

Substantive Consolidation in CCAA Restructurings: A Critical Analysis¹

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I. INTRODUCTION

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

The insolvency of such a corporate group often raises difficult issues of allocation of assets and liabilities among various members of the group which do not need to be addressed while the enterprise is healthy and meeting its obligations. Both common law and statute² recognize that corporations and their shareholders and affiliates are separate legal entities with their own separate assets and liabilities and that creditors of one member of a corporate group generally are not entitled to assert their claims against other members of the group unless circumstances exist which permit the “corporate veil” to be pierced or other exceptional grounds exist.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Bankruptcy and Insolvency Act — Proposals

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

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

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

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

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

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

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

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

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

3. *Bankruptcy and Insolvency Act* — Summary

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

4. *Companies’ Creditors Arrangement Act* — Restructurings

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

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

23 See *supra*, note 5.

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

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

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

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

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

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

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

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

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

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

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

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

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

Some commentators³² have noted that the court seems to have adopted a two-step test (i.e., (a) the need for consolidation and (b) the equities must favour consolidation) or, perhaps, commingled the approaches adopted by the U.S. bankruptcy court. However, the court in *Northland Properties* ultimately focused on the “economic prejudice test” articulated in *Baker* and *Snider Bros.* to conclude that substantive consolidation is permissible under the CCAA at the appropriate stage of the case.³³

28 *Baker, ibid.*, at 142.

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

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

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

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

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

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

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

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

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

35 *Ibid.*, at 202.

36 *Ibid.*

37 *Ibid.*

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

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

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

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

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

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

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

5. Companies’ Creditors Arrangement Act — Liquidations

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

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

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

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

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

6. Companies' Creditors Arrangement Act — Summary

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

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

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

46 *PSINet, ibid.*

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

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

III. CONSOLIDATED PLANS OF ARRANGEMENT OR COMPROMISE UNDER THE CCAA

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

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

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

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

IV. SUBSTANTIVE CONSOLIDATION UNDER U.S. LAW⁴⁷

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

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

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

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

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

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

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

50 *Ibid.*

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

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

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

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

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

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

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

52 *Guloco, ibid.*, at 928.

53 *Supra*, note 29.

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

In addition, U.S. courts have relied on other independent considerations to determine whether to consolidate substantively affiliated entities, including: (i) whether the creation of the affiliate was for the purpose of defrauding, hindering, or delaying creditors;⁵⁵ and (ii) whether a substantive consolidation order would facilitate in the debtor's reorganization plan under Chapter 11.⁵⁶

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

2. The Balancing Tests

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

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

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

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

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

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

(a) Harm or Benefit to Debtor or its Estate

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

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

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

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

(b) Harm or Benefit to Creditors

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

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

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

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

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

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

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

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

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

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

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

3. Substantive Consolidation is an Extraordinary Remedy

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

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

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

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

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

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

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

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

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

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

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

Although *Grupo Mexicano* did not directly address the doctrine of substantive consolidation, some commentators believed that it was merely a matter of time before the court's jurisdiction to order substantive consolidation was challenged.⁷⁴ Following the reasoning in *Grupo Mexicano*, it could be argued that the bankruptcy court does not have jurisdiction to order substantive consolidation since it is neither specifically authorized by statute⁷⁵ nor was it available in 1789.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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