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Substantive Consolidation And Nonconsolidation Opinions

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Substantive Consolidation And Nonconsolidation Opinions

By Bruce J. Zabarauskas¹

Introduction

Commercial real estate financings typically require borrower's counsel to provide a non-consolidation opinion, opining that a bankruptcy of certain insiders or affiliates of the borrower will not result in a substantive consolidation of the borrower's assets with the assets and liabilities of the debtor in bankruptcy. The purpose of this opinion, in addition to satisfying ratings agency requirements in connection with CMBS loans, is to provide assurances to the lender that its borrower's assets will not be subject to the claims of creditors of other entities. This paper approaches this topic by first analyzing the law governing substantive consolidation in bankruptcy, and then discussing the critical elements of nonconsolidation opinions, along with certain "dos and don'ts with respect to nonconsolidation opinions.

The Law Of Substantive Consolidation

In order to understand nonconsolidation opinions, you first need to understand the bankruptcy concept of substantive consolidation. Substantive consolidation is an exception to the general rule that a bankruptcy estate consists only of the assets of the entity that filed the bankruptcy petition.² Substantive consolidation is where the assets and liabilities of two or more entities are combined and treated as if they are a single entity, with the exception of inter-entity liabilities and duplicate claims, which are erased.³ As a result of substantive consolidation, the "claims of creditors against separate debtors morph to claims against the consolidated survivor."⁴ The effect of this is to "restructure, and thereby revalue the rights of creditors and for certain

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² 11 U.S.C. § 541(a) ("Estate is comprised of all the following property, wherever located and by whomever held: (1) ...all legal or equitable interests of the debtor in property as of the commencement of the case."). See also *In re Archdiocese of St. Paul and Minneapolis*, 888 F.3d 944, 951 (8th Cir. 2018) ("Substantive consolidation allows the court, in appropriate situations, to expand the definition of the debtor's bankruptcy estate to include additional assets within debtor's possession and control.")

³ *In re Genesis Health Ventures, Inc.*, 402 F.3d 416, 423 (3rd Cir.2005)(noting that substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased)"); *In re Hemingway Transport, Inc.*, 954 F.2d 1, 11-12 (1st Cir. 1992)("substantive consolidation merges the assets and liabilities of the debtor entities into a unitary debtor estate, to which all holders of allowed claims are required to look for distribution); *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988)(substantive consolidation results in "pooling of the assets of, and claims against, two entities; satisfying liabilities from the resultant common fund eliminating inter-company claims; and combining the creditors of the two companies for purposes of voting on reorganization plan").

⁴ *In re Genesis Health Ventures, Inc.*, 402 F.3d at 423.

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