Citation: White Oak Commercial Finance, LLC v Nygård Holdings (USA) Limited et al, 2023 MBCA 73
Date: 20230911
Docket: AI22-30-09741

IN THE COURT OF APPEAL OF MANITOBA

Coram: Mr. Justice Marc M. Monnin
Mr. Justice Christopher J. Mainella
Madam Justice Jennifer A. Pfuetzner

B E T W E E N:

WHITE OAK COMMERCIAL FINANCE, LLC	)	***W. M. Onchulenko***, ***C. Linthwaite*** *and* ***L. R. Feldman*** *for the Appellants*
(Applicant) Respondent	)	***G. B. Taylor***, ***R. A. McFadyen*** *and* ***M. M. LaBossiere*** *for the Receiver Richter Inc.*
- and -	)	
NYGÅRD HOLDINGS (USA) LIMITED, NYGÅRD INC., FASHION VENTURES, INC., NYGÅRD NY RETAIL, LLC., NYGÅRD ENTERPRISES LTD., NYGÅRD PROPERTIES LTD., 4093879 CANADA LTD., 4093887 CANADA LTD., and NYGÅRD INTERNATIONAL PARTNERSHIP	)	***No appearance*** *for the Respondent*
(Respondents) Appellants	)	*Appeal heard:* ***April 19, 2023*** *Judgment delivered:* ***September 11, 2023***

On appeal from 2022 MBQB 48

PFUETZNER JA

[1] This is an appeal from an order (the consolidation order) of the judge substantively consolidating the respondents, Nygård Properties Ltd. (NPL)

and Nygård Enterprises Ltd. (NEL), with the estates of the seven other respondent corporations (collectively, the debtors).

[2] As a result of the consolidation order, the assets and liabilities of the debtors are to be pooled together to create a common fund out of which the claims of all creditors of the debtors will be paid.

[3] The consolidation order also granted Richter Inc. (formerly, Richter Advisory Group Inc.) (Richter), the court-appointed receiver of the debtors, leave to apply for bankruptcy orders in respect of NPL and NEL.

[4] NPL and NEL assert that the consolidation order was the result of a series of discrete legal errors, each of which resulted in prejudice to them. In response, Richter argues that because the consolidation order is discretionary and fact-driven, it is entitled to deference as the judge made no legal errors or palpable and overriding errors of fact.

[5] For the reasons that follow, I would dismiss the appeal with costs.

Background

[6] The lengthy history of these receivership proceedings is described in the judge's reasons and in his numerous previous written decisions. I will summarize only the relevant facts required for the purposes of the appeal.

[7] The debtors are part of a group of several entities under the direct or indirect ownership and control of Peter Nygard.

[8] The judge has had conduct of the receivership proceedings in respect of the debtors since March 9, 2020, the date that notices of intention to make

proposals under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the *Act*), were filed by five of the debtors, including NPL and NEL.

[9] In an order made on March 18, 2020, pursuant to section 243(1) of the *Act* (the receivership order), the judge appointed Richter as receiver over the assets, undertakings and properties of the debtors in response to a receivership application brought by the applicant on behalf of itself and another secured lender (the secured lenders) pursuant to their rights under a credit agreement and related security agreements. The secured lenders were owed approximately $36 million under the credit agreement. NPL and NEL were not borrowers under the credit agreement, but rather guarantors under the security agreements. The direct borrowers were the respondents, Nygård Holdings (USA) Limited, Fashion Ventures Inc., Nygård Inc. (NI) and Nygård NY Retail, LLC (the direct borrowers).

[10] The receivership order authorized Richter to borrow from the secured lenders in order to fund the receivership. Richter borrowed approximately $30.2 million (the receivership borrowings), which has since been repaid.

[11] NPL was a real estate holding company and is wholly owned by NEL, which is itself a holding company. Only three of the debtors—NPL, NI and Nygård International Partnership (NIP)—had realizable assets of any significance.

[12] Richter realized approximately $28,579,000 on the sale of real properties owned by NPL. An additional $62,748,000 was realized from the liquidation of the assets of NI and NIP. After payment of disbursements and

distributions to the secured lenders, Richter estimates that there will be net receivership proceeds of approximately $9.9 million. As Richter noted in its twelfth report, "Claims to the Net Receivership Proceeds depend upon whether claims are to be determined on a stand-alone 'separate corporation' basis, or on the basis that the Debtors should be substantively consolidated for creditor purposes."

Motion Before the Judge

[13] Richter brought a motion seeking substantive consolidation of the debtors. In order to assess the potential effects of substantive consolidation, Richter also presented the judge with a preliminary allocation, on a separate corporation basis, of priority payment obligations and costs as against the proceeds of realization of the assets of NPL, NI and NIP (the allocation).

[14] The allocation set out the following costs to be allocated to NPL:

- $1,650,000—receivership expenses and landlord charge;
- $4,155,000—corporate overhead pro rata allocation;
- $100,000—disputed landlord charges; and
- $14,192,000—repayment of balance owing to secured lenders under the credit agreement; equal sum paid by each guarantor (NPL and NIP).

[15] NPL and NEL submitted that the net receivership proceeds should be distributed on a separate corporation basis because NPL is solvent, it has no creditors and is entitled to all or a substantial portion of the net receivership

proceeds. NPL and NEL asserted that granting an order of substantive consolidation would seriously prejudice them. NPL also argued that, because its assets were used to pay the debt of the direct borrowers to the secured lenders, it now holds the secured lenders' security and, thus, has a secured claim against the direct borrowers. It asserted that it has a first claim to the net receivership proceeds and that substantive consolidation would extinguish that claim.

[16] In ordering substantive consolidation of the debtors, the judge applied the principles set out by the Court in *Redstone Investment Corporation (Re)*, 2016 ONSC 4453. He found, based on all of the evidence, that the debtors were operated as part of a common enterprise and all of them, including NPL, benefited from work performed by NIP and its employees. The judge also found that the benefits of substantive consolidation outweighed the prejudice to "particular creditors, including NPL pursuant to its potential right of subrogation" (at para 43(b)).

[17] The judge noted that, if substantive consolidation were ordered, assets would be available to satisfy unsecured creditors' claims in respect of all of the debtors—such as employees of NIP and NI, as well as landlords, suppliers, vendors, gift card purchasers and taxing authorities.

[18] In the event he was not correct to order substantive consolidation, the judge assessed the separate corporation analysis and reviewed the allocation—ultimately finding it to be fair and equitable.

[19] Next, the judge considered NPL's argument that, having satisfied its guarantee obligation, it had rights of subrogation, which provided it with

security over the assets of the direct borrowers. He accepted the evidence of Richter that the direct borrowers were insolvent and, as a result, NPL had no subrogated rights or right of contribution or indemnity that could be enforced against them. Moreover, the judge observed that, due to the timing of receipts and disbursements, none of NPL's assets were used to satisfy the debt of the secured lenders under the credit agreement and NPL does not have a subrogated claim against the direct borrowers.

[20] Finally, the judge confirmed his previous finding that NPL and NEL are insolvent, noting that "[o]ther than legal arguments advanced . . . there is no expert evidence that has been filed that proves NPL and NEL are solvent" (at para 127). He authorized Richter to file applications for bankruptcy orders for NPL and NEL.

Issues

[21] Richter raised a preliminary jurisdictional issue at the appeal. It asserted that NPL and NEL do not have an appeal as of right under section 193 of the *Act* and have not obtained leave to appeal. In light of the timing of when this issue was raised and the fact that all of the substantive issues in the appeal have been argued, I would grant leave to appeal to the extent required.

[22] The following issues are raised on the appeal. First, did the judge err in law by ordering the substantive consolidation of NPL and NEL with the other debtors? Second, did the judge err in law in approving the allocation and in deciding that NPL did not possess rights of subrogation pursuant to *The Mercantile Law Amendment Act*, CCSM c M120 (the *MLAA*)? Finally, did the judge err in law in granting Richter leave to apply for bankruptcy orders in respect of NPL and NEL?

Analysis—Substantive Consolidation

[23] This is the key issue on the appeal. If the judge's decision to order substantive consolidation is upheld, his alternative findings regarding the allocation and NPL's subrogation rights become moot.

[24] An order granting substantive consolidation requires a consideration of numerous factors and is an exercise in discretion. Accordingly, such an order will not be interfered with on appeal unless there has been an error in law, a material misapprehension of the evidence or the decision is so clearly wrong as to amount to an injustice (see *White Oak Commercial Finance LLC v Nygård Holdings (USA) Limited et al*, 2020 MBCA 128 at para 29).

[25] While the *Act* does not specifically contemplate orders for substantive consolidation, section 183(1) of the *Act* invests the judges of the Court of King's Bench with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act" (see also *Redstone* at para 8).

[26] *Redstone* is the leading case in Canada in respect of substantive consolidation. After an extensive review of the relevant law in Canada and in the United States, Morawetz J wrote (at para 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?

[27] The first principle—the presence of the so-called elements of consolidation—refers to seven factors adopted from United States law by the Court in *Northland Properties Ltd*, *Re*, 1988 CanLII 2924 (BCSC), aff'd 1989 CanLII 2672 (BCCA). The seven factors, as described in *Redstone*, are (at para 47):

(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.

[28] The consideration of the elements of consolidation in a given case is meant to gauge the level of difficulty (and corresponding expense) that would be involved in administering related corporations' assets and liabilities on a strictly separate basis.

[29] The second principle set out in *Redstone*—whether the benefits of consolidation outweigh the prejudice to particular creditors—requires a brief comment. In cases where substantive consolidation was not ordered, the

potential impact of substantive consolidation on different groups of creditors was a significant consideration.

[30] For example, in *Redstone*, Morawetz J considered whether three related corporations (referred to as RIC, RCC and RMS) should be substantively consolidated. Each corporation had separate groups of third party investors who were unsecured creditors. On an unconsolidated basis, the RCC creditors would recover an estimated 86% of their debt, whereas the RIC and RMS creditors would recover a nominal amount at best. The RIC and RMS creditors supported substantive consolidation as, if that occurred, their recovery would increase to 28%. The RCC creditors opposed the order as their recovery would drop from 86% to 28% (see paras 3, 5-6, 77, 86).

[31] In declining to order substantive consolidation, Morawetz J stated that the result of doing so would be, "from an objective standpoint, extremely prejudicial to the RCC" creditors (at para 86). In conclusion, he wrote, "Substantive consolidation is an equitable remedy. The primary aim of this extraordinary remedy is to ensure the equitable treatment of all creditors" (at para 89).

[32] As will be explained, a further issue raised on this appeal is whether the Court of King's Bench has the jurisdiction to make a substantive consolidation order in respect of a corporation that is solvent. There is little jurisprudence on this question. Indeed, NPL and NEL conceded that they could not point to a Canadian case stating that solvent and insolvent corporations cannot be substantively consolidated.

[33] On the other hand, in *Kriegman v Dill*, 2018 BCCA 86, Newbury JA noted that a large body of law has developed in the United States (in the

context of Ponzi schemes) regarding the courts' jurisdiction to make consolidation orders (at para 14):

> . . . U.S. bankruptcy courts exercise their equitable jurisdiction to bring together all the entities (whether insolvent or not) that have participated in gathering funds from "investors", consolidate those funds in one pool, and apply equitable subordination to permit all creditors to share the monies equitably. . . .

[34] Ultimately, the Court in *Kriegman* ordered enforcement of a judgment issued by the bankruptcy court in the United States substantively consolidating numerous related corporations, including three in British Columbia in respect of which there was little evidence as to solvency.

Positions of the Parties

[35] NPL and NEL maintain that the judge erred in law in ordering their consolidation with the other debtors. First, they assert that NPL is solvent and that substantive consolidation can only be ordered if "the condition precedent of the uniform insolvency of the relevant entities has been satisfied". Next, they argue that the judge erred in his assessment of six out of the seven elements of consolidation. Finally, they submit that the judge erred by engaging in illogical and circular reasoning.

[36] Richter asserts that it is within the equitable jurisdiction of the court to consolidate solvent and insolvent corporations. Moreover, it submits that the making of the receivership order in respect of NPL is conclusive of the fact that it was insolvent at that time and the Court of King's Bench continues to have jurisdiction over NPL. Richter argues that the judge did not err in law

in his assessment of the elements of consolidation merely because he reached a different conclusion than did the Court in *Redstone*.

Decision

[37] The fundamental difficulty with NPL and NEL's first argument is that NPL was, in fact, insolvent. Accordingly, the question of whether the judge had jurisdiction to make a substantive consolidation order affecting both solvent and insolvent corporations is beside the point.

[38] The determination of whether an entity is insolvent is one of mixed fact and law and is entitled to deference absent palpable and overriding error.

[39] As I have already mentioned, NPL and NEL both filed notices of intention to make proposals under the *Act* on March 9, 2020, stating that they were each an "insolvent person". Moreover, the receivership order also clearly establishes that NPL and NEL were insolvent on March 18, 2020.

[40] The judge dealt with the question of NPL and NEL's current insolvency. He wrote, "Other than legal arguments advanced on behalf of NPL and NEL, there is no expert evidence that has been filed that proves NPL and NEL are solvent" (at para 127).

[41] At the end of the day, I am not persuaded by NPL and NEL's assertion that the evidence before the judge was that they were solvent. I am not convinced that the judge made a palpable and overriding error in finding that insufficient evidence had been filed to alter his previous findings of insolvency and I would not disturb the judge's finding.

[42] However, in the event that I am wrong, I will briefly address NPL and NEL's argument that the Court's equitable jurisdiction to order substantive consolidation can never extend to include a member of a corporate group that is technically solvent at the date of the motion.

[43] As I have mentioned, there is no Canadian jurisprudence supporting NPL and NEL's argument and the United States case law, which has strongly influenced Canadian law, indicates that substantive consolidation can be ordered to join solvent and insolvent corporations in appropriate circumstances. Moreover, there is a sound policy basis for this position. As stated in, *in re Raejean Bonham, dba World Plus, Spear-Shipley*, 229 F (3d) 750 (9th Cir 2000), "Without the check of substantive consolidation, debtors could insulate money through transfers among inter-company shell corporations with impunity" (at p 764). The goals of an equitable and orderly distribution of assets to creditors could be very easily thwarted if substantive consolidation could be avoided simply by having debt lodged in one corporation and assets in another.

[44] In my view, the acceptance of NPL and NEL's position would undermine the remedial goals of the *Act*.

[45] I will now turn to NPL and NEL's assertion that the judge erred in his assessment of the elements of consolidation—essentially by coming to a different conclusion than was reached in *Redstone*. They accept that the judge applied the correct legal test, but they dispute the weight given by the judge to six out of the seven factors, including the presence of consolidated financial statements and the co-mingling of assets and business functions.

[46] In my view, the judge made no such errors. He carefully considered each factor in light of the particular circumstances of the present case—circumstances that differed in material ways from those in *Redstone*—and made a discretionary decision based on the weight he assigned to each factor. He made no error in law, there was no material misapprehension of the evidence, nor is the decision so clearly wrong as to amount to an injustice.

[47] As previously explained, the second general principle relating to the doctrine of substantive consolidation is whether the benefits of consolidation outweigh the prejudice to particular creditors.

[48] Ultimately, the main thrust of NPL and NEL's argument throughout is that the consolidation order prejudices them. NPL continues to take the position that it is a secured creditor of the direct borrowers due to rights of subrogation. Its fundamental objection to the consolidation order is that, as a secured creditor, it "was prejudiced *for the benefit of unsecured creditors*" (emphasis in original). NPL also criticizes the judge for attempting "to distinguish *Redstone* on a legally erroneous basis" by noting that *Redstone* dealt with third party investors/creditors whereas in the present case the alleged prejudice is to an affiliated corporation within the Nygård Group of Companies.

[49] I reject these arguments. In my view, the judge focussed in on the key distinction as to why substantive consolidation was appropriate in the present case, but found not to be in *Redstone*. The type of prejudice that the *Redstone* principles are concerned with is in respect of third party creditors and how they may be differently affected by a consolidation order.

[50] Counsel for NPL and NEL did his best to characterize NPL as a third party secured creditor because of its alleged subrogated rights to step into the shoes of the secured lenders, but it simply is not. Not only is NPL a debtor that is under receivership, the critical difference is that it is ultimately controlled by the same individual that controls all of the other debtors. It is not a third party creditor as contemplated by the *Redstone* principles.

[51] It is very telling, in my view, that none of the actual third party creditors in the present case took the position that substantive consolidation would prejudice them. The judge's finding that the benefits of substantive consolidation outweighed any prejudice to creditors is entitled to significant deference.

[52] To conclude, I would not interfere with the judge's discretionary decision to order substantive consolidation. Not only did NPL and NEL fail to prove that they were no longer insolvent, I am not convinced that uniform insolvency of every entity is a pre-condition for substantive consolidation. The judge made no error in his assessment of the elements of consolidation or in weighing the benefits of consolidation against the prejudice to any third party creditors. Finally, NPL and NEL's submission that the judge engaged in circular or illogical reasoning takes certain parts of his lengthy reasons out of context and has no merit. I would dismiss the ground of appeal in respect of the order for substantive consolidation.

[53] In light of my conclusion on this ground of appeal, it is not necessary to deal with the other grounds of appeal in a substantive way. However, I will briefly address them.

Analysis—Allocation

[54] As previously explained, the allocation's relevance was to illustrate how Richter would propose to administer the debtors' estates on a separate corporation basis.

[55] The goal of the allocation is to provide for "an equitable sharing of the burden" of the receivership expenses, the repayment of the debt owing to the secured lenders pursuant to the credit agreement and the payment of landlords' charges. If such expenses were allocated amongst the debtors strictly on the basis of how assets were chronologically realized and costs paid, the result "may be unfairly detrimental to particular stakeholders".

[56] As such, it should be noted that the allocations of expenses and disbursements to NPL do not necessarily reflect the actual flow of payments from its realized assets. For example, the entire debt owing to the secured lenders under the credit facility had already been retired before any of NPL's assets were realized.

[57] NPL and NEL contend that the judge decided the issue of subrogation and approved the allocation on the basis of legal errors and a palpable and overriding error of fact.

[58] Their first argument is that the judge erred in finding that Richter had the discretion to allocate "the proceeds from the sales of assets belonging to separate corporations as among those corporations". That is a mischaracterization of the nature of the allocation. The allocation does not purport to reallocate *assets* or the proceeds of sale of assets among the related corporations. Accordingly, I would not accede to this argument.

[59] Next, NPL and NEL argue that the judge erred by relying on a second allocation prepared by Richter that contradicted the allocation. This is a false distinction. There was no second allocation, rather Richter prepared a supplementary report (the second supplementary twelfth report) setting out what actually happened upon the sale of NPL's assets. The purpose of the supplementary report was to illustrate the actual timing of the receipt of sale proceeds and the disbursement of expenses. As I have noted, none of the proceeds of sale of NPL's assets were used to pay down the debt under the credit agreement.

[60] NPL and NEL's third argument is that NPL obtained subrogated rights in respect of the direct borrowers by virtue of its assets being used to repay the receivership borrowings. The judge rejected this argument and accepted Richter's submission that NPL is not a subrogated secured creditor of any of the other debtors pursuant to the *MLAA* because the application of the proceeds of NPL's assets to receivership borrowings did not trigger rights under the *MLAA*. The judge made no extricable error of law or palpable and overriding error in this finding. I would reject this argument.

[61] Finally, there is simply no merit to NPL and NEL's remaining submissions regarding the defence of set-off and the extent of NPL's guarantee.

Analysis—Leave to Apply for Bankruptcy Orders

[62] NPL and NEL's final ground of appeal is that the judge erred in law in granting Richter leave "to file applications for bankruptcy orders . . . in relation to the Debtors, NPL and NEL, on a basis that reflects the Common

Assets and the Common Liabilities and the substantive consolidation of the estates of the Debtors". They assert that this was "illogic" and that, in doing so, the judge denied NPL and NEL's "existence as separate corporate persons".

[63] These submissions are without merit and I would dismiss this ground of appeal summarily.

Result

[64] For these reasons, I would dismiss the appeal with costs to Richter.

JA

I agree:

JA

I agree:

JA