Estate Nos. 31-2510937
31-2510938
31-2510939
31-2510940
31-2510941
31-2510942
31-2510943

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF URBANCORP (WOODBINE) INC., URBANCORP (BRIDLEPATH) INC., THE TOWNHOUSES OF HOGG'S HOLLOW INC., KING TOWNS INC., NEWTOWNS AT KINGTOWNS INC., DEAJA PARTNER (BAY) INC., AND TCC/URBANCORP (BAY) LIMITED PARTNERSHIP, BANKRUPTS

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Tab 1

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

Related Abridgment Classifications

Bankruptcy and insolvency
XX Miscellaneous

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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s. 183(1) — considered
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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 investors to discuss such risks and other potential risks in detail with their professional advisors prior to making an investment decision.

> 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 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).

End of Document

Tab 2

2013 ONSC 4518
Ontario Superior Court of Justice

Ornge Global GP Inc., Re

2013 CarswellOnt 9770, 2013 ONSC 4518, 230 A.C.W.S. (3d) 354, 5 C.B.R. (6th) 244

In the Matter of the Bankruptcy of Ornge Global GP Inc., A Corporation Incorporated under the Laws of Ontario, Carrying on Business in the City of Mississauga, in the Province of Ontario

In the Matter of the Bankruptcy of Ornge Global Holdings LP, A Limited Partnership, Established under the Laws of Ontario, Carrying on Business in the City of Mississauga, in the Province of Ontario

Morawetz J.

Heard: June 28, 2013
Oral reasons: June 28, 2013
Written reasons: July 10, 2013
Docket: 32-158452, 32-158453

Counsel: L. Coodin for Trustee in Bankruptcy, Duff & Phelps

Subject: Insolvency; Estates and Trusts; Corporate and Commercial

Related Abridgment Classifications

Bankruptcy and insolvency
XIV Administration of estate
XIV.3 Trustee's possession of assets
XIV.3.a Jurisdiction of courts

Headnote

Bankruptcy and insolvency --- Administration of estate — Trustee's possession of assets — Jurisdiction of courts
Consolidation of estates — Bankrupts provided air transport medical services to patients requiring care in Ontario, through profit and non-profit entities — Bankrupts were divided into estates, that of limited partner and general partner — Assets of limited partner had vested in trustee of general partner upon latter's bankruptcy and, as result, trustee held all assets of both estates — Trustee brought motion to consolidate estates — Motion granted — Creditors would not be substantially prejudiced by consolidation — Consolidation would create efficiency by preventing duplication and avoiding issues regarding re-issuing claims against different estate, and accounting and legal fees of separate entities — General partnership had unlimited liability and would be responsible for debts of limited partnership — Court had inherent power to consolidate estates.

Table of Authorities

Cases considered by *Morawetz J.*:

Kingsberry Properties Ltd. Partnership, Re (1997), 51 O.T.C. 252, 3 C.B.R. (4th) 124, 1997 CarswellOnt 5009 (Ont. Bktcy.) — considered

Kingsberry Properties Ltd. Partnership, Re (1998), 1998 CarswellOnt 1039, 3 C.B.R. (4th) 135 (Ont. C.A.) — referred to

Tartan Gold Fish Farms Ltd., Re (1996), 41 C.B.R. (3d) 245, 154 N.S.R. (2d) 272, 452 A.P.R. 272, 1996 CarswellNS 362 (N.S. S.C. [In Chambers]) — referred to

Statutes considered:

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

Generally — referred to

s. 43(15) — considered

s. 43(16) — considered

s. 85(1) — considered

Business Corporations Act, R.S.O. 1990, c. B.16

Generally — referred to

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

Generally — referred to

MOTION by trustee for consolidation of estates in bankruptcy proceedings.

Morawetz J.:

1 Duff & Phelps Canadian Restructuring Inc. ("D&P"), in its capacity as trustee in bankruptcy (the "Trustee") of Ornge Global GP Inc. (the "GP") and Ornge Global Holdings LP (the "LP" and, together with the GP, the "Estates") brought a motion for an order authorizing and directing the procedural and substantive consolidation of the Estates.

2 The motion was not opposed and the Trustee advised that the Office of the Superintendent of Bankruptcy confirmed that it had reviewed the motion record and advised that it would not be attending.

3 The GP was incorporated under the *Business Corporations Act (Ontario)* on November 26, 2010. The LP is a limited partnership which was established under the laws of Ontario on December 24, 2010. The GP and the LP are part of a group of for-profit and not-for-profit entities (collectively, "Ornge") that provide air transport medical services to patients requiring critical, acute or emergency medical care in Ontario.

4 Pursuant to an agreement dated December 24, 2010 (the "Limited Partnership Agreement"), the GP has the exclusive authority to manage, control, administer and operate the LP and, subject to the provisions of the Limited Partnership Agreement, to make all decisions in connection therewith.

5 On February 2, 2012, an order was made pursuant to the *Bankruptcy and Insolvency Act* ("BIA"), adjudging the GP bankrupt. The GP was the sole partner of the LP, which was adjudged bankrupt at the same time. The applications for the bankruptcy orders of both the GP and the LP were made by Ornge Global Real Estate Inc. ("OGRE"), the largest creditor of the Estates and a company related to, or affiliated with, the LP.

6 D&P was appointed trustee of both Estates.

7 Counsel to the Trustee advised that the books and records of the GP and the LP are in the possession of the Ministry of Finance (the "Ministry") and/or the Ontario Provincial Police (the "OPP") as a result of an ongoing investigation into the activities of Ornge. Counsel further advised that the Trustee has met with representatives of the Ministry and was informed that many of the electronic and physical books and records of the GP and the LP are co-mingled with the books and records of other Ornge entities.

8 Proofs of claim ("POCs") have been filed and are summarized below:

Creditor	Amount Claimed Against GP ($)	Amount Claimed Against LP ($)
Byron Capital Markets Ltd.		88,115.65
Cassels Brock & Blackwell		11,300.00
Christopher Mazza	withdrawn	
Fasken Martineau DuMoulin LLP	294,898.99	201,381.12
KPMG LLP		289,847.31
Ministry of Finance	1,168.93	

Ornge Global Air Inc.	38,729.62	38,729.62
Ornge Global Corporate Services Inc.	169,809.62	169,809.62
Ornge Global Real Estate Inc.	5,599,677.27	5,599,677.27
Ornge	27,554.39	27,554.39
Rhoda Beecher Human Resource Consulting	63,205.95	
WSIB	100.76	

9 D&P submits that procedural consolidation is warranted in this case and will result in the most efficient use of the Estates' limited resources and will provide for greater and more certain and timely recoveries for the Estates' stakeholders than would otherwise result if consolidation were not approved.

10 Further, D&P takes the position that procedural consolidation will also save significant estate resources by avoiding duplication in the administration of the Estates and by avoiding the need for the Trustee to resolve complex factual and legal issues among the Estates relating to, among other things, accounting for funds in the two separate bank accounts between the creditors of the LP and the GP, and the allocation of professional fees as between the LP and the GP. In addition, unless the Estates are consolidated, the Trustee will either have to get each creditor that filed against the LP to withdraw their claims and re-issue them in the name of the GP, or disallow each claim.

11 Counsel submits that, of primary importance in considering the appropriateness of substantive consolidation, is the treatment of limited partnerships in the context of bankruptcy. Counsel submits that, pursuant to the *Limited Partnerships Act (Ontario)* (the "LPA"), the GP is liable for the debts of the LP because, while each partner of the LP is only liable to the extent of their contribution, the GP's liability is unlimited. Section 85(1) of the BIA provides that, "on all the general partners of a limited partnership becoming bankrupt, the property of the limited partnership vests in the trustee". Therefore, counsel submits that by operation of law, the assets of the LP vested in the Trustee of the GP on the GP's bankruptcy and as a result the Trustee of the GP holds all of the assets of both Estates. See *Tartan Gold Fish Farms Ltd., Re* (1996), 41 C.B.R. (3d) 245 (N.S. S.C. [In Chambers]) at para. 6. Counsel further submits that a creditor does not need to file an application for a bankruptcy order as against all members of a partnership. Section 43(15) of the BIA provides that a creditor, "may present an application against any one or more partners of the firm without including the others". Section 43(16) provides that if a bankruptcy order has been made against one member of a partnership...the court may give any directions for consolidating the proceedings under the applications that it thinks just". Thus, counsel submits that the court has the explicit power to consolidate the Estates. See also *Kingsberry Properties Ltd. Partnership, Re* (1997), 3 C.B.R. (4th) 124 (Ont. Bktcy.), affirmed (1998), 3 C.B.R. (4th) 135 (Ont. C.A.).

12 In *Kingsberry*, *supra*, at para. 12, Farley J. found that, "A creditor need not petition all the members of the partnership into bankruptcy: see s. 43(15) BIA; however, where there are separate petitions against members of the same partnership, proceedings may be consolidated: See s. 43(16). It is therefore the choice of the plaintiff as to s. 43(15) and the discretion of the court as to s. 43(16), not the constitution of the partnership".

13 I accept the submissions of counsel and its conclusion that, by operation of law, the assets of the LP vested in the Trustee of the GP on the GP's bankruptcy and, as a result, the Trustee of the GP holds all the assets of both Estates. Further, in view of s. 85(1) of the BIA, it is unlikely that any creditor will be prejudiced through substantive consolidation. For the foregoing reasons, I have concluded that substantive consolidation is appropriate in the circumstances.

14 From a procedural standpoint, I am of the view that consolidation of the Estates is also warranted. Procedural consolidation of the Estates will provide for greater administrative efficiency by the Trustee by avoiding unnecessary duplication in the administration of the Estates, both of which arise out of the same transactions and occurrences.

15 Although there is no express power to consolidate the administration of the bankrupt estates, I am satisfied that the inherent jurisdiction of the court permits such an order to be made.

16 In the result, the motion is granted and an order shall issue authorizing and directing the procedural and substantive consolidation of the Estates.

Motion granted.

End of Document

Estate Nos. 31-2510937
31-2510938
31-2510939
31-2510940
31-2510941
31-2510942
31-2510943

IN THE MATTER OF THE BANKRUPTCY OF URBANCORP (WOODBINE) INC., URBANCORP (BRIDLEPATH) INC., THE TOWNHOUSES OF HOGG'S HOLLOW INC., KING TOWNS INC., NEWTOWNS AT KINGTOWNS INC., DEAJA PARTNER (BAY) INC., AND TCC/URBANCORP (BAY) LIMITED PARTNERSHIP, BANKRUPTS

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

(PROCEEDING COMMENCED AT TORONTO)

BOOK OF AUTHORITIES OF THE TRUSTEE

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