Substantive Consolidation After *Nortel*: The Treatment of Corporate Groups in Canadian Insolvency Law

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I. Introduction

Through the exercise of judicial discretion, the *Companies' Creditors Arrangement Act*[1] (CCAA) has been adapted to meet modern commercial and social needs.[2] An issue of growing commercial, social, and legal importance is the treatment of corporate groups in insolvency.[3] To address this trend, courts introduced the doctrine of substantive consolidation. However, rather than advancing a clear and consistent framework for applying this principle, courts have addressed insolvent corporate groups on a case-by-case basis. As a result, substantive consolidation remains relatively undeveloped in Canadian jurisprudence. The Ontario Superior Court of Justice's recent decision in *Re Nortel Networks Corp* had the potential to reverse this trend.[4] Tasked with allocating $7.3 billion among the Nortel Group's 130 corporate entities, the Court drew on a number of principles common to substantive consolidation.

The objective of this paper is to evaluate substantive consolidation under the CCAA prior to *Nortel* and critically assess whether this decision will have a meaningful impact on this area of the corporate insolvency.[5] Part II introduces the challenges posed by insolvent corporate groups and the judicial response of substantive consolidation. Part III provides an overview of Canadian jurisprudence on substantive consolidation prior to *Nortel*, highlighting trends and identifying areas requiring further consideration. Part IV discusses the *Nortel* decision. Finally, part V considers *Nortel*'s long-term impact on the treatment of corporate groups in Canadian insolvency law. Ultimately, given the context-specific nature of the *Nortel* ruling, it appears that this decision will not have a meaningful impact on this area of the law. Therefore, without further judicial attention, the doctrine of substantive consolidation will

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[1] RSC 1985, c C-36 [CCAA].
[2] *Century Services Inc v Canada (Attorney General),* [2010] 3 SCR 379 at paras 57-61.
[3] Vanessa Finch, *Corporate Insolvency Law: Principles and Perspectives* (Cambridge: Cambridge University Press, 2002) at 406: a "corporate group" may be defined as a family of related corporations in which one corporation effectively maintains control over the others through shareholding and managerial controls.
[4] *Re Nortel Networks*, 2015 ONSC 2987 [*Nortel*]. The hearing was conducted jointly with a U.S. Bankruptcy Court: *In re Nortel Networks Inc et al*, 532 BR 494 (Del Bankr 2015) [*Nortel* US]. Although the courts reached the same outcome, an analysis of the U.S. decision is outside the scope of this paper.
[5] This paper will focus on substantive consolidation in the context of the CCAA. However, due to limited CCAA jurisprudence, cases decided under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 will also be analyzed. This is consistent with recent commentary and jurisprudence. See e.g. *Re Redstone Investment Corp*, 2016 ONSC 513 [*Redstone*]; Janis Sarra, "Corporate Group Insolvencies: Seeing the Forest and the Trees" (2008) 24:1 BFLR 63 [Sarra].

remain the subject of uncertainty.

II. Substantive Consolidation as an Answer to the Problem of Corporate Groups

a. Issues Raised By Corporate Groups

Due to a range of operational, financial, and geographic considerations, corporate groups are increasingly prevalent in the Canadian corporate landscape.[6] In the legal context, corporate groups are relatively innocuous in the majority of cases. When operated independently, entities within the group are governed by general principles of corporate law, such as separateness and limited liability.[7] However, a corporate group challenges these core tenants of corporate law when it conducts its affairs as if it were a single corporation. In such cases it is common to observe an extensive comingling of business functions, intercorporate loans, integrated financial systems, and guarantees.[8] These practices are particularly challenging from an insolvency law perspective, as they obfuscate the distinctions between each entity's respective assets and liabilities.[9] The significant time and expense required to resolve these issues ultimately exhausts assets that would otherwise be available to creditors.[10] Insolvency law must therefore resolve the tension between the legal principle of independent corporate personality with the commercial reality of corporate interconnectedness in a cost and time-effective manner.

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[6] Michael MacNaughton & Mary Arzoumanidis, "Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis" in Janis Sarra, ed, *Annual Review of Insolvency Law* (Toronto: Thomson Carswell, 2007) at 525 [MacNaughton & Arzoumanidis]; Michael Rotsztain & Natasha De Cicco, "Substantive Consolidation in CCAA Restructurings: A Critical Analysis" in Janis Sarra, ed, *Annual Review of Insolvency Law* (Toronto: Thomson Carswell, 2004) at 331 [Rotsztain & De Cicco]. See also Jacob Siegel, "Corporate Groups and Cross-Border Insolvencies: A Canada-United States Perspective" (2002) 7 Fordham J Corp & Fin L 367 at 369 where it is argued that corporate groups have become the most typical structure for a large corporation.

[7] *Salomon v A Salomon,* [1897] AC 22 (HL (Eng)).

[8] Michael MacNaughton, "Classification, Consolidation and Context: A Canadian Approach to Substantive Consolidation" (2009) 25 BFLR 141 at 141 [MacNaughton]; Sarra, *supra* note 5 at 68. See e.g. *Re Lehndorff General Partner Ltd*, [1993] OJ No 14 at 3 (Ont Ct J [Commercial List]) [*Lehndorff*]; *Re Northland Properties Ltd* (1988), 69 CBR (NS) 266 at paras 8-10 (BC Sup Ct) [*Northland*]; *Re Atlantic Yarns Inc*, 2008 NBQB 144 at para 31 [*Atlantic Yarns*].

[9] MacNaughton & Arzoumanidis, *supra* note 6 at 526.

[10] Jason Harris, "Substantive Consolidation Under Statute Law: Lessons From Australia" in Janis Sarra, ed, *Annual Review of Insolvency Law* (Toronto: Thomson Carswell, 2008) at 566.

b. The "Solution" of Substantive Consolidation

The exigencies of insolvent corporate groups have given rise to the practice of substantive consolidation.[11] This doctrine provides a mechanism to simplify a corporate group by treating its separate legal entitles as if they were "merged into a single survivor".[12] Substantive consolidation involves combining the corporate group's assets and liabilities, extinguishing intercorporate debt, eliminating guarantees, and creating a single pool of assets.[13] Ultimately, creditors receive distributions from the unified asset pool, regardless of the source of their claim.[14] Thus, by eliminating the cost and time associated with separating assets and liabilities within a corporate group, substantive consolidation can simplify the CCAA claims process.

Although substantive consolidation can facilitate a more expedient and economical claims process, it is a controversial aspect of insolvency law. In particular, combining the assets and liabilities of distinct legal entities has been referred to as "extraordinary",[15] as it has the potential to prejudice certain creditors. Prior to consolidation, debtors generally have different asset-to-liability ratios.[16] All else being equal, it is more advantageous to be a creditor of a debtor with a high asset-to-liability ratio. However, by consolidating the group's assets and liabilities into a single pool, substantive consolidation eliminates such differences. This can significantly reduce the recovery for creditors of debtors whose asset-to-liability ratio is higher than the corporate group as a whole.[17] Therefore, substantive consolidation may

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[11] Substantive consolidation is distinct from procedural consolidation. The latter is an administrative practice designed to enhance the efficiency of insolvency proceedings involving corporate groups. It does not alter the substantive rights of creditors and is generally uncontroversial. See e.g. Kevin McElcheran, *Commercial Insolvency in Canada*, 3rd ed (Toronto: Lexis Nexis Canada Inc, 2015) at 348 [McElcheran]; MacNaughton & Arzoumanidis, *supra* note 6 at 527.
[12] *In re Owens Corning,* 2005 US LEXIS 17150 at 205 (3d Cir 2005) [*Owens*].
[13] *Nortel*, *supra* note 4 at para 213.
[14] *Northland*, *supra* note 8 at para 47; MacNaughton & Arzoumanidis, *supra* note 6 at 526; Robert Harlang & Mitch Vininsky, "Nortel Networks: A New Twist on Substantive Consolidation" (2015) 34:8 Am Bankr Inst J 18 at 18 [Harlang & Vininsky].
[15] *Owens*, *supra* note 12 at 199.
[16] *Re Snider Brothers Inc*, 18 BR 230 at 234 (Mass Bankr 1982) [*Snider*].
[17] *Ibid*. This is illustrated by an example in MacNaughton & Arzoumanidis, *supra* note 6 at 529: "Assume Company A has $6 million in liabilities and $1 million in assets. Assume further that Company B is a related company and has $4 million in liabilities and $2 million in assets. Outside substantive consolidation, creditors of Company A would receive 17 cents on the dollar for their claims, while creditors of Company B would receive 50 cents on the dollar. In substantive consolidation, all creditors will receive 30 cents on the dollar for their claims."

interfere with creditors' rights, redistribute wealth, and, as a consequence, inherently benefit some creditors at the expense of others.[18] As the following section will demonstrate, courts have applied substantive consolidation infrequently in light of these prejudicial effects.

III. The Law of Substantive Consolidation in Canada Prior to *Nortel*

a. Overview of Canadian Jurisprudence

The British Columbia Supreme Court's decision in *Re Northland Properties* was the first Canadian case to address substantive consolidation and it remains a leading authority on the principle.[19] As neither the CCAA nor the *Bankruptcy and Insolvency Act* (BIA) contain provisions relating to substantive consolidation, the Court relied on its equitable jurisdiction to develop the doctrine.[20] *Northland* involved a group of financially distressed real estate corporations that sought protection under the CCAA.[21] The corporate group was managed "as a single entity" and its finances were described as "inextricably intertwined".[22] Based on these facts, the corporation brought an application for substantive consolidation.[23]

Given the lack of Canadian jurisprudence regarding substantive consolidation, the Court drew on a series of American decisions. First, the Court cited the "balancing of interests" test from *Re Baker & Getty Financial Services Inc*.[24] According to *Baker*, substantive consolidation requires evidence that "…creditors will suffer [greater] prejudice in the absence of consolidation than the debtors (and any

[18] *Re PSINet Ltd* (2002), 33 CBR (4th) 284 at para 11 (Ont Ct J [Commercial List]) [*PSINet*]; *Snider*, *supra* note 16 at 234; MacNaughton & Arzoumanidis, *supra* note 6 at 529. See also *Ontario v Canadian Airlines Corp* (2001), 29 CBR (4th) 236 at para 36 (Alta QB): it is a "cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved."
[19] Rotsztain & De Cicco, *supra* note 6 at 340; MacNaughton & Arzoumanidis, *supra* note 6 at 547.
[20] *Nortel*, *supra* note 4 at para 216; *Northland*, *supra* note 8 at para 58; *Ashley v Marlow Group Private Portfolio Management Inc* (2006), 22 CBR (5th) 126 at para 71 (Ont Sup Ct J [Commercial List]) [*Ashley*]; MacNaughton, *supra* note 8 at 142. But see *Northland Properties Ltd v Excelsior Life Insurance Co of Canada*, [1989] 3 WWR 363 at para 33 (BC CA) where the British Columbia Court of Appeal said that the power to substantively consolidate a corporate group lies in section 20 of the CCAA. However, this position has not subsequently found favour with Canadian courts.
[21] *Northland*, *supra* note 8 at para 18.
[22] *Ibid* at paras 8-10, 46.
[23] *Ibid* at paras 45-46.
[24] 78 BR 139 (Ohio Bankr 1987) [*Baker*] cited in *Northland*, *supra* note 8 at para 49.

objecting creditors) will suffer from its imposition."[25] To determine the appropriate balance, the Court noted the "elements of consolidation" delineated in *re Vecco Const Indust Inc*:[26] (1) difficulty in segregating assets; (2) presence of consolidated financial statements; (3) profitability of consolation at a single location; (4) commingling of assets and business functions; (5) unity of interests in ownership; (6) existence of intercorporate loan guarantees; and (7) transfer of assets without observance of corporate formalities.[27] In addition, the Court adopted the proposition from *Re Sinder Bros*,[28] namely, that an applicant must demonstrate that not only are the "elements of consolidation" present, but also that the deleterious effects of continued corporate separateness outweigh the prejudice caused by consolidation.[29] Thus, according to *Northland*, consolidation required not only corporate interconnectedness, but also evidence that maintaining distinct corporate personalities would harm the relevant parties.

In the twenty years following *Northland*, the topic of substantive consolidation received little judicial attention. Although the principle was regularly applied,[30] decisions rarely contained a comprehensive analysis to elucidate the factors that necessitated consolidation. Rather, courts exhibited a preference towards case-specific reasoning.[31] However, in the 2008 *Re Atlantic Yarns* decision, the New Brunswick Court of Queens Bench analyzed the law of substantive consolidation in greater detail.[32] Although the Court accepted the *Northland* framework, it arguably added an additional precondition to substantive consolidation: its overall effect must be "fair and reasonable in the circumstances."[33] While

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[25] *Baker*, *supra* note 24 at 142.
[26] *In re Vecco Const Indust Inc*, 4 BR 407 at 410 (Va Bankr 1980).
[27] *Northland*, *supra* note 8 at paras 50-57.
[28] *Snider*, *supra* note 16 at 234, 238 cited in *Northland*, *supra* note 8 at paras 58-59.
[29] *Snider*, *supra* note 16 at 234.
[30] Anthony Duggan et al, *Canadian Bankruptcy and Insolvency Law: Cases, Text and Materials*, 3rd ed (Toronto: Emond Montgomery Publications, 2015) at 638 [Duggan]: at least sixteen substantive consolidation plans were attempted under the CCAA during the 1980s and early 1990s.
[31] MacNaughton, *supra* note 8 at 158; Sarra, *supra* note 5 at 82; MacNaughton & Arzoumanidis, *supra* note 6 at 545; Rotsztain & De Cicco, *supra* note 6 at 340-341.
[32] *Atlantic Yarns*, *supra* note 8.
[33] *Ibid* at para 36. The "fair and reasonable" element appears to have been accepted in Canadian jurisprudence: *Nortel*, *supra* note 4 at para 217. However, it is unclear whether this requirement originated in *Atlantic Yarns*, *supra* note 8, or if it was an implicit consideration in earlier cases. For example, in the 2007 editions of Janis Sara, *Rescue! The Companies' Creditors Arrangement Act* (Toronto: Carswell, 2007) at 242, it was noted that a "…court will also consider whether consolidation is fair and reasonable in the circumstances of the case." Nonetheless, *Atlantic Yarns* appears to be the first time that a court explicitly invoked "fair and reasonable" as a distinct element

this did not constitute a significant change to the law, it represented the first substantive discussion on the factors supporting substantive consolidation since 1988.

Given the lack of judicial consideration, it is difficult to synthesize Canadian jurisprudence into a definitive test for substantive consolidation.[34] However, commentators have suggested that the law may be distilled into three fundamental principles. First, consolidation requires that the corporate group's financial affairs, business operations, and control functions be significantly intertwined.[35] Second, the court will assess the amount, degree, and type of prejudice suffered by creditors.[36] Finally, consolidation must be fair and reasonable.[37]

b. Unanswered Questions

While *Northland* and *Atlantic Yarns* yielded a set of overarching principles, a lack of subsequent doctrinal analysis has produced a series of unanswered questions. In response, many commentators have critiqued the courts' case-specific approach for failing to provide meaningful guidance in this area of the law.[38] Therefore, in order to transform these overarching principles into a workable framework, the following three issues require further consideration.

First, it is unclear what level of creditor prejudice is sufficient to preclude substantive consolidation. For example, in *Re PSINet Ltd*, Justice Farley stated that prejudice was assessed based on its "overall general effect."[39] Similarly, the Court in *Re Global Light Telecommunications Inc* sanctioned a consolidated plan in spite of creditor objections, noting, "the Plan must satisfy the majority of creditors

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in the substantive consolidation analysis.

[34] Sarra, *supra* note 5 at 80.

[35] *Ibid* at 82. MacNaughton, *supra* note 8 at 153.

[36] Sarra, *supra* note 5 at 82. MacNaughton, *supra* note 8 at 153.

[37] Sarra, *supra* note 5 at 82. But see MacNaughton, *supra* note 8 at 153 where the final element is described as whether "consolidation achieves the purposes of the CCAA". However, the "fair and reasonable" interpretation appears to be more widely accepted: *Nortel*, *supra* note 4 at 217.

[38] See e.g. Sarra, *supra* note 5 at 77; MacNaughton & Arzoumanidis, *supra* note 6 at 529; Rotsztain & De Cicco, *supra* note 6 at 332.

[39] *PSINet*, *supra* note 18 at para 11. See also *Lehndorff*, *supra* note 8 at 5 where the Court found: "[t]he possibility that one or more creditors may be prejudiced should not affect this court's exercise of its authority… because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization." Although this statement was not directed specifically at the issue of substantive consolidation, it remains a helpful indication of the court's perspective on creditor prejudice.

on the whole."[40] However, in *Re Fairview Industries Ltd*, it was held that consolidation could not be approved where three creditors categorically opposed its imposition.[41] Similarly, in the context of the BIA, both *Ashley v Marlow Group Private Portfolio Management*[42] and *Re JP Capital Corp*[43] determined that prejudice to a single creditor was sufficient to prevent the imposition of a consolidated plan. Therefore, courts must clarify the point at which creditor prejudice precludes substantive consolidation.

Second, there is disagreement regarding the appropriate timing of an application for substantive consolidation. In the majority of cases, applications are made at the sanction hearing.[44] However, courts have demonstrated flexibility, for example, approving substantive consolidation at the initial order hearing in *Re Lehndorff General Partner Ltd*.[45] These varied approaches have generated debate regarding the efficacy of late-stage applications. In particular, Rotsztain and De Cicco argue that the momentum to have a plan approved at the sanction hearing makes it "very difficult" to successfully oppose an application for substantive consolidation.[46] In contrast, others have advocated for a more flexible approach, as the need for consolidation may not become apparent until a later stage in the proceedings.[47] Although CCAA courts may wish to preserve flexibility, a demonstrated preference would provide greater certainty for both debtors and creditors.

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[40] 2004 BCSC 745 at para 23 [*Global Light*]. See also paras 14, 18, and 22 where the Court appears to discount the creditors' concerns because they failed to object to an earlier procedural order permitting the presentation of a consolidated plan. See also *Re Atlantic Yarns*, *supra* note 8 where a plan was approved in spite of a secured creditor's objections. However, the precedential value of this aspect of *Atlantic Yarns* is unclear, as the secured creditor only took issue with consolidation as it related to voting rights.

[41] *Re Fairview Industries Ltd*, [1991] NSJ No 453 at 12-13 (Sup Ct) [*Fairview*]; McElcheran, *supra* note 11 at 350. The Court was concerned that, without the approval of these creditors, the plan stood no probable chance of acceptance.

[42] 22 CBR (5th) 126 (Ont Sup Ct J).

[43] 31 CBR (3d) 102 (Ont Sup Ct). In this case, the Court was hesitant to approve a consolidated plan without knowing its effect on creditors. However, note that Justice Farley distinguished this case in *PSINet*, *supra* note 18 on the basis that it was decided under the BIA.

[44] See e.g. *Northland*, *supra* note 8; *Fairview*, *supra* note 41; *PSINet*, *supra* note 18; *Global Light*, *supra* note 40; and *Atlantic Yarns*, *supra* note 8.

[45] *Lehndorff*, *supra* note 8.

[46] Rotsztain & De Cicco, *supra* note 6 at 352. See also *Global Light*, *supra* note 40 at para 23: if the majority of creditors approve a plan there is a "heavy burden on parties seeking to oppose sanctioning."

[47] UNCITRAL Working Group V, Note by Secretariat, Doc A/CN.9/WG.V/WP.90 (2009) at para 155. See e.g. *PSINet*, *supra* note 18 at para 2 where Justice Farley noted that while the applicants initially proposed an unconsolidated plan, it later became apparent that substantive consolidation was appropriate.

Finally, the issue of notice has not been addressed in sufficient detail. In general, an initial order application can be made on an *ex parte* basis to prevent creditors from exercising their enforcement remedies before the application can be heard.[48] However, given the risk of creditor prejudice, this practice is inherently problematic when the applicant also requests an order for substantive consolidation.[49] At the time of writing, only one case has addressed this issue.[50] In this decision, Justice Farley noted that a court will be "concerned" where creditors have not been properly informed.[51] While this suggests that notice is beneficial, the statement's ambiguity indicates that notice remains an open issue.

IV. The *Nortel* Allocation Decision: An Alternative Approach to Substantive Consolidation?

a. Background Facts

Prior to its 2009 CCAA filing, Nortel Networks Corporation (NNC) was a Canadian-based technology corporation.[52] Its principal driver of value was research and development.[53] NNC, together with its 130 subsidiary corporations, formed the "Nortel Group", which operated in sixty sovereign jurisdictions.[54] In order to maximize efficiency, the Nortel Group did not restrict its operations by jurisdiction.[55] Rather, the Group "operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world."[56] As stated by an accountant with the Nortel Group's Chief Technology Office, it functioned "without regard for its different legal entities."[57]

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[48] CCAA, *supra* note 1, s 11; Duggan, *supra* note 30 at 631.
[49] Helen Sevenoaks, *The Remedy of Substantive Consolidation Under the Companies' Creditors Arrangement Act: A Closer Examination of Domestic and Cross-Border Issues* (LLM Thesis, University of British Columbia, Faculty of Law, 2010) [unpublished].
[50] *Lehndorff*, *supra* note 8.
[51] *Ibid* at 4.
[52] *Nortel*, *supra* note 4 at para 1.
[53] *Ibid* at para 18.
[54] *Ibid* at paras 1, 14.
[55] *Ibid* at para 202.
[56] *Ibid* at para 16.
[57] *Nortel* US, *supra* note 4 at 94.

Due to the Nortel Group's multinational scope, transfer pricing was a significant concern.[58] In order to allocate profits and losses on a tax efficient basis, the Nortel Group developed a "Master Research and Development Agreement" (MRDA).[59] Pursuant to the MRDA, a Canadian operating company was designated as the legal owner of all intellectual property.[60] The subsidiaries within the Nortel Group could then be granted a license to make and sell the Nortel Group's products using NNC's intellectual property.[61]

Following a series of economic difficulties, most entities within the Nortel Group filed for bankruptcy protection in January 2009.[62] By June 2009 it was evident that the Nortel Group would not emerge as a going concern and asset liquidation was commenced.[63] However, the parties were unable to reach a settlement regarding the allocation of the proceeds of realization.[64] The central point of contention was the proper interpretation of the MRDA and whether rights obtained under the MRDA determined rights to the proceeds of the asset sale.[65] This disagreement ultimately resulted in the Nortel allocation litigation.

b. The Court's Approach: Pro Rata Allocation

Although the Nortel Group's decentralized structure was considered advantageous from a productivity perspective, it proved challenging in the context of insolvency. This difficulty was compounded by the fact that the MRDA was an "operating agreement"; limited to issues regarding

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[58] *Nortel*, *supra* note 4 at para 47: "Transfer pricing is the act of assigning a monetary value, or price, to movements of resources or economic contributions that occur within a multinational enterprise across different taxing jurisdictions".
[59] *Ibid* at para 185.
[60] *Ibid* at para 169.
[61] *Ibid*.
[62] *Ibid* at paras 22-24.
[63] *Ibid* at paras 26-27.
[64] *Ibid* at para 44.
[65] *Ibid* at para 62.

corporate taxation.[66] On this basis, the Court held that the MRDA did not govern the disposal of assets upon insolvency.[67]

Without the MRDA to determine asset allocation, the Court drew on its broad section 11 powers to achieve a result that was "just in the unique circumstances of this case".[68] According to Justice Newbould, achieving this objective required allocating the Nortel Group's assets on a pro rata basis.[69] The Court's conception of pro rata allocation involved four main features. First, each entity in the Nortel Group was entitled to a pro rata share of the asset realization based on the percentage of claims against that entity relative to the total claims against the Nortel Group.[70] Once the funds were allocated, each entity independently administered its own claims process.[71] Second, all intercorporate claims remained outstanding.[72] Third, each corporate entity retained any cash on hand and applied it towards the entity's creditors.[73] Finally, creditors with guarantees were entitled to make a claim for the full value of the guarantee.[74] The outcome for all creditors was a 71 percent return on their claims against the Nortel Group.[75] This is expected to have the greatest impact on the UK Pension Claimants, who will receive a significantly higher proportion of the assets than if a pro rata allocation had not been adopted.[76]

Ostensibly, pro rata allocation is analogous to substantive consolidation. In particular, it involves distributing assets without regard for their source. However, Justice Newbould explicitly stated that the two doctrines are distinct, as pro rata allocation does not involve wealth transfer.[77] According to the

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[66] *Ibid* at para 172.
[67] *Ibid*.
[68] *Ibid* at para 204.
[69] *Ibid* at para 209.
[70] *Ibid* at para 211.
[71] *Ibid*.
[72] *Ibid* at para 258.
[73] *Ibid* at para 214.
[74] *Ibid* at para 224; Harlang & Vininsky, *supra* note 14 at 20.
[75] Janet McFarland & Jeff Gray, "Unusual Rulings on Nortel Assets Provide Some Solace For Pensioners" *The Globe and Mail* (12 May 2015), online: <http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/nortel-decision/article24400059/>. Note that this figure is subject to change.
[76] Camilla Barry & Simon Beale, "Lessons From Nortel: What Do The Recent Allocation Decisions Mean?" *Lexology* (28 May 2015), online: <http://www.lexology.com/library/detail.aspx?g=c58c5aa3-0205-47d3-941b-d11db20f87b0>.
[77] *Nortel*, *supra* note 4 at paras 212, 214.

Court, the MRDA did not create legal entitlements to intellectual property.[78] As the intellectual property did not constitute separate assets of two or more entities that could be combined, it could not be said that wealth had been transferred.[79] In addition, entities within the Nortel Group retained their distinct corporate personalities.[80] As a result, each corporation had its own creditors, cash on hand, and respective intercorporate loans.[81]

Despite concluding that pro rata allocation was a distinct principle, Justice Newbould addressed the doctrine substantive consolidation. In particular, he highlighted the balancing of interests test as adopted in *Northland*.[82] He then applied the elements of consolidation, noting the Nortel Group's intertwined assets, intercorporate guarantees, consolidated treasury system, and integrated operations.[83] Finally, creditor prejudice was deemed "moot" because the MRDA did not create legal entitlements to the asset realization.[84] It was therefore determined that even if the outcome was substantive consolidation, it was consistent with Canadian jurisprudence.[85]

V. *Nortel*'s Implications for the Treatment of Corporate Groups in Canadian Insolvency Law

Although *Nortel* did not apply substantive consolidation, this decision is significant for a number of reasons. First, it confirmed that substantive consolidation remains entrenched in Canadian insolvency

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[78] *Ibid* at para 214.
[79] *Ibid*.
[80] *Ibid*.
[81] *Ibid*. As articulated by Justice Gross in *Nortel* US, *supra* note 4 at 100 & 106: "[a]ll claims against each Nortel Debtor, including intercompany claims and court approved settlements, will receive distributions from the separate Debtor Estates." In contrast to substantive consolidation, the Court was not directing, "a central insolvency administrator in one jurisdiction, that all of the Nortel Entities be treated as one, that all claims be determined within one proceeding under the supervision of one insolvency administrator, that there be one plan of reorganization for all Nortel Entities or that creditors receive a common dividend on a pro rata, *pari passu* basis."
[82] *Ibid* at paras 218-222.
[83] *Ibid* at paras 221-223.
[84] *Ibid* at para 224.
[85] *Ibid* at para 215. *Cf Nortel* US, *supra* note 4 at 104: Justice Newbould's decision stands in contrast to that of Justice Gross in the parallel U.S. proceeding. Despite concluding that Canada's position with respect to substantive consolidation was "similar" to the American legal framework, Justice Gross determined that the instant case did not "satisfy the legal and factual requirements for substantive consolidation" under U.S. law. This was based on the finding that while "Nortel operated as a highly integrated multinational enterprise, the evidence establishe[d] that the Nortel affiliates respected corporate formalities and did not commingle their distinct assets or liabilities."

law. Second, according to some commentators, by employing a solution that included features of substantive consolidation, *Nortel* reopened the debate on using the principle more generally.[86] Third, the Court highlighted judicial antipathy towards "value-erosive adversarial and territorial litigation."[87] The costs associated with insolvency proceedings are an issue of growing social and legal concern, inciting calls for law reform.[88] It is therefore important for courts to implement cost-reducing measures where possible. Finally, *Nortel* demonstrated the judiciary's ability to craft creative solutions in response to the unique challenges posed by insolvent corporate groups, particularly in a cross-border context.[89] In this sense, *Nortel* may indicate that achieving an equitable, timely, and cost-effective result necessarily entails adopting elements of substantive consolidation.[90]

Conversely, *Nortel* can be viewed as a lost opportunity to provide meaningful guidance on the law of substantive consolidation. Similar to the majority of decisions following *Northland*, the Court in *Nortel* conducted a context-specific analysis based on the "unique circumstances"[91] of the case, rather than espousing general principles on the treatment of insolvent corporate groups. Thus, *Nortel* may be more significant for the questions that it leaves unanswered. For example, the issues noted in Part III regarding creditor prejudice, timing, and notice.

Furthermore, suggesting that there is effectively a dichotomous relationship between substantive consolidation and pro rata allocation may be unhelpful from a doctrinal standpoint. The Court responded to the complexity of the Nortel Group with a novel methodology.[92] Rather than drawing parallels between the doctrines, the Court placed great emphasis on the distinctions between pro rata allocation and

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[86] Harlang & Vininsky, *supra* note 14 at 18.
[87] *Nortel*, *supra* note 4 at para 208. Justice Farley expressed a similar concern regarding the loss of assert value from costly litigation in *PSINet*, *supra* note 18 at para 11. See also *Re A&F Baillargeon Express Inc (Trustee of)*, [1993] QJ No 884 at para 17 (Sup Ct).
[88] Jeff Gray, "From $100-e-mails to $300,000 For Photocopies and Meals, How Nortel Racked up a $755-million Tab" *The Globe and Mail* (25 January 2013), online: <http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/from-100-e-mails-to-300000-for-photocopies-and-meals-how-nortel-racked-up-a-755-million-tab/article7826280/>.
[89] McElcheran, *supra* note 11 at 352. *Nortel* is presently the only Canadian decision to address substantive consolidation in an international context. For a case involving interprovincial substantive consolidation under the BIA see *D'Addario v Ernst & Young Inc,* 2014 ABQB 474.
[90] Harlang & Vininsky, *supra* note 14 at 20.
[91] *Nortel*, *supra* note 4 at para 204.
[92] Note that the Court did not cite any authority for applying pro rata allocation.

substantive consolidation. However, perhaps a better perspective on substantive consolidation is that it exists in a number of forms; pro rata allocation is merely one variation.[93] That is, a court can apply its broad discretionary powers to modify the substantive consolidation doctrine in light of the unique aspects of the case.[94] This approach would have advanced the law on substantive consolidation and assisted future courts in resolving similar issues. However, the Court elected to develop a novel remedy based on the Nortel Group's unique circumstances, thus limiting the decision's precedential value. The *Nortel* decision's notable absence from a motion heard by Justice Morawetz in January 2016 regarding an insolvent corporate group supports this contention.[95] This suggests that, like a number of the decisions before it, *Nortel* will remain confined to its particular factual circumstances.

VI. Conclusion

The pressures of a globalized economy and improvements in communication technology suggest that corporate groups will be an enduring feature of the corporate landscape.[96] However, the Canadian insolvency regime has thus far failed to articulate a clear and consistent framework to address the difficult issues raised by insolvent corporate groups. This has produced a series of criticisms, unanswered questions, and calls for reform.[97] In order to adequately address these concerns, the judiciary must retreat from its adherence to case-specific solutions in favour of substantive analysis. Although this paper has argued that *Nortel* failed to adequately develop the law on substantive consolidation, perhaps this case will signal that in order for the CCAA to continue to evolve to meet modern commercial and social needs, judicial action is required.

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[93] See e.g. MacNaughton, *supra* note 8 at 165; Harlang & Vininsky, *supra* note 14 at 18.
[94] *Ibid*.
[95] *Redstone*, *supra* note 5.
[96] Mihir Desai, "The Decentralizing of the Global Firm" (2008) Harvard University & National Bureau of Economic Research Working Paper No 09-054.
[97] Sarra, *supra* note 5 at 77; MacNaughton & Arzoumanidis, *supra* note 6 at 529; Rotsztain & De Cicco, *supra* note 6 at 332.