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Supreme Court of Canada releases reasons for its decision in Bluberi: Improper purpose and litigation funding in CCAA proceedings

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Introduction

On May 8, 2020, the Supreme Court of Canada (SCC) released its written reasons in *9354-9186 Québec Inc. v. Callidus Capital Corp.*[1](the Bluberi case).

In a unanimous decision, co-written by Chief Justice Wagner and Justice Moldaver, the SCC overturned the Québec Court of Appeal and reinstated the trial judge's decision thereby confirming that (i) a creditor acting for an improper purpose may be barred from voting on a plan of arrangement or compromise and (ii) third-party litigation funding agreements may be approved as interim financing pursuant to section 11.2 of the *Companies' Creditors Arrangement Act*[2] (CCAA).

This decision emphasizes the discretionary powers of the supervising judge in CCAA proceedings to further the remedial objectives of the CCAA and settles some uncertainty in the law regarding the treatment of third-party litigation funding in insolvency proceedings. The extension by the SCC of the improper purpose doctrine to the CCAA is likely to result in additional scrutiny of stakeholders' actions over the course of CCAA proceedings. Third-party litigation funding provides insolvent debtors with a powerful tool where there is a single litigation asset that can be monetized to seek enhanced creditor recovery.

Background

Bluberi Gaming Technologies (together with its sole shareholder Bluberi Group Inc., "Bluberi") was founded in 1994. In 2012, Callidus Capital Corporation (Callidus) extended a $24-million credit facility to Bluberi, secured in part by a share pledge agreement. In 2015, Bluberi sought and obtained an initial order under the CCAA. Bluberi alleged, among other things, that its liquidity issues were attributable to Callidus taking *de facto* control of Bluberi's business and dictating detrimental business decisions with a view to depleting the corporation's equity so Callidus could ultimately acquire Bluberi in an insolvency context.

In 2016, a sale process was approved by the CCAA judge, and Callidus credit bid most of its secured debt to acquire Bluberi's assets. Without other options, Bluberi entered into an asset purchase agreement (the APA) with Callidus whereby Callidus acquired substantially all Bluberi's assets and retained a secured claim of $3 million against Bluberi. The APA also provided that Bluberi would retain essentially one remaining asset: a potential claim of more than $200 million in damages against Callidus (the Bluberi Claim).

The APA was approved by the CCAA judge.

In September 2017, Bluberi filed an application requesting the CCAA judge's approval of a $2-million litigation financing agreement to fund the litigation of the Bluberi Claim against Callidus. Before this application could be heard, Callidus proposed a plan of arrangement (the First Plan), in which Callidus proposed to fund a $2.63-million distribution to Bluberi's creditors in consideration for a release from the Bluberi Claim. The First Plan failed to receive sufficient support from Bluberi's unsecured creditors. Callidus did not vote on the First Plan, acting as a secured creditor.

In February 2018, Bluberi sought authorization to enter into a third-party litigation funding agreement (the LFA) with Bentham IMF (now known as Omni Bridgeway) (Bentham) to fund the litigation of the Bluberi Claim, and sought a $20-million super-priority charge in favour of Bentham (the Litigation Financing Charge). Callidus contested the application. Callidus subsequently proposed a second plan to creditors (the Second Plan), which was identical to the First Plan except that the proposed distribution was increased to $2.88 million. At the same time, Callidus filed an amended proof of claim that valued its $3-million security at zero dollars, with the objective of qualifying as an unsecured creditor to vote on the Second Plan. Callidus's application for permission to vote on the Second Plan as an unsecured creditor was opposed by Bluberi.

The CCAA judge dismissed Callidus's application and approved the LFA. The CCAA judge held that Callidus should not be permitted to vote on the Second Plan as it was acting with an improper purpose by attempting to overturn the results of the First Plan — and shield itself from litigation. According to the CCAA judge, allowing Callidus to vote would be both "unfair and unreasonable" and contrary to the requirements of appropriateness, good faith and due diligence. With respect to the LFA, the CCAA judge determined that it met the criteria for the approval of interim financing. Callidus, supported by certain creditors, appealed the decision. The Québec Court of Appeal overturned the decision, holding that Callidus should have been permitted to vote on the Second Plan, given that the creditors have a right to vote in their own self-interest, and the LFA was akin to a plan of arrangement and needed to be brought to the creditors for a vote. Bluberi, Bentham and the Monitor sought and obtained leave to appeal to the SCC.

Decision

Two issues were raised before the SCC: (1) whether the CCAA judge erred in barring Callidus from voting on the Second Plan; and (2) whether the CCAA judge erred in approving the LFA as interim financing pursuant to section 11.2 of the CCAA. The SCC answered both questions in the negative.

Improper purpose

The SCC held that the CCAA judge made no error in exercising its discretion to bar Callidus from voting on the Second Plan.

No provision of the CCAA expressly authorizes a CCAA judge to bar a creditor from voting on a plan, including a plan that the creditor sponsors. Usually, a creditor with a provable claim is entitled to vote when its interests are affected. Although section 22 of the CCAA prohibits creditors related to the debtor company from voting in favour of a plan, this section does not restrict the voting rights of other creditors.

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Confronted with a situation where no explicit limits are provided by the legislation, CCAA judges must first interpret the available provisions and then rely on their inherent or equitable jurisdiction under section 11 of the CCAA.

In conformity with this approach, the SCC held that section 11 of the CCAA provides the CCAA judge with the necessary jurisdiction to prevent a creditor from voting on a plan of arrangement or compromise where the creditor is acting for an improper purpose for the following reasons:

1. Section 11 provides for a broad reading of the CCAA authority, framed only by restrictions set out in the CCAA and the requirement that the order should be appropriate in the circumstances.
2. Section 11 is the provision of first resort when a requested order does not fall under any CCAA provision.
3. Oversight of the plan negotiation, voting and approval process falls under the CCAA judge's jurisdiction. The CCAA neither expressly protects a creditor's absolute right to vote on a plan, nor specifically provides for when a creditor may be barred from voting on a plan. However, given that creditor participation in decision-making is a fundamental aspect of the CCAA regime, creditors should only be barred from voting under specific circumstances.
4. Thus, following a discretionary, fact-specific inquiry that would be in accordance with the remedial purpose of the CCAA and guided by the baseline considerations of appropriateness, good faith and due diligence, a CCAA judge may, pursuant to section 11 of the CCAA, prevent a creditor from voting when it is "seeking to exercise its voting rights in a manner that frustrates, undermines, or runs counter to [the abovementioned] objectives – that is, acting for an improper purpose."[3]

A similar discretion exists under the BIA and was previously recognized by the Nova Scotia Court of Appeal in *Laserworks Computer Services Inc. (Bankruptcy), Re.*[4] In that case, the Court of Appeal held that the discretion to bar a creditor from voting falls under the court's inherent power in the scheme of the BIA and corresponds to the power to remedy "a substantial injustice," which arises "when the BIA is used for an improper purpose" (para. 54). The Court held that "[a]n improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament" (para 54).[5]

The SCC held that the existence of such a discretion under the BIA militates in favour of the existence of a similar discretion under the CCAA. Moreover, such recognition would emphasize the importance of the basic fairness that is fundamental to the practice of insolvency and restructuring law and would be in conformity with the policy objectives of the CCAA.

The SCC concluded that the CCAA judge did not err in finding that Callidus acted with an improper purpose by its attempt to manipulate the vote on the Second Plan. The SCC emphasized that Callidus's improper purpose was its attempt to subvert the will of other creditors that had already rejected the First Plan. The SCC accepted the findings of the CCAA judge, who concluded that the Second Plan was substantially similar to the First Plan, and there was no prospect unsecured creditors would vote in favour of the Second Plan after rejecting the First Plan. The Second Plan could only succeed if Callidus was able to vote as an unsecured creditor, essentially overriding the clearly expressed wishes of all other unsecured creditors and undercutting the democratic structure of creditor voting provided for in the CCAA.

Approval of litigation funding

The SCC also held that third-party litigation funding may qualify as interim financing in specific situations pursuant to section 11.2 of the CCAA.

There is no definition of "interim financing" in the CCAA. Although it was described in jurisprudence as necessary working capital for the debtor during restructuring proceedings, the SCC held that interim financing can be used for more, its objective being the preservation and realization of the value of a debtor's assets. Section 11.2 of the CCAA empowers a CCAA judge to approve interim financing and provides a non-exhaustive list of factors to be considered for such a decision. According to the SCC, no standard form or terms should be followed, except that the financing must be appropriate, necessary and in accordance with the company's cash-flow. A super-priority charge may be granted to secure the interim lender and encourage the lending in insolvency situations. The SCC concluded that the CCAA judge is best suited to decide whether interim financing should be approved.

Thus, interim financing, being a flexible tool, could present itself as third-party litigation funding. The SCC held that it is not *per se* illegal and therefore nothing prohibits a CCAA judge to approve such an agreement as interim financing in appropriate circumstances. A case-based analysis should be performed, and further guidance may be drawn from other areas in which third-party litigation funding agreements have been approved. Such course of action is consistent with the practice of lower courts. In *Crystallex*,[6] the Ontario Court of Appeal approved third-party litigation funding in circumstances similar to Bluberi's.

In the Bluberi case, considering that the sole asset of Bluberi was a litigation claim that could be monetized for the benefit of creditors, the SCC held that it is in the interest of maximizing the creditors' recovery to allow such financing pursuant to section 11.2 of the CCAA. The SCC rejected Callidus's argument that the LFA qualified as a plan of arrangement and needed to be brought to a vote. According to the SCC, the notion of a plan of arrangement requires some compromise of creditors' rights. A third-party litigation funding agreement does not automatically qualify as a plan of arrangement. Such qualification is circumstantial and is best determined by the CCAA judge.

Implications

1. In its reasons, the SCC restated that in certain circumstances, a liquidation that preserves going-concern value and the ongoing business operations of the debtor may become the predominant remedial focus of CCAA proceedings, thereby making liquidating CCAA proceedings settled law in Canada. This clarification is welcomed given the likely wave of CCAA filings by companies severely affected by the current COVID-19 crisis.

2. The extension of the improper purpose doctrine to the CCAA, in addition to the recent addition to the CCAA of section 18.6, requiring any interested person to act in good faith, will likely bring about increased scrutiny of stakeholders' conduct in the proceedings. Stakeholders must manoeuvre in the proceedings having the principles of creditor

democracy and good faith in mind. Acting in the creditor's self-interest now has limits subject to the discretion of the CCAA judge.

3. The recognition by the SCC that third-party litigation funding is not *per se* illegal in Canada and can be approved as interim financing under section 11.2 of the CCAA is likely to be of significant importance in insolvency practice and in litigation more broadly. Litigation funding will become another tool in the asset maximization toolbox, in addition to giving debtors access to justice. In the current economic environment, litigation funding may become a common place occurrence in insolvency proceedings.

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[1] *9354-9186 Québec Inc. v. Callidus Capital Corp.*, 2020 SCC 10.

[2] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36.

[3] Supra, Note 1, at para 70.

[4] *Laserworks Computer Services Inc. (Bankruptcy)*, Re, 1998 NSCA 42, 165 N.S.R. (2d) 296.

[5] Supra, Note 1, at para 71.

[6] *Re Crystallex International Corporation*, 2012 ONSC 2125, 91 C.B.R. (5th) 169.