each of the five companies separately, the expenses of the bankruptcy would be increased and the realization by the secured creditors would be reduced, thereby diminishing the already faint hope of any dividend to the ordinary creditors.
The concern that one creditor might receive an advantage because of the consolidation while another was disadvantaged was diminished by the fact that the likelihood of realization was remote and that it would have been an unnecessary waste of money, time and effort to oblige the trustee to go through the full exercise in respect of each one of those five companies.
The trustee brought the motions in order to be able to have one consolidated list of creditors for the purpose of sending the notice of the calling of the first meeting of creditors, since it would have been nearly impossible to distinguish which creditors related to which specific one of those five companies. The Act contains no statutory provisions dealing with consolidations, nor does the United States *Bankruptcy Act*. However, courts in the United States have adopted that approach when it is necessary and where to do otherwise would be impractical.
Also, the *Companies' Creditors Arrangement Act* does not contain a statutory provision authorizing consolidation, but it has been permitted where companies' affairs were intermingled in a similar fashion.
In bankruptcy matters, the court exercises an equitable as well as a legal jurisdiction and practicality is always necessary. The Act is a businessmen's law and practical business considerations should not be disregarded.
The registrar did not err in his judgment since he did not have the chance to consider the evidence presented on appeal as well as the arguments in law and the jurisprudence, both Canadian and American.
If a creditor feels unjustly prejudiced by the consolidation, it may petition the court pursuant to s. 187(5) of the Act to have the judgment modified, varied, rescinded or otherwise dealt with and the notice to all creditors would contain such information.

. . . . .

L'appelante a été nommée syndic de chacune des cinq sociétés faillies, et séquestre intérimaire de 21 autres sociétés. Toutes ces compagnies formaient un regroupement extrêmement complexe. Les cinq sociétés faillies fonctionnaient comme s'il ne s'agissait que d'une seule compagnie, sans faire de distinction quant à leurs clients, leurs institutions bancaires ou leurs actifs, et sans tenir compte des identités corporatives et personnalités juridiques distinctes de chacune. Les 26 sociétés ne détenaient que quatre comptes d'opérations bancaires et un seul compte consolidé réunissant tout l'argent provenant des autres comptes. Les actifs, opérations et responsabilités étaient entièrement entremêlés. En sa qualité de séquestre intérimaire, le syndic avait la responsabilité de percevoir les comptes recevables des 21 sociétés non faillies.
Le syndic a présenté des requêtes afin que soit ordonnée la consolidation de l'administration des actifs des cinq sociétés faillies. Le registraire a rejeté les requêtes et le syndic en a appelé de cette décision.
Arrêt:
Le pourvoi a été accueilli.
La notion de protection incorporée au droit de la faillite au Canada par les modifications récemment apportées à la *Loi sur la faillite et l'insolvabilité* (la "Loi") justifiait la Cour de référer et, dans une certaine mesure, de s'en remettre à la jurisprudence et à la doctrine américaines, par opposition au renvoi traditionnel au droit de la faillite britannique.
Dans ce contexte, il faut tenir compte de la proposition suivante en matière de consolidation : [Traduction] "Si les rapports existant entre des entreprises affiliées sont tellement embrouillés qu'il est impossible de démêler leurs

affaires, alors les procédures de faillite qui les concernent devraient être consolidées. Dans une telle situation, même le plus simple argument de confiance ne pourrait sérieusement être invoqué."

Le syndic a déclaré que les dossiers étaient devenus désespérément confus et, dans plusieurs cas, littéralement inexistants, de sorte qu'il était impossible d'identifier à laquelle de ces sociétés appartenaient les immobilisations. De plus, les factures adressées aux clients provenaient de la société considérée comme étant la plus expéditive.

Il était très peu probable qu'un dividende puisse être versé aux créanciers ordinaires mais, dans la mesure où cela demeurait possible, il était important que les créanciers garantis réalisent le plus gros montant possible de leurs réclamations. Par conséquent, si le syndic se voyait obligé d'exécuter des tâches distinctes pour chacune des cinq sociétés prises séparément, les frais de la faillite augmenteraient et la réalisation des créanciers garantis diminuerait, réduisant ainsi l'espoir déjà précaire qu'un dividende soit éventuellement versé aux créanciers ordinaires.

La crainte qu'un créancier soit avantagé par la consolidation au détriment d'un autre créancier était tempérée par le fait que la probabilité de la réalisation était assez éloignée, et que le fait d'obliger le syndic à effectuer toutes ces tâches pour chacune des cinq sociétés individuellement aurait entraîné une perte inutile d'argent, de temps et d'énergie.

Le syndic a présenté ces requêtes afin de n'avoir qu'une seule liste consolidée des créanciers lorsqu'il serait temps d'envoyer l'avis de convocation de la première assemblée des créanciers, puisqu'il aurait été virtuellement impossible de distinguer à laquelle des cinq sociétés spécifiquement était lié chacun des créanciers. La Loi ne comporte aucune disposition statutaire concernant les consolidations, non plus que la loi américaine sur la faillite. Toutefois, les tribunaux des États-Unis ont adopté cette approche lorsque cela s'avérait nécessaire, et lorsqu'une autre méthode se serait avérée peu pratique.

Par ailleurs, la *Loi sur les arrangements avec les créanciers des compagnies* ne comporte aucune disposition statutaire autorisant la consolidation, bien qu'elle ait été permise dans des cas où les affaires de sociétés étaient confondues de façon similaire.

En matière de faillite, la Cour exerce une juridiction d'équité aussi bien que juridique, et l'aspect pratique est toujours important. La Loi est une loi d'hommes d'affaires, et des considérations d'affaires pratiques ne devraient pas être négligées.

Le registraire n'a pas fait erreur en rendant sa décision puisqu'il n'a pas eu l'opportunité de se pencher sur la preuve soumise en appel, ni sur les arguments invoquant la loi et la jurisprudence, canadiennes et américaines.

Si un créancier devait se considérer injustement désavantagé par suite de la consolidation, il pourrait toujours présenter à la Cour une requête en vertu du par. 187(5) de la Loi afin que le jugement soit modifié, annulé ou autrement révisé, et l'avis aux créanciers comporterait une mention à cet effet.

Table of Authorities

Cases considered:

Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1996) — *considered*

Northland Properties Ltd., Re, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, 34 B.C.L.R. (2d) 122, [1989] 3 W.W.R. 363 (C.A.) — *applied*

Statutes considered:

Bankruptcy Act (U.S.).

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

s. 183

s. 187(5)

s. 192(4)

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

Appeal from registrar's decision to dismiss trustee's motions seeking consolidation of administration of five bankruptcy estates.

Greenberg J. **(orally):**

1 In the five bankruptcy files which appear on today's Roll and which we will now enumerate: A. & F. Baillargeon Express Inc., Western Crating & Moving Limited, Kenwood's Moving & Storage (1986) Inc., A. & F. Baillargeon Express (Canada) Inc. and Borisko Brothers Moving Inc., each of those companies has been declared bankrupt and Richter & Associates Inc. named as Trustee.

2 Those five companies, together with twenty-one others not in bankruptcy, form together what is commonly referred to in the moving trade as the "Baron Group of Companies" and, technically, the parent company bears the name "Baron Moving Systems Inc."

3 The Trustee had petitioned the Registrar of the Court to order the Consolidation of the administration of those five bankruptcy estates, and all five Motions were dismissed by the Registrar on May 26th last. The Trustee now comes before this Court on appeal from those decisions in virtue of s. 192(4) of the *Bankruptcy and Insolvency Act*, [1] hereinafter "the Act".

4 The organigram of the group of twenty-six companies was filed as Exhibit R-1 and is, to say the least, a highly complex one. It has also been proven by the Exhibits and the testimony of the representative of the Trustee that, in the language of the trade, these five companies comprised the "Montreal Branch" in the case of three of them and the "Toronto Branch" in the case of the two others. The three in the first instance, the Montreal Branch, were A. & F. Baillargeon Express Inc., Western Crating & Moving Limited and Kenwood's Moving & Storage (1986) Inc., and the Toronto Branch consisted of the other two companies, A. & F. Baillargeon Express Canada Inc. and Borisko Brothers Moving Inc.

5 It has been demonstrated in the evidence that these five companies operated as if they were one, indistinctly as to their customers, their bank and their assets, with intermingling; trucks being registered with the Provincial authorities as being the property of one company and yet appearing on the books of another, and moves being booked and executed by one company or another and billed by even a third. There was a total disregard for the niceties of corporate identity and separate juridical personalities.

6 The leading Exhibit in that regard is Exhibit R-2, which is the "Joint Banking Agreement" between the Canadian Imperial Bank of Commerce (hereinafter "the CIBC") and the companies enumerated therein. We note with interest that, even though there is in that Agreement a list of those twenty-six companies, there are among them only four operating accounts with that Bank, so that certainly it is not true to say that each company had its own bank account, which again is in keeping with the total intermingling of assets, operations, liabilities, etc.

7 Part II of that Schedule is entitled the "Concentration Accounts" and indicates only the name of the lead borrower, Baron Moving Systems Inc. & al. Hence, Baron Moving Systems Inc., as the lead borrower, is the only company of the Group which operated a "Concentration Account". It has been explained in evidence and argument how this account is the "nest to which all the robins returned", and this is the resting place of all monies funnelled through other accounts and that, in effect, it is as though we were dealing with only one company.

8 In respect of the other twenty-one not-bankrupt companies of the group of twenty-six, and not therefore among the five companies in respect of which the Trustee now petitions this Court, the Court has previously appointed the same Trustee in the capacity of Interim Receiver, but with powers and seizin limited only to the collection of the accounts receivable.

9 All of those accounts receivable are part of the security of the CIBC, which had invited in the Bank of Nova Scotia as a co-participant, and the latter bank was co-Petitioner on the Bankruptcy Petitions. Accordingly, it is only in respect of the five bankrupt companies that the present proceedings are taken, but the same Trustee is proceeding, as Interim Receiver, to collect the receivables of the other twenty-one companies as well.

10 Traditionally, until the recent major amendments to the Act, Canadian bankruptcy law has been inspired by British bankruptcy law. Thus, it has been common to refer to British authorities and only less frequently to American authorities. However, as a result of those recent amendments, one now speaks of "protection under the Bankruptcy Act", a concept which has been long known to American bankruptcy law but not known to Canadian bankruptcy law as expressed in the former version of the Act.

11 This explains in large part the frequent recourse in the past by debtor companies to the *Companies' Creditors Arrangement Act*,[2] (hereinafter the "CCAA"). The Act now has been reformed to bring it more in line with the spirit of the United States Bankruptcy Act, which we believe gives this Court even greater justification to refer to and to some extent rely upon American jurisprudence and authorities.

12 The attorney for the Trustee has brought to our attention a very well researched article published in the *California Law Review*[3] relative to Consolidations in matters of Bankruptcy and the "Flow-of- Assets Approach". We read in that article[4] the following very interesting citation:

> An alternative theme of some recent case law is that the bankruptcy proceedings of affiliated corporations should be consolidated whenever it is impractical to separate their financial affairs. The outstanding example of this proposition is the majority opinion in *Chemical Bank New York Trust Company* vs. *Kheel* ...[5]

a decision of the second American Circuit Court of Appeals.

13 The enterprise in that case consisted of eight affiliates, which the Referee found were "operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations ...". Upon motion by a major creditor, the assets and liabilities of the corporations were consolidated. Chemical Bank, a creditor of one of the stronger affiliates, appealed. The majority opinion in *Kheel* is said in that Article[6] to reflect the following proposition:

> If the relationships between affiliates are so obscured that it is impossible to disentangle their affairs, of course their bankruptcy proceedings should be consolidated. In such a situation even a simplistic reliance argument could not seriously be advanced.

14 Further on in that same Article, and in the actual *Kheel* case itself, the extract which is of interest[7] reads as follows:

> The debtor corporations are all owned or controlled by the former shipping magnate, Manuel E. Kulukundis. The Referee found that the debtor corporations were operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations, that the officers and directors of all, so far as ascertainable, were substantially the same and acted as figureheads for Kulukundis, that funds were shifted back and forth between the corporations in an extremely complex pattern and in effect pooled together, loans were made back and forth, borrowings made by some to pay obligations of others, freights due some pledged or used to pay liabilities and expenses of others, and withdrawals and payments made from and to corporate accounts by Kulukundis personally not sufficiently recorded on the books.

15 That recitation reflects very closely the situation in the case of the Baron Group and specifically the five companies with which we are here concerned. It is interesting to note that the resolution of each participating

company affixed to that Joint Banking Agreement, Exhibit R-2, is in all cases signed by the same Mr. B. Baillargeon, so that he can readily be seen to be the equivalent of Mr. Kulukundis in the American case cited above.

16 Also, the Trustee has testified here that the records became so hopelessly confused, and in many instances were non-existent, that it is impossible to know which fixed assets belong to which of those companies. People who did business with them, either as suppliers (therefore creditors) or customers (therefore debtors in respect of those accounts receivable), were simply calling the Montreal office or Branch of that Group of companies, often without distinguishing among them, and were billed indiscriminately as among the Group of companies by the one which management felt was most expedient.

17 The evidence of the Trustee is also to the effect that, in this case, it is extremely unlikely that there will be any dividend for ordinary creditors. However, to the extent that there is any possibility, it is important that the Banks, which are secured, realize the maximum possible on their claims. If we were 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.

18 During the argument and the evidence, we expressed the concern that a creditor of one of those five companies who might stand to get a larger dividend on an individual company basis than through an intermingled and consolidated basis could be prejudiced, whereas other creditors in respect of other specific companies might be benefited by the mechanism of consolidation.

19 That first concern is largely diminished by the fact that the likelihood of realization is remote and that it would be an unnecessary waste of money, time and effort to oblige the Trustee to go through the full exercise in respect of each one of those five companies. Moreover, the Trustee must by next Monday, today being Friday, send out lists and Notices of the calling of the First Meetings of Creditors.

20 We understand that one meeting will be held in Toronto with respect to the two companies to which we referred as the "Toronto Branch" and another in Montreal with respect to the three to which we referred as the "Montreal Branch" and that, on a practical basis, it would be nearly impossible to distinguish without simply guessing which creditors relate to which specific one of those five companies. The Trustee and the attorneys on his behalf have presented these proceedings in order to be able to have one consolidated list of creditors used to send out the notices for those meetings.

21 It is important to note that the Act has no statutory provision dealing with Consolidations. Of interest also is the fact that the United States Bankruptcy Act has none either. Yet, in spite of the absence of any statutory authority for such a process, the doctrine and the Judgments of the Courts in the United States have adopted that approach where it is necessary and where to do otherwise would be impractical.

22 Another interesting analogy is the case of *Re Northland Properties Ltd.* [8] That case also involved a Group of companies and it was a plan of reorganization under the CCAA, which statute also does not contain a statutory provision authorizing Consolidation. There, the Consolidation for the purposes of that Law in respect of the group of companies whose affairs were intermingled in a similar fashion to that of the Baron Group here was approved by the Appeal Court of British Columbia.

23 There is also the consideration that in Bankruptcy matters the Court exercises an equitable [9] 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.

24 The decision of this Court is to grant the request of the Trustee in this case. Hence, we wish to make clear that this in no way implies that the Registrar erred in his Judgment, from which this is an Appeal. Most of the evidence presented to us was not presented before him. He did not hear any witness, as we did, and, more importantly, the arguments in law and the jurisprudence, both Canadian and American, as well as the American doctrine, were not laid out before him due to the exigencies of *ex parte* procedures before the Registrar in this Jurisdiction.

25 It is therefore without in any way concluding that he erred in misinterpreting any part of the Act, since no specific provision of the Act was in play before him.

26 Moreover, in virtue of s. 187(5) of the Act, it is always open for this Court to review an Order or Judgment already rendered and to rescind, modify or revise it. Therefore, this Judgment will also require, in its Notice to all the creditors of the five companies, that the Trustee advise that by Judgment of the Court on this day, an Order was given consolidating the administration of the five bankruptcy estates.

27 This must be explained to the creditors at the two meetings, in terms of the reasons which underlay that decision, and it must be pointed out specifically to them that any creditor who feels itself or himself unjustly prejudiced by such a Consolidation may petition the Court pursuant to s. 187(5) to modify, vary, rescind or otherwise deal with or affect the present Judgment.

28 FOR THE REASONS GIVEN ORALLY AND RECORDED, THE COURT:

29 MAINTAINS the appeal in each of the five files;

30 REVERSES and ANNULS the decision of the Registrar in each of those five cases rendered by him on May 26, 1993 with respect to the "Motion for the Consolidation of the Administration of Bankruptcy Estates" dated May 21, 1993 in each of those files and, rendering Judgment on each of those five Motions of May 21, 1993;

31 GRANTS Judgment in accordance with the conclusions thereof;

32 ORDERS the Trustee to inform all Creditors of the five Bankrupt Companies of the present Judgment and generally of the reasons for same and moreover inform them of their right under s. 187(5) of the *Bankruptcy and Insolvency Act* to apply to the Court to review, rescind or vary this Order, if they allege a particular prejudice and can prove same;

33 THE WHOLE with costs against the mass.

Appeal allowed.

Footnotes

1 R.S.C. 1985, c. B-3.

2 R.S.C. 1985, c. C-36.

3 Volume LXV, p. 720.

4 At pp. 733 and 734.

5 369 F.2d 845 (2d Cir. 1966).

6 At pp. 734 and 735.

7 At p. 846.

8 (1989), *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122 (C.A.).

9 Section 183 of the Act.