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Sarah P. Bradley*

Unlimited Liability in the Modern Context: An Examination of Shareholder Liability in Nova Scotia Unlimited Liability Companies

For over 30 years, unlimited liability companies have been ubiquitous in US-Canadian M&A transactions. Typically interposed between a US parent company and a Canadian operating company, these entities quietly function to make such structures more tax efficient. They are facilitated by Nova Scotia's venerable Companies Act, *which has allowed for the incorporation of corporations with unlimited liability for over a hundred years. Unlimited liability of shareholders is the singular defining characteristic of the ULC, but the precise nature of ULC shareholder liability was apparently regarded as something of a technicality and rarely, if ever, closely examined in the professional or academic literature or considered by the courts. Perhaps unlimited liability was considered too familiar a concept to require detailed analysis, or perhaps it was considered irrelevant in practice because the debts of modern ULCs are typically guaranteed by their parent companies. In such a structure, the liability of the parent company seems clear. This apparent clarity proved illusory, however, following the recent financial crisis, when a number of ULC parent companies faced bankruptcy and restructuring and the precise nature of their unlimited liability was suddenly the subject of intense scrutiny and conflict.*

Depuis plus de 30 ans, les sociétés à responsabilité illimitée (SRI) ont été omniprésentes dans les transactions de fusions et acquisitions É.-U.-Canada. Souvent interposées entre une société mère américaine et une société d'exploitation canadienne, ces entités sont des acteurs silencieux qui font que ces structures sont efficientes sur le plan de la fiscalité. Elles peuvent être constituées sous le régime de la vénérable Companies Act *de la Nouvelle-Écosse qui depuis plus de cent ans prévoit la constitution de sociétés à responsabilité illimitée. La responsabilité illimitée des actionnaires est la caractéristique singulière qui définit les SRI, mais la nature précise de la responsabilité de leurs actionnaires était apparemment considérée comme un simple point technique et rarement examinée de près, si tant est qu'elle l'ait jamais été, dans les documents professionnels universitaires ou même étudiée par les tribunaux. Peut-être la responsabilité illimitée était-elle considérée comme étant un concept trop bien connu pour justifier une analyse détaillée, ou peut-être était-elle considérée comme n'étant pas pertinente en pratique parce que les dettes des SRI modernes sont habituellement garanties par leurs sociétés mères. Dans une telle structure, la responsabilité de la société mère semble claire. Cette clarté apparente s'est cependant révélée illusoire lors de la récente crise financière, alors que les sociétés mères de nombreuses SRI ont été acculées à la faillite et à la restructuration et que la nature exacte de leur responsabilité illimitée a soudainement fait l'objet d'un examen rigoureux et de conflits.*

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Introduction

It has been possible to incorporate companies with unlimited shareholder liability in Nova Scotia for more than a hundred years, but for most of the twentieth century, such companies were as unheard of in Nova Scotia as they were everywhere else. They existed only as anachronisms in the outdated sections of the infrequently amended Nova Scotia *Companies*

Act[1]—legal relics of a bygone era that had yet to be erased completely through the process of statutory reform. Then, in the 1990s, thanks to the evolution of U.S. tax laws and the pioneering work of a few Nova Scotia lawyers,[2] Nova Scotia unlimited liability companies (NSULCs) experienced a dramatic and sustained burst of popularity, becoming more frequently used than they had ever previously been, and for many years, NSULCs were used in the structuring of virtually every U.S.-Canada cross-border acquisition.

The key to this sudden popularity was the NSULC's singular defining characteristic: unlimited shareholder liability.[3] The possibility of unlimited

1. *Companies Act*, RSNS 1989, c 81 [*NSCA*].

2. The watershed moment for the modern ULC occurred in 1988, with US, IRS Revenue Ruling 88-8, 1988-1 CB 403, in which the IRS concluded that a British ULC should be classified for federal tax purposes as a partnership on the basis of Regulations 301.7701-2 (26 CFR § 301.7701-2 (2014)), because it had associates and possessed an objective to carry on business and divide the gains therefrom, but lacked the corporate characteristics of limited liability and free transferability of interests. See "Important Developments During the Year: Administrative Practice" (1989) 42:4 Tax Lawyer 1103. Previously, the IRS had concluded in a private letter ruling that a foreign ULC would be treated as a "corporation 'per se'" (US, Internal Revenue Service, PLR 8426031, 26 March 1984; for discussion, see Robert Thornton Smith, "Substance and Form: A Taxpayer›s Right to Assert the Priority of Substance" (1990) 44:1 Tax Lawyer 137).

This decision was soon followed by an article published in the International Tax Journal (Walter F O'Connor, "Using a UK Unlimited Liability Company in US Tax Planning" (1989–1990) 16:1 Intl Tax J 54). For a more detailed analysis, see also Thomas R Bretz & Steven White, "Cross-Border Placement/Movement of Indebtedness and Tax-Effective Use of Cash Accumulated Offshore" (1990) 68:12 Taxes: Tax Magazine 1103.

In 1991, the IRS took a further step by concluding that a British ULC would be treated as a partnership for US Federal tax purposes despite being owned by a 1st and 2nd tier subsidiary of a US company, provided it did not have the hallmark "corporate characteristics" outlined in Regs 301.7701-2 (26 CFR § 301.7701–2 (2014)). This marked a departure from the IRS's previous position on "single economic theory" (for discussion see David R Ryder, Lowell D Yoder & Sandra P McGill, "Beneficial Uses of Foreign Entities and Structures in Tax Planning for the US Multinational Company" (1992) 70:12 Taxes: Tax Magazine 1021.

In 1995 the IRS issued a private letter ruling concluding specifically that an NSULC may qualify as a partnership under US law (US, Internal Revenue Service, PLR 9538020, 22 June 1995). This was followed in 1996 by the introduction of "check the box" regulations, giving US taxpayers the ability to simply select flow-through tax status for certain single-member entities, including NSULCs (26 CFR § 301.7701-3 (2015)) (for a general discussion see Joel Rabinovitz & Eric M Zolt, "Tax Nothings" (1997) 75:12 Taxes: Tax Magazine 869.

The first publication relating to the use of NSULCs in US tax planning was a brief article in the American Bar Association's Section of Taxation newsletter: J Gerald Godsoe, "A Flow-through Hybrid: Nova Scotia Unlimited Liability Companies" (Fall 1995) 15:1 Newsletter ABA Section Taxation 5. This was followed by more detailed articles, such as: Paul W Festeryga, "Nova Scotia Unlimited Liability Companies: What Are They and How Do They Work?" in *Report of Proceedings of the Fiftieth Tax Conference* (Toronto: Canadian Tax Foundation, 1999) 17:1, and Barry D Horne, "The Nova Scotia Unlimited Liability Company: Surf and Turf" in *Report of Proceedings of the Fifty-seventh Tax Conference* (Toronto: Canadian Tax Foundation, 2006) 26:1.

3. In the *NSCA*, *supra* note 1, s 135, the term "member" is used. Member is a somewhat broader term than "shareholder" because it is possible to be a member of an *NSCA* company without owning shares. All shareholders are members, however, and every provision in the Act applying to members

liability allowed for the creation of an entity considered a corporation under Canadian law that could be treated as a partnership for U.S. tax purposes. Although this advantage has been somewhat diminished recently due to U.S. tax law reforms, for over 20 years it provided a significant incentive to incorporate NSULCs under the *NSCA* and over 7780 were formed between 1990 and 2013.[4]

The unlimited nature of the liability borne by the shareholders of an NSULC was apparently regarded as something of a technicality that was rarely, if ever, addressed in detail. The precise nature of that liability was not closely examined in the professional or academic literature, and until recently was never considered by the courts. Perhaps unlimited liability was considered too familiar a concept to require detailed analysis, or perhaps it was considered irrelevant in practice because modern NSULCs are typically used in very close corporate structures, usually as wholly-owned subsidiaries with clearly defined assets and liabilities and with debts guaranteed by their parent companies. In such a structure, the liability of the parent company seems clear. This apparent clarity proved illusory, however, following the recent financial crisis, when a number of NSULC parent companies faced bankruptcy and restructuring and the precise nature of their unlimited liability was suddenly cast into the spotlight.

The principal bankruptcy proceedings for these large NSULC parent companies have typically been heard by the United States Bankruptcy Court in New York and Delaware, with related actions in Canadian courts. As discussed below, most of these cases have been settled by the parties before the courts had an opportunity to comment directly on the issue of NSULC shareholder liability. As a result, despite its recent relevance, the specific contours of NSULC shareholder liability have yet to be judicially considered. Nevertheless, these cases highlight the importance of the issue and the gap in the existing literature and jurisprudence, and they provide an interesting basis for closer examination.

The recent Delaware cases have all involved similar fact patterns with respect to NSULC shareholder liability. Fundamentally, each case has involved a wholly-owned NSULC subsidiary that had issued debt instruments which were guaranteed by its parent. Upon the bankruptcy of the parent company, the holders of the NSULC's debt instruments asserted what are sometimes referred to as "double-dip" claims—one claim is made

applies to shareholders. Accordingly, I will use the more familiar term "shareholder" throughout this paper.

4. Data received from the Nova Scotia Registry of Joint Stock Companies. Formations include incorporations, amalgamations or conversions upon continuance or memorandum alteration.

by the holders of the debt instruments (through the indenture trustee) against the NSULC's parent on the basis of its liability as a guarantor (referred to in this paper as a "guarantee claim"), while a concurrent claim is made by the NSULC (through its liquidator or trustee) against the parent company on the basis of the parent's unlimited liability as a shareholder pursuant to section 135 of the *NSCA*[5] (referred to in this paper as a "contribution claim"). This incremental claim asserted by the NSULC has the potential to enhance the recoveries of all of the NSULC's creditors, over and above what has been recovered by the parent company's creditors directly.

In each case, the holders of the NSULC's debt instruments have asserted that the guarantee claim and the contribution claim are distinct from one another and that both are separate obligations of the parent, while the parent company and the parent company's other creditors have argued that because these claims arise from the same originating transaction, and because they are both in substance owed to the same creditor, they cannot both be valid under the *NSCA* and should be disallowed as duplicative under bankruptcy law and the common law rule against double proof.

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5. In its entirety, section 135 reads:
In the event of a company being wound up, every present and past member shall, subject to this Section, be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges, and expenses of the winding up and for the adjustments of the rights of the contributories among themselves, with the qualifications following:
(a) a past member shall not be liable to contribute if he has ceased to be a member for one year or upwards before the commencement of the winding up;
(b) a past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member;
(c) a past member shall not be liable to contribute unless it appears to the court that the existing members are unable to satisfy the contributions required to be made by them in pursuance of this Act;
(d) in the case of a company limited by shares, no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member;
(e) in the case of a company limited by guarantee, no contribution shall be required from any member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up;
(ea) in the case of an unlimited company, no contribution exceeding the amount, if any, unpaid on the shares in respect of which the member is liable as a past member, shall be required from a past member who was not a member of the company at any time on or after the time the company became unlimited;
(f) nothing in this Act shall invalidate any provision contained in any contract whereby the liability of the individual members of the contract is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract;
(g) a sum due to any member of a company, in his character of a member, by way of dividends, profits or otherwise, shall not be deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.

In Part I of this paper, I introduce these recent cases, and the issue of NSULC shareholder liability in the circumstances in which modern NSULCs have typically been used. In Part II, I discuss the issues of Nova Scotia corporate law raised by the recent cases, including the history, context and purpose relevant to the interpretation of section 135 and some of the arguments put forward by the litigants in these cases, and demonstrate that as a matter of Nova Scotia law, the fact that a parent company has guaranteed the debts of a subsidiary NSULC does not change the nature of its obligation as a contributory under section 135 unless the debt instrument specifically excludes such contributory liability. In some cases, this means that a contribution claim can validly be made under the *NSCA* against a parent company in relation to debt issued by a subsidiary NSULC, despite the fact that the parent is also liable for this debt pursuant to a guarantee.

Because winding up is a fundamental requirement for shareholder liability under the *NSCA*, in Part III I discuss the meaning and nature of winding up under the *NSCA* in the modern context. In Part IV, I canvass the bankruptcy law issues raised by the litigants relating to the single satisfaction rule and the doctrine of equitable consolidation in the United States and the rule against double proof and the piercing of the corporate veil in Canada, as well as the question of which set of laws will be most relevant in determining these bankruptcy law issues. I demonstrate that in most modern NSULC cases, questions as to whether the claims are duplicative and the underlying corporate structure should be disregarded will be determined principally by U.S. law, where numerous cases have allowed double recovery in circumstances quite similar to the fact patterns presented by the modern NSULC cases, with the caveat that no creditor can ever recover more than 100 per cent of the underlying debt.

I. *Recent cases and issues*

The first of the cases that raised the issue of the potential double liability of ULC shareholder-guarantors was the bankruptcy of General Motors.[6] Starting in 2006, as GM's financial position worsened and its debt was deeply discounted, hedge funds began buying up bonds that had been issued by an NSULC wholly owned by GM's Canadian subsidiary. The funds had targeted this debt strategically on the basis of their assessment of GM Canada's concurrent liability as both guarantor and an NSULC shareholder. By the time of GM's bankruptcy proceedings in 2009, four

6. The GM Chapter 11 case is *In re Motors Liquidation Co*, 09-50026-reg (Bankr SDNY 2010), online: <www.nysb.uscourts.gov>.

hedge funds had acquired more than two-thirds of the NSULC's $1.07 billion in outstanding bonds for pennies on the dollar.

The Canadian subsidiary of GM was just one part of a larger restructuring of its U.S. parent and as the bankruptcy deadline drew near, GM and GM Canada were under immense pressure to settle with the NSULC noteholders or see the entire restructuring collapse. In these circumstances, at the eleventh hour, the NSULC noteholders were able to leverage their contribution claim arguments strategically to achieve a settlement that granted them recovery on their notes of $367 million in cash and $2.67 billion in claims for shares—almost triple the recovery of GM's other unsecured creditors.[7] This settlement was challenged by GM's other unsecured creditors in a lawsuit filed in 2012 in the U.S. Bankruptcy Court in Manhattan.[8] The unsecured GM creditors alleged that the Nova Scotia noteholders' conduct in the settlement negotiations was wrongful and damaging to other creditors' recoveries. This case was ultimately settled in 2013 and the claim of the NSULC noteholders was reduced to $1.55 billion, giving them approximately 1.8 times the recovery of the other creditors.[9] Both settlements were strategic, however, and the issue of the NSULC shareholder's liability as a contributory, though vigorously argued, was never decided or conceded.

The Chapter 11 bankruptcy proceedings of Smurfit-Stone Container Corporation were commenced in 2009 and presented a similar fact pattern involving an NSULC finance subsidiary.[10] In *Smurfit-Stone*, however, the debt instruments in question were notes issued pursuant to an indenture that included a specific provision that the noteholders would have:

> No recourse for the payment of the principal of, premium, if any, or interest...in respect of any of the Notes, or for any claim based thereon or otherwise in respect thereof, and no recourse under or upon any obligation, covenant or agreement of [the ULC]...shall be had against any incorporator or against any past, present or future partner, stockholder, other equityholder, officer, director, employee or controlling person,

7. *In re 12-09802-reg Motors Liquidation Co GUC Trust v Appaloosa Investment LP I, 12-09802* (Bankr SDNY 2012) (Complaint against Appaloosa Investment LP I, Doc 11476 filed 1 March 2012), online: <www.motorsliquidationdocket.com/pdflib/11476_50026.pdf>.

8. *In re Motors Liquidation Co GUC Trust v Appaloosa Investment LP I, 12-09802* (Bankr SDNY 2012), online <www.nysb.uscourts.gov>.

9. *In re 12-09802 Motors Liquidation Co GUC v Appoloosa Investment LP I, 12-09802* (Bankr SDNY 2012) (Order Approving the Global Settlement Agreement by and Among the GUC Trust, the GUC Trust Monitor, the Nova Scotia Trustee, New GM, GM Canada, and the Representative Noteholders, Doc 12531 signed 21 October 2013), online: <www.motorsliquidationdocket.com/pdflib/12531_50026.pdf>.

10. *In re Smurfit-Stone Container Corporation*, 09-10235 (Bankr Del 10 January 2011), online: <www.deb.uscourts.gov> [*Smurfit-Stone*].

> as such, of [the ULC]...whether by virtue of any constitution, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly understood that all such liability is hereby expressly waived and released as a condition of, and as a consideration for, the execution of this Indenture and the issue of the Notes.[11]

The Court held that this "no recourse" provision prevented the noteholders from pursuing any claim for contributory liability against the ULC shareholders due to the application of Section 135(f) of the *NSCA*.[12]

Another similar scenario unfolded in the bankruptcy of AbitibiBowater Inc.,[13] and in that case, the indenture did not contain a "no recourse" provision such as the one seen in *Smurfit-Stone*. This placed the issue of the parent company's liability as both a guarantor and an NSULC shareholder squarely at issue. The issue was vigorously argued before the U.S. Bankruptcy Court for the District of Delaware and the Quebec Superior Court in the related Canadian *Companies' Creditors Arrangement Act*[14] proceedings, but the case was settled before any judicial determination was made.[15]

Given the prevalence of NSULC finance subsidiaries in cross-border structures, these cases present questions of both practical and academic interest relating to both Nova Scotia corporate law and fundamental principles of Canadian and U.S. bankruptcy law. The corporate law issue calls for an analysis of the interpretation of section 135 and nature of the liability of NSULC shareholders to determine whether the existence of a guarantee by an NSULC shareholder should preclude concurrent liability as a contributor for the company's liabilities. The bankruptcy law issues relate to the question of whether the single satisfaction rule (in the United States) or the common law rule against double proof (in Canada) apply to prevent the recovery of both a guarantee claim and a contribution claim against an NSULC parent company guarantor.

II. *Nova Scotia corporate law issues*

The fundamental corporate law question raised by these recent cases is whether Nova Scotia corporate law requires or permits contributory

11. *Ibid* at 4-5 [emphasis omitted].
12. Section 135(f) provides: "[N]othing in this Act shall invalidate any provision contained in any contract whereby the liability of the individual members of the contract is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract."
13. *In re Abitibi Bowater, 09-11296* (Bankr Del 2011), online: <www.deb.uscourts.gov> [*AbitibiBowater*].
14. *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].
15. I acted as an expert consultant to the noteholders in *AbitibiBowater*, *supra* note 13.

liability on winding up to be reduced or eliminated if a sole shareholder has made or agreed to make a partial payment of the NSULC's debt.

This fundamental question raises three sub-issues, all of which were argued by the litigants in the modern NSULC cases, and all of which are based in the statutory interpretation of section 135. The interpretation of section 135 requires an analysis of the history, context and purpose of the section, which are canvassed below. The sub-issues relevant to the question of whether contributory liability should be reduced or eliminated in the modern NSULC context are:

1. whether section 135 allows for any limitation of NSULC shareholder liability other than as explicitly provided for in that section;
2. whether a shareholder guarantee of an NSULC's debt precludes concurrent liability as a contributory; and
3. whether the principles of partnership liability apply to the unlimited liability of NSULC shareholders.

Each of these issues is discussed in detail below.

1. *Interpretation of section 135: History, context and purpose*

Section 135 of the *NSCA* is the basis for contributory liability for NSULC shareholders. The relevant portions of this provision, in the modern NSULC context, stipulate that in the event of an NSULC "being wound up,"[16] its shareholder is liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges, and expenses of the winding up. There are eight enumerated "qualifications" on this liability, with the only relevant one in this context set out in clause 135(f), which stipulates that contributory liability is subject to any contractual agreement specifically limiting it with respect to a particular debt. Clause 135(f) was pivotal in excluding contributory liability of the parent company in the *Smurfit-Stone* case, as discussed above.

Because NSULC shareholder liability arises directly and exclusively from section 135, understanding the precise nature of this liability is, first and foremost, an exercise in statutory interpretation, which requires consideration of the "modern principle" formulated by Elmer Driedger in the second edition of his book *Construction of Statutes*, in which he asserts:

16. The nature of "being wound up" is the subject of Part III of this paper.

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.[17]

This enunciation of the modern principle has been frequently cited and relied upon by Canadian courts of all levels and is unquestionably at the foundation of any Canadian statutory analysis.[18] However, Driedger's modern principle is far from a simplistic formula. It is composed of a number of elements, requiring an analysis of a statute's "entire context," the plain meaning of its words, its scheme and object, and the intention of Parliament in enacting it. The Supreme Court of Canada has observed, however, that "this framework need not be applied in a formulaic manner. The factors need not be canvassed separately in every case, given that they are very closely related and interdependent."[19]

For Driedger, the "entire context" of a statute includes its internal context as well as its external context, consisting of the statute book as a whole and the body of law as a whole, as well as the statute's intellectual, social and legal contexts. The "grammatical and ordinary sense" of the words is the meaning that would be understood immediately by an ordinary reader.[20]

The modern principle has been referred to as an "intentionalist" approach to statutory interpretation, in that its purpose is to discover and implement the intention of the enacting legislature. For Driedger, the intention of Parliament consisted of four elements: Parliament's expressed intention, its implied intention, its presumed intention and its declared intention. However, it has been observed that the Supreme Court of Canada has been somewhat inconsistent on this point and at times has not delved

17. EA Driedger, *Construction of Statutes*, 2nd ed (Toronto: Butterworths, 1983) at 87. This framing of the modern principle was altered by Driedger in subsequent editions of his book, and these latter articulations have not been as readily accepted by the courts, though Ruth Sullivan has argued that they are not substantively different. See Ruth Sullivan, "Statutory Interpretation in the Supreme Court of Canada" (1999) 30:2 Ottawa L Rev 175 at 219.

18. See: *Rizzo & Rizzo Shoes Ltd (Re)*, [1998] 1 SCR 27 at para 21; *Bell ExpressVu LP v Rex*, 2002 SCC 42 at para 26, [2002] 2 SCR 559; *HL v Canada (AG)*, 2005 SCC 25 at paras 186-187, [2005] 1 SCR 401; *Marche v Halifax Insurance Co*, 2005 SCC 6 at para 54, [2005] 1 SCR 47; *Harvard College v Canada (Commissioner of Patents)*, 2002 SCC 76 at para 154, [2002] 4 SCR 45; *Bristol-Myers Squibb Co v Canada (AG)*, 2005 SCC 26 at para 96, [2005] 1 SCR 533 [*Bristol-Myers*]; *R v Middleton*, 2009 SCC 21 at para 154, [2009] 1 SCR 674. For detailed discussion, see Sullivan, *supra* note 17.

19. *Bristol-Myers*, *supra* note 18 at para 96, citing *Chieu v Canada (Minister of Citizenship and Immigration)*, 2002 SCC 3 at para 28, [2002] 1 SCR 84.

20. Sullivan, *supra* note 17 at 216.

very deeply into the intention of Parliament, preferring instead to treat the modern principle as "'plain meaning in a substantive sense.'"[21]

Driedger also set out steps of construction, which have been cited with approval by the Supreme Court of Canada, referring to the modern principle as the "'contextual approach'":

1. The Act as a whole is to be read in its entire context so as to ascertain the intention of Parliament (the law as expressly or impliedly enacted by the words), the object of the Act (the ends sought to be achieved), and the scheme of the Act (the relation between the individual provisions of the Act).
2. The words of the individual provisions to be applied to the particular case under consideration are then to be read in their grammatical and ordinary sense in the light of the intention of Parliament embodied in the Act as a whole, the object of the Act and the scheme of the Act, and if they are clear and unambiguous and in harmony with that intention, object and scheme and with the general body of the law, that is the end.
3. If the words are apparently obscure or ambiguous, then a meaning that best accords with the intention of Parliament, the object of the Act and the scheme of the Act, but one that the words are reasonably capable of bearing, is to be given them.
4. If, notwithstanding that the words are clear and unambiguous when read in their grammatical and ordinary sense, there is disharmony within the statute, statutes in pari materia, or the general law, then an unordinary meaning that will produce harmony is to be given the words, if they are reasonably capable of bearing that meaning.
5. If obscurity, ambiguity or disharmony cannot be resolved objectively by reference to the intention of Parliament, the object of the Act or the scheme of the Act, then a meaning that appears to be the most reasonable may be selected.[22]

A proper interpretation of section 135, then, must begin with an analysis of the grammatical and ordinary sense of the words used. This is not difficult to discern because the language used by the drafters of the section is clear and unambiguous. A finer analysis is required, however, to understand the context in which the words are used, and the scheme, object and intention of Parliament in enacting the statute. These topics are discussed below.

21. *Ibid*, citing *Stubart Investments Ltd v The Queen*, [1984] 1 SCR 536 at 578 and numerous subsequent cases.

22. See *R v McIntosh*, [1995] 1 SCR 686 at para 21, citing Driedger, *supra* note 17 at 105.

2. *History and context of section 135*

The *NSCA* is a very old statute with a long history, dating back to the very origins of the business corporation in the common law world.[23] When first enacted in 1900, it was an almost verbatim adoption of the then-modern U.K. *Companies Act, 1862*,[24] and since its enactment it has been subject to infrequent amendment and limited modernization.[25] Section 135 of the *NSCA* was originally based on the analogous section 38 of the *1862 Act*.

The *1862 Act* represented the culmination of nearly two decades of dramatic corporate law development and reform in the U.K., where prior to 1844, there was no system for incorporation by registration. Before 1844, corporations could be created by a Crown Charter, which was virtually impossible to get, or by an act of Parliament, which was only slightly more accessible. The imperatives of business, however, were burgeoning as a result of the industrial revolution, which had created demand for large enterprise and correspondingly large accumulations of capital, as well as the emergence of a new merchant class with capital to invest. In order to assemble capital pools in this environment, joint stock partnerships with transferrable shares were commonly used, and such partnerships were typically referred to as "companies."

The liability of the investors in such unincorporated companies was unlimited, but the risk associated with this unlimited liability was typically minimized by contracts with major creditors that limited the creditors' recourse to the assets of the business. The inefficiencies of such a system were profound, but the profits they made possible presumably outweighed the costs of such private ordering.

At the time, a number of select committees were struck to examine whether the European limited partnership model should be implemented in Britain, and a variety of views were heard on the issue, with the majority of witnesses opposing a limited liability regime. The reports of these Committees variously supported and opposed creating the limited liability company.[26] By the early 1840s, however, the collapse of a number of speculative "bubbles" brought political pressure to bear on the matter of the regulation of companies. More select committees were established. The most influential of these, the Gladstone Committee on Joint Stock

23. The *NSCA* is one of the oldest general incorporation statutes still used in Canada today for business incorporations. Only the Prince Edward Island *Companies Act*, RSPEI 1988, c C-14, originally enacted in 1888 as *The Prince Edward Island Joint Stock Companies Act*, SPEI 1888, c 14 (the only remaining letters patent general incorporation statute in Canada), pre-dates it.

24. *Companies Act, 1862* (UK), 25 & 26 Vict, c 89 [*1862 Act*].

25. See Sarah P Bradley, *Nova Scotia Companies Act & Commentary, 2014* (Markham: LexisNexis Canada, 2013).

26. For example, the Select Committee on Partnerships of 1837.

Companies, reported that fraud could be reduced through a system of mandatory registration and reporting of prospectuses and audited accounts. The Gladstone Committee also considered the issue of limited liability and concluded that it was an unnecessary enticement for investors, which were apparently considered abundant.[27]

The result of the Gladstone Committee's work was the U.K. *Joint Stock Companies Act, 1844*,[28] which drew the first legislative distinction between partnerships and companies. The *1844 Act* provided for registration of any company that met the registration requirements, and required the registration of all partnerships with over 25 members and freely transferable shares. There was no provision for limited liability. The *1844 Act* was introduced principally for the protection of the public, and not for the advantage of the companies registered. However, in the absence of a suitable regulatory framework, the Act was widely criticized as ill-conceived and ineffective.[29]

At this point, registered companies remained more akin to partnerships than corporations, and the system of liability of the members had not changed from that of the partnership model. While the need for corporations to carry out large infrastructure projects was accepted, the availability of limited liability and other modern incidents of corporate personality to regular commercial enterprises was the subject of significant public debate in Britain.

Then, faced with pervasive private structuring of limited liability through contract, and the acknowledgment by the U.K. courts in 1852 of the efficacy of such private contractual limitations of liability, as well as public pressure, the U.K. Parliament was forced to reconsider its position respecting limited liability. As Gower observes, "public opinion began to harden in favour of the extension of limited liability, particularly when the slump of 1845–1848 drew poignant attention to the consequences of its absence."[30] In that era, the failure to pay debts was still considered a crime punishable by imprisonment, and the conditions in debtors prisons were notoriously harsh. This shift in public opinion, along with the relentless pressures of industrialization and the public benefits of infrastructure investment by private companies were politically compelling. It became clear that growth could be advanced through private investment, and that

27. See Rob McQueen, *A Social History of Company Law: Great Britain and the Australian Colonies, 1854–1920* (Burlington, VT: Ashgate, 2009).

28. *Joint Stock Companies Act, 1844* (UK), 7 & 8 Vict, c 110 [*1844 Act*].

29. See McQueen, *supra* note 27 at 51.

30. LCB Gower, *Gower's Principles of Modern Company Law*, 5th ed (London, UK: Sweet & Maxwell, 1992) at 41.

such investment could be encouraged most effectively through limited liability.

The *Limited Liability Act, 1855* was a breakthrough that granted limited liability to companies of more than 25 members (reduced to 7 in 1856).[31] The *1855 Act* was introduced in the House of Commons and passed through the lower house relatively quickly, but was not favourably received in the House of Lords—the controversial Act was only passed following numerous protests and amendments.[32] The Law Times famously called the bill proposing the *1855 Act* "[t]he Rogues' Charter."[33] Nevertheless, the efficiencies were obvious. It was said at the time that limited liability was introduced for the purpose of encouraging investment by "[b]usy persons and 'those unaccustomed to business'" and "[to] foster the alliance of 'science and ability with capital.'"[34]

The first winding-up statute in the U.K. was the *Joint Stock Companies Winding-Up Act, 1844*,[35] enacted simultaneously with the first incorporation statute, the *1844 Act.* Over the next two decades in the U.K., both corporate law and insolvency law rapidly developed. A number of winding-up statutes were enacted; others were repealed. The object of these statutes was to provide for the orderly distribution of the assets of failed companies, enforce contributions against such companies' shareholders and other contributories, and enforce the rights of the contributories among themselves. Before the enactment of the first incorporation and insolvency statutes in 1844, the courts had great difficulty dealing with the complexities of winding up the large unincorporated joint stock companies of the day. Although the rights of creditors could be enforced against the assets of the company and the property of its shareholders, no court was empowered to deal with the rights of the contributories among themselves, or to oversee the orderly distribution of the company's assets to discharge its liabilities.[36]

31. *Limited Liability Act, 1855* (UK), 18 & 19 Vict, c 133 [*1855 Act*].
32. See Bishop Carleton Hunt, *The Development of the Business Corporation in England, 1800–1867* (Cambridge, MA: Harvard University Press, 1936).
33. Tony Orhnial, ed, *Limited Liability and the Corporation* (London,UK: Croom Helm, 1982) at 33.
34. Bishop C Hunt, "The Joint-Stock Company in England, 1830–1844" (1935) 43:3 J Political Economy 331 at 355, 356.
35. *Joint Stock Companies Winding-Up Act, 1844* (UK), 7 & 8 Vict, c 111.
36. See Leonard Shelford, *The Law of Joint Stock Companies: Containing the Companies Act, 1862 and the Acts Incorporated Therewith: With Copious Notes of Cases Relative to Joint Stock Companies, the Rules and Forms of the Court of Chancery in Proceedings Under the Above Act, and Forms of Articles of Association* (London, UK: Butterworths, 1863) at 78.

The statute on which the *NSCA* was originally based, the *1862 Act*,[37] consolidated the *1844 Act*, the *1855 Act* and all related winding up Acts, and established a new regime of liability for all companies. The winding up provisions of the *1862 Act* and its predecessors were enacted not just for winding up incorporated companies, but for all business enterprises then active in the U.K., whether incorporated or not. Any partnership, association, or company (except railway companies) with more than seven members was required to be registered and could be wound up under the *1862 Act*, with certain minor exceptions. Section 38, the predecessor to section 135 of the *NSCA* dealing with the liability of members, however, applied only to companies formed under the *1862 Act*.[38]

The *1862 Act* established three categories of incorporated company: the company limited by shares, the company limited by guarantee, and the unlimited liability company.[39] The *NSCA* wholly adopted these categories when it was enacted in 1900. Crucially for the interpretation of section 135 of the *NSCA*, the new unlimited liability regime under the *1862 Act* was distinct from that which then existed for unincorporated joint stock partnerships. For example, even in that early text, section 38 included relief from liability for past members after one year and required winding up before imposing liability. The *1862 Act* did not merely codify the existing law relating to unlimited liability of partners/co-venturers in a joint stock company, but rather, established three new liability regimes for share-limited, guarantee-limited, and unlimited companies. This in effect set out a new, comprehensive system of corporate organization, with special provisions relating to limited liability, which at that point was still a relatively controversial concept.

The *1862 Act* was adopted nearly verbatim by the legislature of Nova Scotia in 1900 and has remained fundamentally intact ever since. The provisions of the current *NSCA* relating to the liability of shareholders in the event of winding up are unchanged in any material respect.

Although the *NSCA* was based on the *1862 Act*, the two differ significantly with respect to winding up. The *1862 Act* provides a comprehensive regime for the winding up of both solvent and insolvent companies. When the *NSCA* was enacted, however, insolvent winding up was not possible under Nova Scotia law due to the constitutional division of powers in Canada that gives the federal government jurisdiction over

37. *1862 Act, supra* note 24.
38. *Ibid*, s 38.
39. *Ibid*, ss 7–10.

bankruptcy and insolvency,[40] a jurisdiction which has been interpreted broadly.[41] As a result, when the *NSCA* was enacted, it included no provisions relating to winding up. The winding up of solvent companies was dealt with under the Nova Scotia *Companies Winding Up Act*,[42] and corporate insolvencies in Canada were administered under the federal *Winding-up Act*,[43] the predecessor to the federal *Winding Up and Restructuring Act*.[44] At that time, federal bankruptcy and restructuring statutes had not yet been enacted, and there was no general bankruptcy law in force in Canada.[45]

Therefore, aside from the liability provisions set out in section 135, the NSCA does not deal with the procedures or mechanisms of winding up, which must take place under another statute. The statutes most commonly used for this purpose today are the federal *Bankruptcy and Insolvency*

40. The division of powers in the Canadian Constitution allocates jurisdiction between the federal government and the provinces in broad terms, which can result in apparently overlapping jurisdiction. For example, "[b]ankruptcy and [i]nsolvency" fall under the federal legislative authority, while "[p]roperty and [c]ivil [r]ights in the [p]rovince" are within the provincial jurisdiction: *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3, ss 91(21), 92(13), reprinted in RSC 1985, Appendix II, No 5. Canadian courts resolve constitutional challenges to legislation that apparently overlaps with the legislative authority of another level of government by considering the "pith and substance" of the impugned legislation. If the principal purpose or pith and substance of the legislation falls within one of the enumerated classes of subjects stipulated to be within the enacting jurisdiction's constitutional powers, then it will be considered to be valid, whether or not it also incidentally affects a subject matter assigned to the other jurisdiction.

41. In *Sam Lévy & Asssociés v Anzo Mining Inc*, 2001 SCC 92 at para 38, [2001] 3 SCR 978 [*Sam Lévy*], Binnie J, writing for the Supreme Court of Canada, observed:

> It seems to me that the decided cases recognize that the word "Bankruptcy" in s. 91(21) of the *Constitution Act, 1867* must be given a broad scope if it is to accomplish its purpose. Anything less would unnecessarily complicate and undermine the economical and expeditious winding up of the bankrupt's affairs. Creation of a national jurisdiction in bankruptcy would be of little utility if its exercise were continually frustrated by a pinched and narrow construction of the constitutional head of power. The broad scope of authority conferred on Parliament has been passed along to the bankruptcy court in s. 183(1) of the Act, which confers a correspondingly broad jurisdiction.

42. *Companies Winding Up Act*, RSNS, c 82 [*CWUA*].

43. *Winding-up Act*, RSC 1906, c 129, later RSC 1927, c 144. This federal statute was originally enacted as *An Act respecting Insolvent Banks, Insurance Companies, Loan Companies, Building Societies, and Trading Corporations*, SC 1882, c 23 and by 1906 was known as the *Winding up Act*. Its name was changed in 1996 to the *Winding-up and Restructuring Act* pursuant to *An Act to amend, enact and repeal certain laws relating to financial institutions*, SC 1996, c 6, which was assented to on 29 May 1996. For context and further discussion, see John Honsberger, "Bankruptcy Administration in the United States and Canada" (1975) 63:6 Cal L Rev 1515 and Jacob S Ziegel, "Canada's Phased-In Bankruptcy Law Reform" (1996) 70:4 Am Bank LJ 383.

44. *Winding-up and Restructuring Act*, RSC 1985, c W-11 [*WURA*].

45. The Canadian *Bankruptcy and Insolvency Act (BIA)* was first enacted in 1919 and was based on the 1904 United Kingdom statute. The 1919 *BIA* focused on liquidation rather than reorganization. The *CCAA*, *supra* note 14, focused principally on reorganization and was enacted in 1933 in response to the grim economic conditions of the Great Depression.

Act[46] and the *CCAA*, though winding up is also possible under the Nova Scotia *CWUA* and the federal *WURA*.

3. *Scheme, object and intention of section 135*

Section 135 appears in part IV of the *NSCA*, which generally deals with management and administration of Nova Scotia companies. In addition to the liability of members on winding up set out in section 135, Part IV deals with matters such as the calling of meetings, proxies, the appointment of directors and auditors, and compromises and arrangements with creditors.

Section 135, like its predecessor section 38 of the *1862 Act*, establishes a basis for contributory liability when a company is being wound up. It does not provide any framework for winding up or otherwise deal in any way with the mechanisms by which winding up may take place. As discussed above, those matters have always been dealt with in other statutes. However, the object and intention of section 135 is tied closely to the object and intention of section 38 of the *1862 Act* and the related winding up provisions of that act.

In the early development of U.K. corporate law, the courts of the day stated explicitly that the object of the winding-up Acts was to enable the managers of joint-stock companies to wind up the affairs of the company and to compel the shareholders to contribute, but not to alter the legal rights or liabilities of anyone involved in the company.[47] However, the House of Lords subsequently made it clear that section 38 of the *1862 Act* created new rights which did not exist before the passing of the *1862 Act*, and rights and shareholder liabilities which did not exist until there was a winding up. They were also clear that section 38 alone regulated shareholders' liability as contributories.[48]

In the 1915 case of *Carson v. Montreal Trust Co.*,[49] the Nova Scotia Supreme Court specifically discussed the object of winding up and contemplated the analogous nature of the winding up provisions of the *1862 Act* and the federal *Winding-up Act*. The Court said:

> I think the first thing to be considered is what is the object of winding up? The answer to this question is given in clear and direct language by Jessel, M.R., in the case of *In Re The International Pulp and Paper Co.*, 3 Ch. D. 597, at 598. He says:

46. *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*].
47. See *Re Great North of England Railway Company, Ex parte Carrick* (1851), 20 LJ, Ch 670; *Beardshaw v Lord Londesborough* (1851), [1852] 21 LJ, CP 17.
48. *Webb v Whiffin* (1872), LR 5 HL 711.
49. *Carson v Montreal Trust Co* (1915), 23 DLR 690 (NSSC).

> What is the object of winding up? It is to distribute the assets of the company ratably amongst its creditors and enforce contributions against its shareholders or contributories, and make them pay what they are liable to pay with a view to liquidating the affairs of the company. That is the object of the Act. How is that object effected? By stopping all actions or suits brought against the company when the winding up is commenced so as to compel creditors to come in and share ratably.
>
> These remarks were made with reference to the Companies Act, 1862, but they apply with equal force to the Winding-up Act passed by the Parliament of Canada.[50]

As described above, prior to the enactment of the *1844 Act* and the *Joint Stock Companies Winding-Up Act, 1844*, the vast majority of companies in the U.K. were essentially large partnerships with partnership agreements that facilitated the free transfer of shares. The winding up of such partnerships was complex and taxed the resources of the courts, which were ill-equipped to deal with the multitude of transactions and rights created by such business entities. Before the 1844 statutes, the winding up of such companies required a suit in chancery to which all shareholders would have had to be joined, and the mechanism of bill and answer was used to enforce creditors' rights.[51]

The winding up provisions of the *1862 Act* and its predecessors were clearly intended to overcome this difficulty by providing an orderly mechanism for the distribution of failed companies' assets among their creditors, the enforcement of contributory liability, and the enforcement of the rights of contributories among themselves. This introduced a new regime for all business enterprises in the U.K. at that time, as evidenced by the fact that the winding up provisions of the *1862 Act* applied not only to corporations formed under the Act, but also to any organizations with seven or more members, including partnerships and associations.

For companies incorporated under the *1862 Act*, however, the statute also established a new regime of shareholder liability for corporate debts, which Parliament enacted as a result of the extensive public debates of the mid-1800s described above. This regime did not simply continue the traditions of the past, but rather created an entirely new standard of business liability which, in the words of Lord Cairns in *Webb v. Whiffin*, "entirely swept away" the old state of corporate creditor and shareholder relationships.[52]

50. *Ibid* at 691-692.
51. See Shelford, *supra* note 36.
52. *Webb v Whiffin, supra* note 48 at 734.

4. *Section 135 establishes a closed system of shareholder liability*

In the modern NSULC cases, the parent companies argued as a preliminary matter that the eight enumerated qualifications of shareholder liability set out in section 135 were not exclusive, and that further exceptions or limitations of NSULC shareholder liability are possible or permissible under the *NSCA*. They argued that courts interpreting the liability of NSULC shareholders should not be constrained from finding or applying other exceptions from liability, based on the principles of partnership liability or equitable doctrines such as the rule against double proof.

The statutory language of section 135 and the history and context described above, however, do not support the contention that the qualifications of liability set out in section 135 are open to judicial expansion. The plain language used in the section indicates clearly that the enumerated exclusions from general liability are exclusive, and does not leave open the possibility that other claims are available to relieve shareholder liability under the section. If they were, the purpose of the section, which as discussed above was to establish a new and specifically tailored regime of contributory liability, would be undermined.

Although this specific question has never to my knowledge been tested in the courts, based on the context, ordinary meaning, object and purpose of section 135, it is clear that the section contemplates a closed system of liability for members.

Canadian courts always have the jurisdiction to alter prescribed legal outcomes in the interests of equity, but it is unusual for such jurisdiction to be exercised in commercial cases, and such equitable interference is virtually unheard of in the kind of complex commercial arrangements between sophisticated parties that typify the modern NSULC cases.

5. *A shareholder's guarantee does not preclude contributory liability under section 135*

In the modern NSULC cases arguments were also made that a shareholder's guarantee of an NSULC's debt should preclude the NSULC from claiming against its shareholder for contributory liability because of the functional equivalence of the guarantee and the contributory liability. However, numerous distinctions between the liability associated with a contractual guarantee and the liability of an NSULC contributory undermine this argument. There is also no basis for this argument in the statutory language of section 135 or in its history and context, provided there is no ancillary agreement with the debtholder that recourse would be had exclusively to the guarantee, which would engage the exception found at clause 135(f), discussed above.

While liability under a guarantee is contractual in nature, contributory liability is statutory and can only be derogated from in accordance with the provisions of the statute. Clause 135(f) itself establishes the only mechanism by which a contractual guarantee, or any other contract with a creditor, can exclude contributory liability, and is engaged if the guarantee provides explicitly that no recourse will be had to the guarantor in its contributory capacity. Clause 135(f) itself would be superfluous if the existence of a guarantee itself were sufficient to relieve liability pursuant to section 135.

Although in the modern wholly-owned NSULC context, a guarantee claim and a contribution claim will both be paid by the same entity, they are distinct in a number of respects that reinforce the view that they are mutually exclusive and that the existence of one does not and ought not diminish the legitimacy and potency of the other.

An important fundamental distinction is that the guarantee claim and the contribution claim are paid to different creditors. In the guarantee context, the creditor is the indenture trustee, representing the collective interests of the debtholders. In the contribution context, the creditor is the NSULC itself, possibly represented by its liquidator. In all of the recent NSULC cases, the parent companies have resisted the contribution claim by arguing that the liquidator of the NSULC is, in effect, also a representative of the debtholders and that therefore the guarantee claim and the contribution claim are, in substance if not in form, both made by the same creditor. This assertion is important to the bankruptcy law arguments discussed below, but is clearly false in the corporate law context.

It has been clear in the U.K. and Canada since before the *NSCA* was enacted that money owed by contributories is owed to the company and is not an obligation from the contributory to the company's creditors. In *Webb v. Whiffin*, Lord Cairns observed:

> Now, I ask the question, are the contributions to be made by the ex-members the property of the company or are they not? Can it be contended for a moment that they are not? Whose property are they, if they are not the property of the company? Is there any thing in this Act of Parliament which makes them the property of any other person but the company? It appears to me, my Lords, beyond all doubt, that all unpaid calls, whether from members or from ex-members, are part of the property and the assets of the company.[53]

53. *Webb v Whiffin*, *supra* note 48 at 735. Cited with approval in *Barned's Banking Co v Reynolds* (1878), 3 OAR 371 [*Barned's Banking*].

Additionally, it is well settled by courts in the U.K. and Canada that the liability of a contributory under the *1862 Act* commences on the date of the contract under which the contributory became a member of the company. The debt of the contributory exists from the date they subscribe for or purchase their shares, though the amount is contingent and the debt is not payable until the call is made. Since this is the case, on the date the liability commences, the liability of the contributory can only be to the company.[54] In the 1878 case of *Barned's Banking Co. v. Reynolds*, the Ontario Court of Appeal considered this issue in the context of section 38 of the *1862 Act* and stated:

> Being a debt at that time, who was the creditor? Plainly no one but the company, as no one else existed to whom it could be argued the debt accrued. If it was originally a debt to the company, which accrued while the company was solvent, though it did not become payable until the call was made in the winding up proceedings, there has occurred no process of novation by which it has become a debt to the liquidator, nor has the corporate existence of the company ceased, nor any other event happened to render it uncertain to whom the debt is due. The existence of the debt being established, the right to bring an action to recover it follows of course, unless restrained by some statutory bar....The effect of the call is, by sec. 38, to make the debt payable which already existed as a debt.[55]

It is also important to note that in many cases, bondholders are not the only creditors of an NSULC. There may be claims such as those made by employee pension funds, taxation authorities, or other creditors that will also benefit from a successful contribution claim. Although a circumstance may arise where the bondholders are the only creditors of the NSULC, this does not justify disregarding the reasoning of the body of law described above, and cannot support the contention that the corporate personality of the NSULC should be disregarded for that purpose.

In the early Supreme Court of Canada case, *McKenzie v. Kittridge*, the Court considered the application of a statute that imposed joint and several liability on shareholders until properly registered under the Act. The Court observed that such liability was akin to a guarantee, and was distinct from the obligations of the shareholder as contributory.[56]

54. See, e.g., *Ex parte Canwell* (1864), 4 De G J & S 539 at 542 (Ch); *In re China Steamship Company* (1869), LR 7 Eq 240 (Ch); *Williams v Harding* (1866), LR 1 HL 9; all cited with approval in *Barned's Banking*, *supra* note 53.

55. *Barned's Banking*, *supra* note 53 at 387.

56. *McKenzie v Kittridge* (1879), 4 SCR 368.

There are numerous other distinctions between a guarantee claim and a contribution claim that further demonstrate that the two should not be conflated. For example, guarantee claims and contribution claims are each triggered by a distinct event, and thus, one may be payable while the other is not. A guarantee claim will be triggered by the events stipulated in the guarantee itself, which may include various acts of insolvency or non-performance, while the contribution claim exists from the time of the share acquisition and is only payable upon the winding up of the NSULC, and even then only if the company's assets are insufficient to pay its debts, liabilities, and wind up expenses. Additionally, guarantee claims can be made against the guarantor regardless of their status as a shareholder, while contribution claims can only be made against current shareholders or former shareholders within one year of their ceasing to be a shareholder.

On the basis of this analysis, it is plain that a shareholder's guarantee of an NSULC's debt should not preclude its liability as a shareholder under section 135 for any amounts unpaid on the debt in the event of a winding up.

6. *Partnership principles are not applicable to NSULCs contributory liability*

The parent companies in modern NSULC cases have argued that companies under the NSCA evolved from and are therefore analogous to partnerships and that the provisions of section 135 are essentially a codification of the equitable doctrine of contribution, which provides that a debtor who discharges a debt owed severally with others is entitled to the payment of proportionate contribution from his co-debtors.[57]

57. See *Abakhan v Halpen*, 2008 BCCA 29, [2008] 7 WWR 510 discussing the doctrine as codified in section 34 of the British Columbia *Law and Equity Act*, RSBC 1996, c 253. This provision is similar in content to section 43(7) of the Nova Scotia *Judicature Act*, RSNS 1989, c 240, which provides:

> Every person who, being surety for the debt or duty of another or being liable with another for any debt or duty, pays such debt or performs such duty, shall be entitled to have assigned to him, or to a trustee for him, every judgment, specialty or other security which is held by the creditor in respect of such debt or duty, whether such judgment, specialty or other security is or is not deemed at law to be satisfied by the payment of the debt or performance of the duty, and such person shall be entitled to stand in the place of the creditor and to use all the remedies and, if need be, and upon a proper indemnity, use the name of the creditor in any proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, as the case may be, indemnification for the advances made and the loss sustained by the person who has so paid such debt or performed such duty, and such payment or performance so made by such surety shall not be a defence to such proceeding by him, provided always, that no co-surety, co-contractor or co-debtor shall be entitled to recover from any other co-surety, co-contractor or co-debtor, by the means aforesaid, more than the just proportion to which, as between those parties themselves, such last mentioned person is justly liable.

Although it is historically accurate to observe that corporate law in England evolved from the law that then applied to large commercial partnerships, it is important to note that at the time of the enactment of the *1862 Act* in the U.K., as discussed above, corporations were considered a new and distinct form of business enterprise and they were approached as such by the courts of the day. In *Webb v. Whiffin*, Lord Cairns stated:

> It was always the habit in ordinary partnerships, and it was the habit in previous Acts, or in almost all previous Acts of Parliament, to constitute more or less of a direct relation between the creditor and the debtor, between the creditor and the particular individual shareholder in the company....But by the Act of 1862 that state of things is entirely swept away.[58]

Therefore, the argument that the liability of a member of a Nova Scotia company is akin to that of a partner is an assertion that is only true at the most superficial level: the liability in both cases may be described as "unlimited." However, this analogy does not withstand deeper consideration. It is clear that the nature of a partner's liability and a shareholder's liability are very different. The persons to whom the resultant debt is owed are different, the circumstances under which the obligation to pay is triggered are different, and a further important distinction is that the obligation of a contributory can be unilaterally terminated by the disposition of shares.

This is uncontroversial and has consistently been recognized by the U.K. courts. In *Burgess's Case*, the U.K. Chancery Court observed:

> It has been decided by a series of decisions in the House of Lords, commencing with *Webb v. Whiffin*, that the 38th section of the Companies Act is not to be read otherwise than literally, and it is not to be read with reference to the previous liabilities of the shareholders or by analogy to the law of partnership whether of a limited or unlimited character, but it is to be read as imposing new liabilities on the members of the company—liabilities imposed and defined by that section.[59]

The distinctions between an NSULC and a partnership therefore are and always have been significant. Clearly, as an incorporated entity, an NSULC has perpetual succession, as well as characteristics of personality such as the ability to contract, own property, sue and be sued, and so forth that are not possessed by a partnership. The shareholders of an NSULC are not fiduciaries of one another as partners are. Furthermore, although an unlimited liability company does not shield its shareholders from the

58. *Webb v Whiffin*, *supra* note 48 at 734.

59. *Burgess's Case* (1880), 15 Ch D 507 at 511 (Ch).

company's liabilities, it benefits from asset partitioning such that the company is protected from its shareholders' liabilities in a manner not possible for a partnership.[60]

It is clear, therefore, that although the legal relationships of NSULC shareholders evolved from the concepts of partnership, and the liability of both NSULC shareholders and partners are "unlimited," the regimes are entirely distinct from one another and any analogy between them should be undertaken cautiously.

III. *Winding up under the* NSCA

In modern NSULC cases, the question has often arisen as to when, specifically, in the convoluted procedural process of a large-scale international insolvency case, the winding up of the NSULC subsidiary has commenced. A great deal can hang on this question, particularly if the quantum of the NSULC's assets or liabilities is in a state of flux, or where issues arise relating to claim filing deadlines. The *NSCA*, however, is silent on this question. Section 135 itself states only that members are liable "[i]n the event of a company being wound up." A fundamental issue to be determined for the purpose of any claim for contribution, therefore, is when in the history of a company's existence, or upon the occurrence of what event, the liability imposed upon members by section 135 is engaged.

This question has not been considered by Nova Scotia courts, and there are no Nova Scotia cases directly, or even tangentially, on point. The *NSCA* provides no definition for "winding up," and does not stipulate any particular process for winding up. This leaves open the question of when and under what circumstances a company is "being wound up" for the purposes of section 135.

Below, I examine this question in detail and demonstrate that winding up is a process that can be commenced in many ways. Winding up is not a specific event; rather, winding up for insolvent companies commences upon public notice of the winding up. I also argue that winding up for the purpose of the *NSCA* is not limited to proceedings under any specific statute, need not take place in the jurisdiction of incorporation, and can be commenced by a U.S. Chapter 11 filing.

1. *Winding up is a process, not a specific event*

"Winding up" is an expression that is used in many legal contexts. It generally refers to the process of orderly, ratable distribution of the assets

60. For a discussion of the role of asset partitioning in organization law, see Henry Hansmann & Reinier Kraakman, "Organizational Law as Asset Partitioning" (2000) 44:46 European Economic Rev 807.

of an entity among its creditors following the discontinuance of its normal business and prior to its ultimate legal termination. Partnerships, trusts, bankrupt estates and corporations may all be said to "wind up."[61]

Winding up, as used in section 135, is a term that is general in nature, and does not refer to a specific legal procedure under a specific legislative enactment. The *NSCA* clearly contemplates a number of different avenues by which a winding up can take place, with processes that vary depending on whether the company is solvent, and whether it is winding up voluntarily.

The use of the term winding up is gradually falling into disuse in Canada, with most modern statutes using the more precise language of liquidation and distribution instead. In some Canadian provincial incorporation statutes, winding up is a term that is still used to specifically refer to the process of voluntary and involuntary winding up of solvent companies pursuant to the provincial incorporation statute.[62] Under many other provincial incorporation statutes however, the use of the term winding up has been discontinued, with reference made instead to the processes of liquidation and dissolution.[63]

The *NSCA* consistently refers to the winding up of a company as a process, rather than a specific point in time. In clause 135(a), for example, "the commencement of [a] winding up" is referred to as the point in time relevant to the determination of liability for a past member, but clearly contemplates that the winding up will continue for some time after its commencement. Similarly, the opening sentence of section 135 refers to the "expenses of the winding up,"[64] which cannot be known until some time later, implying that winding up is a process that takes place over a period of time.

This interpretation of winding up is clearly consistent with the practical requirements of businesspersons and their legal advisers seeking to wind up a company. It is an event that by its nature cannot happen instantaneously. Therefore, a winding up will commence at one point in time and conclude at another, and is a process that will take some time to occur. Throughout this period, the company is "being wound up."

61. Court discussions have reflected the general nature of the term. For example, in the Nova Scotia case of *Re Maple Leaf Fruit Co*, [1949] 3 DLR 426 at 427 (NSSC) the Court referred to a winding up under the federal *Bankruptcy and Insolvency Act*, observing that "[i]n the *winding-up of the bankrupt estate*, the trustee was ready to pay to all persons whose claims were approved a dividend of 20%" [emphasis added].

62. See, e.g., Part XVI of the Ontario *Business Corporations Act*, RSO 1990, c B-16.

63. For example, the British Columbia *Business Corporations Act*, SBC 2002, c 57 and the Alberta *Business Corporations Act*, RSA 2000, c B-9.

64. *NSCA*, *supra* note 1, ss 135, (a).

Contributories, such as the shareholders of an NSULC, are liable to contribute to the company "an amount sufficient for payment of its debts and liabilities and the costs, charges, and expenses of the winding up."[65] This is an amount that is unlikely to be known at the commencement of the winding up, but rather is a liability that is of indeterminate amount until the assets and liabilities of the company and the costs of its winding up are settled. This amount is not fixed at the commencement of the winding up, but is likely to increase over the course of the winding up. Where there is more than one contributory, then the determination of the rights of the contributories as among themselves also cannot be known at the commencement of a winding up. The determination of the liability of the contributories of a company is a fundamental task that must be completed during the winding up process.

The purpose of winding up of an insolvent company is to stop further claims and compel creditors to come in and share ratably, and winding up is a process that is defined and understood by its purpose and effect, rather than by any specific statutory procedural requirements.

In a number of decisions, principally in relation to tax law, Canadian courts have been willing to construe winding up quite broadly, under the "substance over form" doctrine.

In *Merritt v. MNR*, the Exchequer Court considered the appeal of a tax ruling.[66] The appellant was a shareholder of a company that had disposed of all its assets and undertakings as a going concern, including its undistributed profits. The consideration to the shareholder was given as cash and shares in the acquiring company. The tax authorities assessed the shareholder for income tax purposes for her portion of the undistributed income that the company had on hand when its property was distributed on the discontinuance of its business, and she challenged this characterization.

The Court considered, inter alia, whether the company had engaged in a "winding up, discontinuance or reorganization" of its business, and expressed the view that there was probably a winding up but that in any event there was a discontinuance of business in a real and commercial sense and that it was immaterial whether that was brought about by a sale or amalgamation. In discussing the preliminary issue of whether there had been a winding up, the Court observed:

> I entertain no difficulty over the construction to be given the words "winding up, discontinuance or reorganization," as used in s. 19 (1) of the

65. *Ibid*, s 135.
66. *Merritt v MNR*, [1941] Ex CR 175 [*Merritt, Exch C*], rev'd on other grounds [1942] SCR 269 [*Merritt, SCC*].

> Act. In construing those words we must look at the substance and form of what was done here. In the case *In re South African Supply and Cold Storage Company*, Buckley J. had to consider whether or not there had been a winding-up "for the purpose of reconstruction or amalgamation," and he said
>
> > "that neither the word reconstruction nor the word amalgamation has any definite legal meaning. Each is a commercial and not a legal term, and, even as a commercial term has no exact definite meaning."
>
> I think that would be equally true of the words of s. 19 (1) which I have just mentioned. There was no "winding-up" of the Security Company by a liquidator, but there was in fact, I think, a winding up of the business of that company and I think the word "winding-up" may be given that meaning here, although I need not definitely so decide....There is, therefore, no necessity for attempting any precise definition of the words "winding up, discontinuance or reorganization." What was done with the business of the Security Company fell somewhere within the meaning and spirit of those words.[67]

The Supreme Court of Canada reversed the Exchequer Court's decision, but on other grounds. On the winding up issue, the Supreme Court of Canada stated:

> It was first contended on behalf of the respondent that, within the meaning of subsection 1 of section 19 of the *Income War Tax Act* as above enacted, there was no distribution of the property of the Loan Company and no winding up, discontinuance or reorganization of its business. The learned President decided against this contention and on that point I agree with his statement of the facts and with his conclusions and have nothing to add.[68]

The Supreme Court of Canada and the Tax Court of Canada have also often characterized surplus stripping transactions as winding up.[69]

Although these are tax cases, and as such take a liberal, broad and purposive approach to statutory construction,[70] they demonstrate that the term "winding up" is not a term of art in Canadian law, but rather refers

67. *Merritt, Exch C, supra* note 66 at 181-182.

68. *Merritt, SCC, supra* note 66 at 274.

69. *Smythe v MNR*, [1970] SCR 64, *Geransky v The Queen*, [2001] DTC 243 (TCC); *RMM Canadian Enterprises Inc v The Queen* (1997), 97 DTC 302 (TCC). These cases typically involved a corporation with a substantial surplus and the use of another corporation as a means of getting the surplus into the hands of the shareholders.

70. For a summary of the law in this regard, see *Glaxo Wellcome Inc v The Queen* (1996), 96 DTC 1159 (TCC), aff'd (1998), DTC 6638 (FCA), leave to appeal to SCC refused, 26834 (10 December 1998).

generally to a process of concluding the business affairs of a corporation and distributing its assets ratably among those entitled to them.

2. *Winding up for insolvent companies commences upon public notice of the winding up*

Historically, a compulsory winding up was said to date from the presentation of the petition (typically a petition to the court by a creditor or contributory), and a voluntary winding up was said to commence from the date of the resolution authorizing it.

Nova Scotia's *CWUA*, which, as discussed above, applies only to solvent companies, provides that:

> A winding up shall be deemed to commence (a) in case of the passage of a resolution authorizing the winding up, at the time of the passing of such resolution; [or] (b) in case of the making of an order directing the winding up, from the making of such order.[71]

The federal *WURA* stipulates that:

> The winding-up of the business of a company shall be deemed to commence at the time of the service of the notice of presentation of the petition for winding up.[72]

Where a resolution for a voluntary winding up is followed by a compulsory order, the voluntary winding up is superseded by the compulsory winding up, and the winding up will date from the service of notice of presentation of the petition, even though this is later than the commencement of the voluntary winding up.[73]

These provisions are consistent with the objects and purposes of winding up legislation, which relate principally to the protection of the interests of the creditors and contributories of the company. With respect to the voluntary winding up of a solvent company, the date upon which the board of directors has resolved to wind up the company is appropriate, as it signifies the date upon which the company has determined to discontinue its business and wind up its affairs. Though the creditors of the company have not yet been notified of the winding up, they are not prejudiced because they will be paid in full in the course of the winding up process. The considerations are different with respect to an insolvent company, where at least some creditors will not be paid in full, and must be given

71. *CWUA*, *supra* note 42, s 7.
72. *WURA*, *supra* note 44, s 5.
73. *Re Taurine Co* (1883), 25 Ch D 118 (CA), Cotton LJ, dissenting.

fair notice that the company is commencing to wind up and that it is no longer operating in the ordinary course.

Throughout the history of company law, courts have discussed the commencement of winding up with reference to the specific provisions of the relevant statute, but also in terms of the policy rationale for the choice of a particular date. Winding up statutes all specify when a winding up is deemed to commence, but courts have indicated flexibility in this regard. For example, winding up statutes based on old U.K. Acts, including those in Canada, typically provide that a winding up will commence upon the service of the petition, but courts have held that the practical commencement of the winding up is in fact upon the notice or advertisement of the petition, and not the date of filing with the court. The rationale for this is that it is on the date of the advertisement that there is "notice to all the world" that the winding up could occur and creditors should no longer be entitled to proceed as usual in their business dealings with the company. In *Emmerson's Case*, the Master of Rolls held that:

> [T]he first appearance of the advertisement determines *ipso facto* the position of all the parties, and that it must be treated as notice to all the world...from the day on which the advertisement appears all parties are bound...[but] up to that time it is open to the parties to deal exactly as if the company were not about to be wound up, assuming, of course, the transaction to be perfectly *bona fide* in the strictest sense of the term.[74]

It is important to note that the notice of the petition serves only to advise interested parties that a hearing will be scheduled to determine whether the petition for winding up will be granted or denied—the actual winding up of the company is not inevitable on the date of the notice, but rather is a potentiality. Nevertheless, creditors are expected to heed this potential outcome and if they choose to continue to deal with the company, they are presumed to understand the consequences of doing so.[75]

3. *Winding up for the purpose of the* NSCA *is not limited to proceedings under any specific statute*

As discussed above, "winding up" is not a term of art, but rather is a process that is understood by its substance. As such, winding up of an *NSCA* company does not need to take place under a statute that uses the language of winding up specifically and section 135 of the *NSCA* does

74. *Emmerson's Case* (1866), LR 2 Eq 231 at 233 (Ch).

75. For example, see *Roman Catholic Episcopal Corp of the Diocese of London v Home Bank of Canada (Liquidator of)* (1925), 7 CBR 223 (Ont SC), holding that the date of commencement of the winding up was the date of the notice of the presentation of the petition, and not the earlier date upon which the bank had closed its doors, nor the later date upon which the petition was granted.

not require a company to be wound up under the Nova Scotia *CWUA*, the federal *WURA*, or any other particular statute. The *NSCA* itself contains nothing to indicate that it refers only to proceedings under the *CWUA* or the *WURA*, and such a limitation would be inconsistent with the context and legislative intent of the Act.

It is evident that section 135 contemplates both solvent and insolvent companies winding up, but that contributory liability for a company's debts is an issue that will only be relevant in the winding up of an insolvent company. As discussed above, the Canadian Constitution mandates that matters of bankruptcy and insolvency fall within the exclusive legislative authority of the federal government, and therefore cannot be addressed through provincial legislation.[76] This clearly means that *NSCA* companies cannot be required to wind up under the *CWUA*, and winding up in other statutes must have been contemplated from the outset.

In the past, it has been suggested that because calls on shareholders to contribute to the assets of the company are considered property of the company, any company should be considered solvent if it has contributories with sufficient assets to pay its liabilities. However, the courts have not supported this view. In a case from British Columbia, which at the time had a system of corporate law very similar to Nova Scotia's, the British Columbia Supreme Court considered an application from an insolvent B.C. company that sought to wind up voluntarily under the B.C. *Companies Act*, with the principal member undertaking to pay all creditors. The Court declined to allow such a winding up, and stated that insolvent B.C. companies are obliged to wind up either by way of a petition in bankruptcy or under the federal *WURA*. The Court observed that:

> Over many years it has been the law in this Province that a company cannot resolve to voluntarily wind itself up when it is insolvent: *Re Western Hemlock Products Ltd.* Where a provincially incorporated company is insolvent, the appropriate procedure to distribute its assets is either by way of a petition in bankruptcy or a petition under the Federal *Winding-Up Act*, R.S.C. 1970, c. W-10. *Re: Cramp Steel Company (Ltd.); Re B.C. Ironworks Co. Ltd.*
>
> The main reason for this is because provincial Companies Acts do not contain any scheme whereby the priority of creditors is established. Section 91(21) of the *British North America Act, 1867* gives the federal Parliament exclusive jurisdiction to legislate on "Bankruptcy and Insolvency" and so determine the method of paying creditors of insolvent companies. Provincial statutes relating to insolvency where they conflict with federal legislation are *ultra vires* the power of a

76. *Constitution Act, 1867*, *supra* note 40, s 91(21).

provincial legislature: *Re Wentworth Insurance Co.*[77]

Though the *WURA* is the only federal statute that uses the specific nomenclature of "winding up," it is unlikely and impracticable that a court in Nova Scotia would insist upon its use for the purpose of winding up a Nova Scotia company. Today, the *BIA* and the *CCAA* are the principal bankruptcy and restructuring statutes used by Canadian business corporations. The *WURA* has become antiquated since it was enacted in the 1800s and has been modernized only with respect to financial institutions and insurance companies, which are obliged to use it because they are specifically excluded from both the *BIA* and *CCAA*.[78] Corporations incorporated under the *Canada Business Corporations Act* are specifically excluded from *WURA*,[79] and in recent years, there have been credible calls for *WURA*'s application to be limited exclusively to financial institutions.[80] It is notable that in the excerpt from *Tober Entreprises* above, the British Columbia Court recognized that the appropriate procedure for winding up the insolvent B.C. company was either bankruptcy (under the *BIA*) or a petition under the *WURA*.

Circumstances may also arise where winding up under the *WURA* is impossible. For example, the *BIA* provides that once an assignment has been filed or an application for bankruptcy has been made under the *BIA* in respect of a corporation, the *WURA* no longer applies to it, and any proceedings commenced under the *WURA* are deemed to abate.[81] Therefore, if a Nova Scotia company has made an assignment or filed an application under the *BIA*, it is no longer possible for it to obtain a winding

77. *Re Tober Enterprises Ltd* (1980), 109 DLR (3d) 184 at 186 (BCSC) [*Tober Enterprises*] [citations omitted].

78. Many Canadian corporations could initiate winding up proceedings under the federal *Winding Up and Restructuring Act* but rarely do so (except where the *WURA* itself requires it or they are unable to proceed under the more modern *BIA* and *CCAA*) because the Act is badly dated and expensive to use. See Ziegel, *supra* note 43.

79. For example, see the *Canada Business Corporations Act*, RSC 1985, c C-44, s 3(3)(b). See also *DX Ashe Holdings Ltd v Money's Mushrooms Ltd*, 2003 BCSC 1146, 126 ACWS (3d) 55, clarifying that this exclusion prevails over the more general wording of the *WURA*, which provides that it applies "to all corporations incorporated by or under the authority of an Act of Parliament."

80. See Insolvency Institute of Canada, "The Winding-up and Restructuring Act: Recommendations for Reform," (IIC, 14 June 2000), online: <www.insolvency.ca/en/iicresources/IIC_Recommendations_Reform_WURA_2000.pdf>.

81. See *BIA*, *supra* note 46, s 213:

> If an application for a bankruptcy order or an assignment has been filed under this Act in respect of a corporation, the *Winding-up and Restructuring Act* does not extend or apply to that corporation, despite anything contained in that Act, and any proceedings that are instituted under the *Winding-up and Restructuring Act* in respect of that corporation before the application or assignment is filed under this Act shall abate subject to any disposition of the costs of those proceedings to be made in the bankruptcy proceedings that the justice of the case may require.

up under the *WURA*. In such a case, the company could be dissolved and its assets distributed under the *BIA*, but it could not also be wound up under the *WURA*. It would be an absurd result and clearly contrary to the context and intention of the *NSCA* if a company dissolved under the *BIA* was considered not to have been wound up and never able to wind up. Therefore, winding up under statutes other than the *WURA* must have been contemplated by the legislature.

It also should be observed that winding up is a process that is separate and distinct from bankruptcy, and the filing of an assignment under the *BIA* or any other bankruptcy statute is not necessary to commence a winding up. Though the purposes and the ultimate results of an insolvent winding up and a bankruptcy proceeding are similar,[82] they are distinct, the principal difference being that in a bankruptcy, the property of the corporation vests in the bankruptcy trustee, while in a winding up, this does not occur and the company continues to own its property. In several cases, courts have specifically distinguished winding up from bankruptcy, or decided cases where winding up is sought as an alternative to bankruptcy proceedings, principally due to the distinction between the role of the trustee in bankruptcy and the role of the liquidator in a winding up, which is that of an agent or quasi-trustee.

Traditionally, in a winding up the liquidator will ostensibly act in the name of the corporation being wound up and will exercise the powers of the corporation's board of directors without actually acquiring an interest in any of the corporation's property. By contrast, the authority of a trustee in bankruptcy to deal with the property of the bankrupt is derived from the fact that the bankrupt's property vests in the trustee by operation of law. In the early case of *Re Commonwealth Trust Co.*, the British Columbia Supreme Court discussed this distinction in detail, observing:[83]

> *Partington v. Cushing* deals with the difference between a proceeding in bankruptcy and a winding-up under the Act. As to this I cite from the judgment of Barker J.…as follows:
>
> > There is in reality but little analogy between a winding-up of a

82. Courts have recognized that insolvent winding up proceedings and bankruptcy proceedings, while distinct, share the same purposes and serve the same interests. In *Sam Lévy*, *supra* note 41 at para 27, Binnie J, writing for the Supreme Court of Canada, applied the reasoning from a winding up case to a bankruptcy case, observing:

> Stewart was, as stated, a winding-up case, but the legislative policy in favour of "single control" applies as well to bankruptcy. There is the same public interest in the expeditious, efficient and economical clean-up of the aftermath of a financial collapse. Section 188(1) ensures that orders made by a bankruptcy court sitting in one province can and will be enforced across the country.

83. *Re Commonwealth Trust Co* (1971), 20 DLR (3d) 170 at 175 (BCSC) [citations omitted].

> company and a bankruptcy. The property of a bankrupt vests by operation of law in his assignee; the title as well as the control is completely divested from the one and vested in the other. Nothing of the kind takes place in the case of a winding-up. The title to the company's property remains in the company; the control and management and disposal of it is taken from the directors and placed in the liquidators, who simply are officers of the Court—receivers and managers acting under the direction of the Court for the purpose of closing up the company's business, realizing its assets and making a legal distribution of them among the creditors and shareholders. See *Gooch's Case; In re Anglo-Moravian Railway Company*. Every statutory power conferred upon the liquidators is given with a view to the speedy, inexpensive and effectual accomplishment of this object.
>
> This brings me directly to the problem in the present case: the divergence in view as to the duties of inspectors in a winding-up. The most important consideration to bear in mind is that in a winding-up the liquidator, unlike a trustee in bankruptcy, has sole responsibility, acting under the statute and on direction of the Court, where necessary, to conduct the affairs of the company to achieve final liquidation.

In the Nova Scotia case of *Crowther v. Canadian Mercantile Insurance Co.*, the Supreme Court held that the Crown was at liberty to pursue its rights against a winding-up company's property and was therefore entitled to priority, because "[i]t was a case of winding up, not of bankruptcy. The property had not passed out of the Company."[84]

These distinctions demonstrate that winding up is a process that does not require bankruptcy, but is a distinct procedure, and that the filing of an assignment under the *BIA* is therefore not necessary to commence a winding up.

For these reasons, it is clear that section 135 of the *NSCA* does not require that winding up take place under the *CWUA*, the *WURA*, the *BIA* or any other particular statute. This is supported by the context of the Act, its object and purpose, and the parliamentary intent behind it, as well as the case law canvassed above.

4. *Winding up need not take place in the jurisdiction of incorporation*

Although foreign orders with respect to the capacity, powers and status of a Nova Scotia company or directly dealing with the distribution of property situate in Nova Scotia are outside the jurisdiction of a foreign court, the commencement of a winding up can take place anywhere in the world.

84. *Crowther v Canadian Mercantile Insurance Co* (1958), 15 DLR (2d) 204 at 208 (NSSC).

In Canada, winding up is not and never was understood to be a process that must be commenced or otherwise take place in the jurisdiction of incorporation. Canadian courts have long been willing to commence the winding up of foreign corporations, and Canadian bankruptcy and winding up statutes clearly contemplate the recognition of foreign proceedings. Both the *BIA* and the *CCAA* contain explicit provisions for the recognition of foreign proceedings,[85] and the federal *WURA* specifically states that it applies to all corporations incorporated by Parliament and the provinces, as well as "incorporated trading companies doing business in Canada, wherever incorporated."[86] This provision was enacted in the late 1880s and was held by the Supreme Court of Canada in 1890 to be *intra vires* Parliament.[87]

From these earliest cases, it was clear that a winding up could be initiated in a foreign jurisdiction and could take place in multiple jurisdictions simultaneously. In the 1890 case of *Allen v. Hanson*, Ritchie C.J., speaking for the majority of the Supreme Court of Canada, made several observations relating to the constitutionality of the federal *WURA*'s application to foreign companies, the practical necessity of such provisions, and the jurisdictional limitations of winding up orders made with respect to foreign corporations:

> [S]urely it must be said that the Dominion Parliament can in its right to legislate in reference to bankruptcy and insolvency, legislate respecting insolvent companies doing business in Canada, and with reference to property of such companies within its jurisdiction.
>
> Inasmuch then as the Dominion statute declares that the winding-up act now applies to all companies which are doing business in Canada and no matter where incorporated, *there can be no doubt of the intention of Parliament to apply the winding-up act to foreign as well as domestic incorporated companies*, and as I think such an enactment is within the legislative power of the Dominion Parliament, and it being admitted that this company was carrying on its business, and held valuable lands in Canada, and was insolvent, and as the provisions of the English Companies Act, 1862, are held to apply to foreign companies carrying on business in England and are worked out as nearly as may be, or left not worked out as the exigencies of the case dealt with require; and inasmuch as the greater part of the assets of this company would seem to be in Canada, there is the more reason why the property within the territorial limits of the jurisdiction of the courts of Canada should be dealt with under the provisions of the Canadian act; in fact it is difficult to

85. See *BIA*, *supra* note 46, ss 267-284 and *CCAA*, *supra* note 14, ss 46-51.
86. *WURA*, *supra* note 44, s 6.
87. *Allen v Hanson* (1890), 18 SCR 667.

> see how such property could be dealt with by the English liquidators; and inasmuch as in this case it appears the liquidators under the English Act are acting in concert with the liquidators under the Canadian act, I can see no reason for supposing that any conflict can possibly arise whereby this stockholder can be in any way damnified; on the contrary, it appears to me that this is the most satisfactory way by which the company can be wound up and its assets realized for the benefit of the company and all the parties interested.[88]

The Supreme Court of Canada had no difficulty reaching the conclusion that the inability of Canadian courts to fully exercise all of the powers under the *WURA* with respect to foreign corporations was not a barrier to the winding up of foreign companies under the Canadian statute. Patterson J. observed:

> It is true that our courts cannot exercise with regard to an English company the full extent of the powers conferred by our Winding-up Act. For example, they cannot, by the effect of a winding-up order, affect the operations of the company in England, causing it to cease to carry on its business there, as under section 15 the company must do in this country. But the same difficulty was presented when the English courts were asked to make orders to wind up colonial companies, and was held not to affect the jurisdiction. See particularly the observations of Mr. Justice Kay *in re Matheson Brothers* and of Mr. Justice North *in re Commercial Bank of South Australia.*
>
> The fallacy in this particular may perhaps have been contributed to by an idea that an order called a Winding-up order, made in pursuance of an act called a Winding-up Act, must be inoperative if, in its potential effect, it must stop short of winding up or dissolving the company.
>
> The expression usually employed in our statute is "winding up the business of the company," though the phrase "the winding up of the company," is sometimes used, as e g. in section 42 (6). The terms are convertible, and the former readily adapts itself to the operation of the order now in question, which is to wind up the business carried on by the company in Canada, though our courts may be as powerless as the English courts find themselves in dealing with colonial companies, to dissolve the corporation or to administer the assets that are beyond the territorial limits of their jurisdiction.[89]

The Supreme Court's position on permitting foreign companies to be wound up under the *WURA* was consistent with that of the courts of

88. *Ibid* at 672-673 [emphasis added].
89. *Ibid* at 683-684.

England at the time, which regularly ordered the winding up of colonial companies.[90]

Where Canadian courts have refused to grant petitions for foreign companies, it has generally been because such winding up orders have been deemed impractical or otherwise inappropriate in the circumstances of the case. For example, in *Re Halifax Sugar Refinery Co.*, the Nova Scotia Court of Appeal refused to grant a petition in a case where English proceedings were already in progress because it determined that the petitioner, who had already made his claim in the U.K. courts, had little to gain from the ancillary proceeding and that to grant the petition would add only to the costs of the winding up.[91]

5. *Winding up of an NSULC can be commenced by a U.S. Chapter 11 filing*

Based on the foregoing analysis, a filing in a U.S. Chapter 11 claim would be considered to be equivalent to the filing of a petition for winding up if by its terms it serves as a public notice that the liquidation of the NSULC is potentially imminent. From the date of filing, creditors have notice that the affairs of the NSULC will, if the court so orders, be wound up and they are no longer free to deal with the company as if such notice had not occurred.

It would be contrary to the purpose and policy that underlies winding-up legislation for a Canadian court to hold that such a filing was insufficient to commence a winding up, because to do so would entitle the company's creditors to continue to deal with the company in the normal course, after it has taken an explicit and legally effectual action to wind up.

It should be noted that although a Chapter 11 filing would be sufficient to commence a winding up of an NSULC for the purposes of the *NSCA*, Canadian courts have occasionally been unwilling to recognize the orders of U.S. bankruptcy courts respecting Canadian subsidiaries, particularly where the Canadian subsidiary is solvent. For example, in *Re Singer Sewing Machine Co. of Canada Ltd.*[92] the Alberta Registrar refused to recognize the U.S. Chapter 11 proceedings in respect of a Canadian affiliate on the basis that the Canadian company was not insolvent and the U.S. bankruptcy court lacked jurisdiction. The approach in *Singer* has not been followed, however, and in the same year in *Re Babcock & Wilcox*

90. See *In re Union Bank of Calcutta* (1850), 3 De G & Sm 253 (Ch); *In re Commercial Bank of India* (1868), LR 6 Eq 517 (Ch); *In re Commercial Bank of South Australia* (1886), 33 Ch D 174 (Ch); *In re Matheson Brothers Ltd* (1884), 27 Ch D 225 (Ch). See also *Merchants' Bank of Halifax v Gillespie* (1885), 10 SCR 312.

91. *Re Halifax Sugar Refinery Co Ltd* (1889), 22 NSR 71 (SC).

92. *Re Singer Sewing Machine Co of Canada Ltd*, 2000 ABQB 116, [2000] 5 WWR 598 [*Singer*].

Canada Ltd., the Ontario court recognized a Chapter 11 proceeding of a U.S. parent of a solvent Canadian corporation as a foreign proceeding for the purposes of the *CCAA*.[93] Any uncertainty in this regard has been largely resolved by amendments to the *BIA* and *CCAA* proclaimed in 2009, which provide comprehensively for the recognition of foreign insolvency proceedings under both statutes and are based on the UNCITRAL Model Law on Cross-Border Insolvency, resulting in provisions quite similar to Chapter 15 of the U.S. Bankruptcy Code.

IV. *Bankruptcy law issues*

In addition to the corporate law issues discussed above, the parent companies and the parent company creditors in the recent NSULC cases have also argued that the guarantee claims and contribution claims cannot both be allowed because they are duplicative under bankruptcy law, and are therefore prohibited by the rule against double proof in Canada and the single satisfaction rule in the U.S.

In the double proof and single satisfaction rules, a tension arises between two foundational principles of law: respect for the existence of separate corporate entities on one hand, and the overarching ethic of pari passu distribution of assets on the other. These venerable legal principles are inevitably argued vociferously in cases such as these, but one must give way to the other for the duplication arguments to be resolved. If distinct corporate personality is to be recognized, then clearly obligations owed to two distinct corporations must be considered separate debts and not duplicative; but if the principle of pari passu distribution is to be given meaning in the modern business context, the substance of the transaction must be examined—and courts have recognized that the mere interposition of a corporate entity in a transaction that otherwise would be duplicative cannot be determinative of the application of the doctrine.

1. *Jurisdiction: Does U.S. or Canadian bankruptcy law apply?*

A primary question to be considered is the jurisdiction whose laws will govern the question of duplicativeness. Both Canadian and U.S. bankruptcy laws prohibit duplicative claims in order to ensure pari passu distribution and the fair treatment of creditors, but the nature of these prohibitions and the legal tests employed are different in each country, which magnifies the importance of the jurisdiction question.

In the modern NSULC cases, the most significant bankruptcies have been those of the U.S. parent companies, because that has been the locus of the bulk of the assets. The related bankruptcies and restructurings of

93. *Re Babcock & Wilcox Canada Ltd* (2000), 5 BLR (3d) 75 (Ont Sup Ct).

various subsidiary companies have been less important to the vital issue of asset distribution among the creditors, and the bankruptcy or restructuring of some subsidiary entities has not been necessary at all. As described above, however, in order for a contribution claim to be made by an NSULC, it must have commenced winding up.

Where the NSULC is wound up in Canada, or proceedings under the *BIA* or *CCAA* are commenced, Canadian law will apply to the winding up of the NSULC, and the law of the jurisdiction governing the parent company's bankruptcy—typically the United States—will apply to the parent company. Bankruptcy courts in both countries are accustomed to international bankruptcies and the principles of international comity will generally incline them to show deference and respect for one another's orders and determinations.[94] However, where a guarantee claim and a contribution claim are made in the modern NSULC context, the question of whether the claims are duplicative will be determined first under the principles of U.S. bankruptcy law, because both claims are against the assets of the U.S. parent: the guarantee claim will be made by the indenture trustees and the contribution claim will be asserted by the representative of the NSULC, both directly against the estate of the parent. If the NSULC is successful in its claims and is being wound up under Canadian law, then Canadian law will be relevant to the distribution of the assets it recovers from its parent company.

This provides the potential opportunity for the argument against double proof and single satisfaction to be made in both jurisdictions, but in most cases, the primary determination of the U.S. bankruptcy courts will be pivotal. This is because not only must the determination under U.S. law occur before the application of Canadian law is relevant, but the arguments that the claims are duplicative will principally be made by the parent company's other creditors, who will naturally only be interested in the U.S. bankruptcy proceedings. Any other creditors that the NSULC may have will stand to benefit from the contribution claim along with the noteholders and so would not be inclined to argue against the claim under Canadian law. The application of the Canadian rule against double proof, therefore, will be secondary to the application of the U.S. single satisfaction rule in the context of most modern NSULC structures.

94. For discussion see *Holt Cargo Systems Inc v ABC Containerline NV (Trustees of)*, 2001 SCC 90 at para 68, [2001] 3 SCR 907.

2. *U.S. Law: The single satisfaction rule and the doctrine of equitable consolidation*

It is a general rule of law in the United States that a claimant can only recover once on account of any claim. This principle is known as the rule against duplicative claims, or the "single satisfaction" rule. There are many circumstances, however, in which multiple claims will be allowed in respect of similar or related obligations.

As a preliminary observation, it is clear that a single creditor can hold multiple debtors liable for the same obligation pursuant to transactions involving guarantees or joint and several liability. Generally, in such cases the creditors' claims can be asserted in their full amount against each debtor and not reduced by amounts received from other debtors, until the creditor is paid in full, though it is clear that no creditor may recover more than the full amount owed to that creditor.[95]

U.S. courts will also usually allow claims that have been partially paid by other means to be claimed in their full amount against a bankrupt estate, provided the creditor does not recover more than 100 per cent, allowing a creditor to assert multiple claims and obtain closer to 100 per cent recovery than it would otherwise receive. In the 1935 *Ivanhoe Building* case, for example, the Supreme Court allowed a creditor who had already foreclosed on third-party collateral to assert the full amount of its claim against a debtor.[96] The Court allowed the claim to be made in its full amount in order to preserve the amount that the creditor would be entitled to in the distribution from the debtor's estate, with the caveat that the creditor could not receive more than 100 per cent recovery on its claim. *Ivanhoe Building* has been followed in numerous other U.S. cases to allow the holders of guaranteed debts to assert the full value of their claims upon the bankruptcy of the principal debtor despite having recovered partial payment from guarantors.[97]

The modern NSULC cases, however, involve multiple claims against a single debtor's estate. The holders of the guarantee claims and the contribution claims have taken the position that because each claim involves a separate creditor (the indenture trustee and the NSULC or its liquidator, respectively), the claims should be recognized as distinct and allowable. The parent companies and their other creditors have resisted this characterization, and argued instead that both claims are for the benefit of the same creditor, in substance though not in form.

95. See, e.g., *In re Gessin*, 668 F (2d) 1105 (9th Cir 1982).
96. *Ivanhoe Building & Loan Ass'n of Newark, NJ v Orr*, 295 US 243 (1935) [*Ivanhoe Building*].
97. See, e.g., *In re National Energy & Gas Transmission, Inc*, 492 F (3d) 297 (4th Cir 2007).

U.S. courts have allowed claims asserted by separate creditors arising from a single transaction. In *Delta Air Lines*, for example, the claims made by two groups of creditors in relation to the same underlying facts were found not duplicative because each claim arose pursuant to a separate legal obligation and the total recovery would not exceed 100 per cent.[98] The Court stated that such claims will be allowed in full against the debtor where they "arise under agreements (1) between different parties, (2) addressing different events, and (3) providing for different remedies." The Court rejected the proposition that "a single loss can only give rise to a single claim in bankruptcy."[99]

If the *Delta Air Lines* test is applied in the modern NSULC context, the bondholders are in a position to make a strong argument because:

(1) the parties are different: the indenture trustee for the guarantee claim and the NSULC for the contribution claim;
(2) the events are different: the default of the primary debtor for the guarantee claim and the winding up of the NSULC for the contribution claim; and
(3) the remedies are different: the remedy is contractual for the guarantee claim and statutory for the contribution claim.

So-called "double dip" scenarios are not unusual in U.S. bankruptcies, and often arise where the primary debtor has an independent claim against another entity, the recovery of which will benefit all of the primary debtor's creditors. Such an incremental claim may arise from a number of circumstances, such as an intercompany loan or a fraudulent transfer claim. Such cases are similar to the modern NSULC contribution claims, in that the creditors in these cases will seek to recover from the guarantor, and then also compel the primary debtor to recover its intercompany loan or fraudulent transfer from its related company. Where the related company and guarantor are the same entity, this creates the potential for an allowable double recovery against a single debtor, which will be capped at the full recovery of the debt obligation.[100]

A prominent recent example of such a "double recovery" claim arose in the bankruptcy of Lehman Brothers Holdings Inc.,[101] where creditors with $34.5 billion in claims against a Dutch subsidiary filed guarantee claims

98. *Northwestern Mutual Life Insurance Co v Delta Air Lines Inc*, 608 F (3d) 139 (2nd Cir 2010) [*Delta Air Lines*].
99. *Ibid* at 149.
100. For a full discussion, see Mark P Kronfeld, "The Anatomy of a Double-Dip" (2012) 31:2 Am Bankr Inst J 24.
101. *In re 08-13555-jmp Lehman Brothers Holding Inc, 08-13555* (Bankr SDNY 2009), online: <www.nysb.uscourts.gov>.

against the parent company and also sought to recover the full value of their claims from the parent company through the recovery of intercompany loans to the Dutch subsidiary. Although the creditors originally filed claims for two times the value of the underlying instruments, they later agreed to a plan that allowed them approximately 1.77 times recovery.[102] The validity of the claims was not tested by the court; however, in approving the settlement, the court observed that the reduced recovery appropriately reflected the risk of a finding of substantive consolidation.[103]

Under U.S. bankruptcy law, substantive consolidation is an equitable doctrine by which courts disregard the separate corporate entities in an affiliated group of companies, merging their assets and liabilities into a single estate. This makes the creditors of each of the various entities in the corporate group joint creditors of the new consolidated estate, rather than the separate estates of each of the once-separate companies. Another important consequence is that intercompany claims among the debtor companies are eliminated.[104] These and other results associated with substantive consolidation can have dramatic impacts on the rights of the companies' creditors and as such, U.S. bankruptcy courts have stated that

102. Although multiple claims were allowed in respect of these underlying instruments, actual recovery from the distribution of assets remained capped at 100 per cent of the value of the instruments. In the final result, certain creditor groups of Lehman Brothers' 23 operating companies had recovery rates of 100 per cent, while others saw recovery of 30 per cent or less. See Michael Fleming & Asani Sarkar, "The Failure Resolution of Lehman Brothers" (2014) 20:2 Economic Policy Rev 175.

103. See *In re 08-13555-jmp Lehman Brothers Holdings Inc, 08-13555* (Bankr SDNY 2009) (Order Confirming Modified Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc and its Affiliated Debtors, Doc 23023 filed 6 December 2011) at 13-14, online: SEC <www.sec.gov/Archives/edgar/data/806085/000119312511339839/d267202dex22.htm>, stating:

> The Debtors and the Creditors' Committee have conducted a thorough factual and legal analysis to determine whether the substantive consolidation of the Debtors and their Affiliates is appropriate. The facts and analysis set forth in the Disclosure Statement, the Debtors' Memorandum of Law In Support of the Global Settlement, and the Suckow Declaration, reflect that there are facts that support and facts that militate against the substantive consolidation of the Debtors and their Affiliates based upon the law in this jurisdiction. There is a possibility that if litigated to final judgment, a court may find that the substantive consolidation of the Debtors and their affiliates, including their Foreign Affiliates, is appropriate.
>
> The Global Settlement gives due consideration to the strengths and weaknesses of potential arguments that have been made for and against substantive consolidation. Litigation regarding substantive consolidation of the Debtors would require vast amounts of discovery and investigation into the operations of Lehman prior to the Commencement Date, would be extraordinarily complex and costly for all parties involved, and would significantly delay Distributions to all Creditors.

104. See J Stephen Gilbert, "Substantive Consolidation in Bankruptcy: A Primer" (1990) 43:1 Vand L Rev 207.

it is an "extraordinary remedy" to be used "sparingly,"[105] and the tests imposed before employing it are difficult to meet.[106]

In *Owens Corning*, the Third Circuit Court of Appeals discussed the doctrine of substantive consolidation in detail and highlighted the Court's reluctance to use equity to reverse bargains and guarantees lawfully negotiated among commercial parties, and to treat parties as equal when they had negotiated preferential treatment for themselves. The Court observed:

> Substantive consolidation at its core is equity. Its exercise must lead to an equitable result. "Communizing" assets of affiliated companies to one survivor to feed all creditors of all companies may to some be equal (and hence equitable). But it is hardly so for those creditors who have lawfully bargained prepetition for unequal treatment by obtaining guarantees of separate entities. Accord Kheel, 369 F.2d at 848 (Friendly, J., concurring) ("Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite").[107]

It is important to recognize that although claims for multiples of the amount outstanding on the debt may be allowed in a U.S. bankruptcy, recovery will be capped at 100 per cent. The additional claim or claims serve only to increase the amount recoverable on the debt as compared to other creditors who also share in the pari passu distribution of the parent company's estate, but who do not have the benefit of multiple claims for recovery.

The parent companies and their other creditors in the modern NSULC cases have all resisted the contribution claims on the grounds that they are duplicative of the guarantee claims. They argue that because the claims arise from the same underlying transaction, and are both, in substance,

105. See *In re Owens Corning*, 419 F (3d) 195 at 208-209 (3rd Cir 2005) [*In re Owens Corning*], and *In re* Archdiocese of Milwaukee, 483 BR 693 at 699-700 (Bankr ED Wis 2012).

106. US Courts have been inconsistent in their approach to substantive consolidation. Factors that have been considered, though none are determinative, include:

1. The presence or absence of consolidated financial statements.
2. The unity of interests and ownership between various corporate entities.
3. The existence of parent and intercorporate guarantees on loans.
4. The degree of difficulty in segregating and ascertaining individual assets and liabilities.
5. The existence of transfers of assets without formal observance of corporate formalities.
6. The commingling of assets and business functions.
7. The profitability of consolidation at a single physical location.

These factors are often referred to as the "*Vecco* factors," referring to *In re Vecco Const Industries Inc*, 4 BR 407 at 410 (Bankr ED Va 1980). See Dennis J Connolly, John C Weitnauer & Jonathan T Edwards, "Current Approaches to Substantive Consolidation: Owens Corning Revisited" [2009] Norton Annual Survey Bankruptcy L 27 and Seth D Amera & Alan Kolod, "Substantive Consolidation: Getting Back to Basics" (2006) 14:1 Am Bankr Inst L Rev 1.

107. *Owens Corning*, *supra* note 105 at 216.

owed to the same creditor, they are duplicative and should not be allowed. There are numerous U.S. cases in which duplicative claims have not been allowed—for example, circumstances where individual claims were not allowed because a union had filed a claim on behalf of all union members that included the same loss,[108] or where claims filed by a pension fund for unpaid contributions were disallowed to the extent that other claims relating to the same contributions were allowed.[109]

Determinations relating to duplicativeness, like determinations relating to the appropriateness of substantive consolidation, are highly fact-specific and U.S. courts have avoided bright-line tests when making such determinations. The question of whether the NSULC liquidator is in fact a separate creditor from the bondholders' indenture trustee will be critical to the duplicativeness claim and the outcome is likely to turn on the facts of each case. Although it is clear as a matter of corporate law that the entities are separate, and that the nature of the obligations are entirely distinct, it remains possible that the U.S. Bankruptcy Court could be persuaded to view them as a single creditor, which would strengthen the argument that the claims are duplicative.

One strong argument against the finding that the NSULC liquidator and the indenture trustee are in substance representing the same creditor exists if the NSULC has creditors other than the noteholders, as was the case in some of the modern NSULC cases. Though the noteholders held the overwhelming majority of the NSULCs' debts, other creditors such as employee groups had also filed claims and would also realize an incremental benefit from any recovery on the contribution claims.

Ultimately, NSULC bondholders in the modern context are in a strong position in the U.S. Bankruptcy Court to resist arguments for substantive consolidation and claims of duplicativeness and to see both the guarantee claim and the contribution claims allowed as separate claims against the parent company's estate, subject to a maximum recovery of 100 per cent. It is unfortunate, however, that the U.S. courts have yet to consider the question.

3. *Canadian law: The rule against double proof and piercing the corporate veil*

Canadian law has evolved somewhat differently with respect to the prohibition against duplicative claims, though there have been very few

108. See *In re 05-17930-alg Northwest Airlines Corp*, 05-17930, 2007 WL 2682129 (Bankr SDNY 2007); *In re 01-16034-ajg Enron Corp*, 01-16034, 2006 WL 1030420 (Bankr SDNY 2006).

109. *LTV Corp v Pension Benefit Guaranty Corp*, 115 BR 760 (Bankr SDNY 1990), aff'd 130 BR 690 (SDNY 1991), vacated by agreement of the parties.

cases considering the issue. The most recent case squarely dealing with the rule against double proof is the 1998 *Olympia & York* case, in which the determinative question was whether two claims were asserted "on account of the same debt."[110]

Olympia & York involved a wholly-owned finance subsidiary that had borrowed approximately $2.5 billion through the issuance of notes guaranteed by its parent. It then loaned these funds to its parent. Upon the bankruptcy of both companies, the noteholders claimed against the estate of the subsidiary as primary obligor and the parent company as guarantor and the subsidiary claimed against the parent on its intercompany loan. The noteholders were the only creditors of the subsidiary. The noteholders and the trustee for the subsidiary argued that the debt of the parent to the subsidiary on the intercompany loan was separate and distinct from the parent company's liability on its guarantee and therefore both debts should be allowed against the parent company's estate. The trustee of the parent company resisted this, arguing that both loans arose from the same transaction and related to the same underlying debt and were therefore duplicative and violated the rule against double proof.

The trustee in bankruptcy for the parent company initially disallowed the claims as duplicative, stating that although the claims of subsidiary and the lenders were based on different instruments, they were in reality the same debt. The trustee was willing to accept one of the claims against the parent but not both. The trustee also determined that the amount of the claim should be reduced by the amounts that the lenders had already recovered on the debt from other sources of security.

The decision of the trustee of the parent company was appealed by the lenders and the trustees of the subsidiary, and the Registrar in Bankruptcy granted the appeals, finding that the claims were not duplicative because a payment of one obligation would not reduce the other and the disregard of the separate corporate entity of the subsidiary was inappropriate. The Registrar cited with approval the English *Barclays Bank*[111] case, where Oliver L.J. suggested a test for determining whether the rule against double proof had been contravened:

> One has, as it seems to me, to look at the position at the point at which the dividend is actually about to be paid and to ask the question then whether two payments are being sought for a liability which if the company were solvent, could be discharged as regards both claimants by one payment.[112]

110. *Re Olympia & York Developments Ltd* (1998), 4 CBR (4th) 189 (Ont Ct J (Gen Div)) [*Olympia & York, Blair J*], rev'g (1998), 3 CBR (4th) 304 (Ont Ct J (Gen Div)) [*Olympia & York, Reg Ferron*].
111. *Barclays Bank Ltd v TOSG Trust Fund Ltd* (1983), [1984] 1 All ER 628 (CA) [*Barclays Bank*].
112. *Olympia & York, Reg Ferron, supra* note 110 at para 11.

The Registrar applied this rule and determined that because a payment on the guarantee to the lenders would not reduce the intercompany loan, nor vice versa, the rule against double proof was not violated unless the separate corporate existence of the subsidiary were to be disregarded. On the veil piercing question, the Registrar cited *Re Polly Peck International PLC* which set a high bar for disregard of the corporate entity, quoting from the earlier case of *Adams v. Cape Industries PLC*, to observe that, "save in cases which turn on the wording of particular statutes or contracts the court is not free to disregard the principal of *Salomon v. Salomon & Co. Ltd.*, merely because it considers that justice so requires."[113] On the basis of this standard, the Registrar declined to pierce the veil and concluded that the claims were distinct and did not violate the rule against double proof.

The trustee of the parent company appealed the Registrar's decision to the Bankruptcy Division of the Ontario Court of Justice, which determined that the claims were duplicative. The Court echoed the Registrar's framing of the fundamental issue, stating that, "'the question [is] whether two payments are being sought for a liability which, if the company were solvent, could be discharged as regards both claimants by one payment.'"[114] However, the Court was willing to be more flexible on the question of when it was appropriate to pierce the corporate veil in the insolvency context:

> Whether or not a "double proof" has been lodged with respect to what is in substance the same debt is a matter to be determined on the facts of each individual case. From my understanding of the authorities, the underlying principles which should frame this analysis in group corporate insolvency situations may be summarized as follows. First, where the interests of different creditors of the various corporate entities come into play, the courts should be careful to respect the axiom regarding separate corporate existence enunciated by the House of Lords in *Salomon v. Salomon & Co.* At the same time, however, the courts should strive to give effect to the ethic of pari passu distribution and to the fundamental underlying principle of justice as between all creditors. Balancing these sometimes competing principles calls for a consideration of the true nature of the transaction, and the relationship between, and the presumed common intention of the parties. Finally, in seeking a just solution in novel situations the court may engage in an analysis which, while not ignoring the separate corporate being of the members of the corporate group, nonetheless transcends the mere legal fact of that existence. See in particular, as to the foregoing summary, *Ford & Carter Ltd. v. Midland*

113. *Re Polly Peck International PLC* (1995), [1996] 2 All ER 433 at 447 (ChD) [citations omitted].
114. *Olympia & York, Blair J, supra* note 110 at para 45, citing *Barclays Bank, supra* note 111.

> *Bank Ltd.* at p. 544; *Polly Peck* at pp. 444-445; and *Barclays Bank Ltd.* at pp. 645 and 647–648, and at pp. 636 and 640.
>
> In insolvency cases—as in, for example, tax cases—the court will not allow technicalities to obscure the essence of the transaction. This includes, in my opinion, not being either too dazzled or too immobilized by intricate corporate footwork which is designed to accomplish legitimate business and tax purposes, but which may not be as directly dispositive in resolving insolvency cases.[115]

The Court went on to express the view that the Registrar's conclusions regarding whether the loans were separate and distinct and whether the corporate veil should be lifted were "mirror images of each other," and, after examining the structure of the transactions closely, determined that there was an "'inseparable nexus'" between the obligation of the subsidiary to pay the lenders and the obligation of the parent to make payments to the subsidiary. The Court also assessed the intention of the parties and determined that the parties intended that there would be a single U.S. $2.5 billion loan facility made available to the parent company and that the lenders would look to the parent company ultimately and primarily, if not solely, for payment. The Court found that the parties did not intend, in the event of the bankruptcy of both the parent and the subsidiary, that they would be able to recover a dividend based upon 200% of their claim.[116]

In separate proceedings, Farley J. upheld the Trustee's decision that the lenders were required to deduct the sums recovered on other security from the amount of their claim, and this decision was upheld by the Ontario Court of Appeal.[117]

In my view, the result in *Olympia & York* is problematic. Although Blair J. stressed that findings relating to double proof and disregard of the corporate entity would be highly fact-specific, and observed that "courts should be careful to respect the axiom regarding separate corporate existence" and should strive to achieve the underlying objective of "justice as between all creditors," he nevertheless arrived at a result that negated the effects of the lawful, pre-bankruptcy bargain of the parties.[118] The noteholders and the parent company in that case had lawfully negotiated guarantees, presumably for their mutual benefit, that placed the noteholders in a preferential position relative to other creditors and in the final result,

115. *Olympia & York, Blair J, supra* note 110 at paras 27-28 [citations omitted].
116. *Ibid* at paras 33-35.
117. *Olympia & York Developments Ltd (Trustee of) v National Bank of Canada* (1998), 6 CBR (4th) 254 (Ont CA).
118. *Olympia & York, Blair J, supra* note 110 at para 27.

they were relegated by the Court's decision to a position of equality with those other creditors.

The Court in *Olympia & York* based its decision in part on its finding that in the circumstances of the particular case, the parties intended that they

> would look to [the parent company] ultimately and primarily, if not solely, for payment. It was not the common intention of the parties that in the event of the bankruptcy of both [the parent and subsidiary], the [noteholders] would be able to recover a dividend based upon 200% of their claim.[119]

As a result, the Court did not explicitly consider the issue of how the freely-negotiated arrangements of different classes of creditors should influence considerations of "justice as between all creditors," particularly in the absence of inequitable or wrongful conduct. Rather, the Court examined the specific contractual language used in the loan structures and found an "inseparable legal nexus between the two loans in the structure of the transaction" that justified disregard of the separate corporate entity of the subsidiary.[120]

Olympia & York is an important Canadian precedent relating to the rule against double proof, and does bear some important similarities to the typical fact patterns of modern NSULC cases. The case had a number of unique elements, however, that are likely to limit its application to future cases, and there are also some important distinctions that must be considered in determining the application of the rule in the modern NSULC context. For example, *Olympia & York* did not involve a statutory contribution claim, but rather both claims were based on contracts entered into contemporaneously with the underlying loan that explicitly referenced one another. By contrast, in recent NSULC cases the second claim is made by the subsidiary directly against its own parent company for contribution, which is, as described above,[121] based on statutory liability to the subsidiary that commenced on the date the parent company subscribed for or purchased their shares.

It is clear that any determination regarding the rule against double proof and the piercing of the corporate veil that is inherent in the application of such a rule in this context will always turn on the facts of the particular case. In any given case, the noteholders may be able to demonstrate that the two obligations are sufficiently distinct that they are not "on account of

119. *Ibid* at para 34.
120. *Ibid* at paras 27, 39.
121. See text accompanying note 50 above.

the same debt," and future litigants may also be able to persuade the courts to proceed cautiously when reallocating among creditors' rights that were lawfully bargained for pre-bankruptcy.

Conclusion

In this paper, I have canvassed the major corporate and bankruptcy law issues raised by a parent company insolvency in a typical modern NSULC corporate structure. From the foregoing discussion and analysis it is apparent that an NSULC can commence winding up through a U.S. Chapter 11 filing and that typical NSULC financing structures can lead in some cases to NSULC creditors having two allowable claims for recovery against the parent's estate, subject to the caveat that they cannot recover more than 100 per cent of the value of the underlying debt obligation.

This is the case because the obligation of the parent company to the creditor as guarantor is separate and distinct from its obligation to the NSULC as a contributory, and there is no basis in Nova Scotia corporate law to diminish or eliminate contributory liability on the grounds that the contributory has made a payment directly to the creditor in partial satisfaction of a contractual guarantee.

Additionally, where the bankruptcy of the parent company is taking place in the United States, the noteholders also have a strong basis on which to resist arguments that their claims and those of the NSULC trustee are unallowable because they are duplicative. The case law that has developed around the single satisfaction rule in the U.S. has allowed double recovery in circumstances very similar to the fact patterns presented by modern NSULC cases, and although U.S. courts have yet to rule specifically on the NSULC issue, they have repeatedly emphasized that the doctrine of substantive consolidation is an extraordinary remedy that will be applied sparingly.

In such cross-border insolvencies, U.S. bankruptcy law is likely to be dispositive of the issues relating to whether the claims are duplicative, but there may be circumstances where the Canadian approach is relevant. To the extent that it is, there has thus far been only one Canadian case squarely on point[122] and in that case, the Ontario Bankruptcy Court demonstrated a more flexible approach than that typically seen in the U.S. and disallowed claims on a guarantee and an intercompany loan as duplicative. The Court made it clear however, that all determinations relating to the rule against double proof would be highly fact specific and determined with due regard for the importance of respect for the separate corporate entities involved

122. *Olympia & York, Blair J, supra* note 110.

in the transactions. It is important to note, however, that this case dealt with a contractual intercompany loan entered into contemporaneously with the underlying debt obligation. As discussed above, a contribution claim is distinguishable from such a loan in several meaningful respects and therefore the question of whether a guarantee claim and a contribution claim would be considered duplicative in Canadian law is not yet settled.

It is the nature of business that financial disputes are usually settled by the parties themselves once the strengths and weaknesses of their relative positions are made sufficiently clear. Businesspeople and their advisers are, by their nature and experience, skilled negotiators inclined to pragmatism in such matters. The consequence of this is that many questions of corporate law that arise in such disputes are not resolved with the benefit of judicial interpretation that would serve to guide future cases. This is particularly true in jurisdictions such as Canada, where disputes relating to the intricacies of corporate law are relatively rare to begin with. Numerous recent U.S. cases have raised interesting and important issues relating to the liability of the shareholders of an NSULC and the bankruptcy law questions associated with insolvencies in modern NSULC corporate structures, but unfortunately for those looking for judicial guidance on these issues, all have settled before a judicial determination on the key issues at stake. These cases have highlighted, however, the importance of the issue and the gap in the existing literature and jurisprudence, and have provided an interesting basis for closer examination.