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9254-9186 Quebec inc. v. Callidus Capital Corp. (“Bluberi”): Affirming Judicial Discretion and Litigation Funding in Insolvency

BY VIRGINIA TORRIE · SEPTEMBER 25, 2020

Introduction

Insolvency judgements from Canada’s highest court are relatively rare. The Supreme Court of Canada (“SCC”) has decided only six since 2015. The most recent of these decisions, *9254-9186 Quebec inc. v. Callidus Capital Corp.,* 2020 SCC 10 (https://decisions.scc-csc.ca/scc-csc/scc-csc/en/item/18365/index.do) [*Bluberi*], is not only rare, but also timely. The adverse impact of COVID-19 on the global and domestic economy is causing corporations across all sectors to increasingly filing for creditor protection under the *Companies’ Creditors Arrangement Act* (https://laws-lois.justice.gc.ca/eng/acts/c-36/) , RSC 1985, c C-36 [CCAA]. The CCAA is Canada’s premier insolvency regime for large companies.

The insolvency in *Bluberi* was one in which substantially all of the debtor’s assets had been liquidated (*Bluberi,* para 1). The SCC dealt with two main issues. Firstly, can a supervising judge bar a creditor from voting on a plan of arrangement on the basis that it was acting for an improper purpose? And secondly, can a litigation financing agreement [LFA] be approved as interim financing under section 11.2 of CCAA (CCAA, s 11.2)? According to the Court, the answer to both questions is “yes.” The SCC decision overturns the Quebec Court of Appeal’s (“QCCA”) decision and restores the orders of the supervising judge (*Bluberi,* para 117).

The Court’s synthesis and affirmation of the broad remedial objectives of the CCAA — in both the restructuring and liquidation contexts — and the importance of appellate courts showing deference to the supervising judge’s decisions,

together reinforce and clarify this important area of law at a crucial moment for insolvency practice. The SCC's judgement also affirmed the use of LFAs to pursue claims in an insolvency context, expanding the potential of such arrangements to maximize creditor recoveries. The Court's decision is likely to be seen as a green light for the growth and expansion of the litigation funding business in Canada. Following the SCC's decision, new litigation funders are already emerging, such as Lazarus LF (https://lazaruslf.com/%3e) .

Facts

Bluberi Gaming Technologies ("Bluberi") sought financing from the respondent, Callidus Capital Corporation ("Callidus") in 2012. Callidus extended a credit facility of about $24 million. Over the next three years Blueberi lost significant amounts of money and Callidus continued to extend credit. In 2015, Bluberi filed for creditor protection under the CCAA. The Court subsequently approved a sale transaction through which Callidus would obtain all of Bluberi's assets in exchange for its secured claim, worth $135.7 million. Callidus would maintain an unsecured claim of $3 million. This agreement allowed Bluberi to retain claims for damages against Callidus arising from its alleged involvement in Bluberi's financial difficulties. Bluberi asserted that this retained claim (the "Retained Claims") was valued at over $200 million in damages.

On 11 September 2017, Bluberi applied for interim financing to fund litigation against Callidus. A day before the hearing regarding interim financing, Callidus proposed a plan of arrangement ("First Plan"). The First Plan proposed that Callidus would fund a $2.63 million distribution to Bluberi's creditors, except itself, in exchange for a release from the Retained Claims. On December 15, 2017, Callidus submitted its First Plan to a creditors' vote, but the plan failed to receive sufficient support. Section 6(1) of the CCAA provides that, to be approved, a plan must receive a "double majority" vote of two-thirds of claims in number and in value (CCAA, s 6(1)). Callidus did not vote in the decision regarding this plan despite the fact that the Monitor said that it could have voted.

On 6 February 2018, Bluberi filed one of the applications underlying the appeal, seeking authorization of a proposed third-party LFA with a publicly traded litigation funder. Callidus and other creditors argued that the LFA was a plan of arrangement and therefore had to be submitted to a creditors' vote.

On 12 February 2018, Callidus filed the other application underlying these appeals, seeking to put another plan of arrangement to a creditors' vote ("New Plan"). The New Plan was identical to the First Plan, except that Callidus increased the proposed distribution by $250,000. Callidus also filed an amended proof of claim, valuing the security attached to its $3 million claim at $0, making it an unsecured creditor. Callidus argued that this valuation was proper because Bluberi had no assets other than the Retained Claims. Therefore, Callidus asserted that it was effectively an unsecured creditor, and sought the supervising judge's permission to vote on the New Plan with the other unsecured creditors. Given the size of its claim, if Callidus were permitted to vote on the New Plan, the plan would necessarily pass a creditors' vote. Bluberi opposed Callidus's application.

The supervising judge dismissed Callidus' application and held that it should not be allowed to vote on its own plan because it was acting for an improper purpose. The supervising judge also approved the use of the LFA as interim financing. The QCCA reversed both of the supervising judge's decisions. It held that Callidus should be allowed to vote in its own self-interest on the New Plan. The QCCA also ruled that the LFA was not interim financing, and should have been put to a creditors' vote because it was effectively a plan of arrangement. Both parties appealed to the SCC.

Decision

The SCC affirmed that Canadian insolvency statutes are remedial in nature, and aimed at addressing the potentially "catastrophic" effects that an insolvency can have (*Bluberi*, para 40). CCAA proceedings have evolved in recent years to include those aimed primarily at liquidating the debtor company, and such "liquating CCAAs" are now commonplace

(*Bluberi*, 43). The court noted that when "reorganization or liquidation is completed and the court is dealing with residual assets, the objective of maximizing creditor recovery from those assets may take centre stage" (*Bluberi*, para 46).

Section 11 of the CCAA grants broad discretion to the supervising judges, allowing them to "make any order that [the judge] considers appropriate in the circumstances" (CCAA, s 11; *Bluberi*, para 48). In *Bluberi,* the SCC made clear that a high degree of deference is owed to supervising judges in CCAA proceedings (*Bluberi*, paras 47-52). The dynamism of CCAA law is largely attributable to the broad discretion afforded to supervising judges and their tendency to take a hands on approach to developing the law case-by-case (*Bluberi*, para 48). In *Bluberi*, the SCC affirmed that "[a]ppellate courts must be careful not to substitute their own discretion in place of the supervising judge's" (*Bluberi*, para 53).

On the first question regarding the ability of a judge to prevent a creditor from voting, the SCC concluded that a supervising judge has discretion to bar a creditor from voting if it would frustrate, undermine or run counter to the remedial objectives of appropriateness, good faith, and due diligence (*Bluberi*, para 70). The second proposed plan was almost identical to the first, on which Callidus had abstained from voting despite the Monitor saying that it could vote. The SCC held that if Callidus was allowed to vote on the new proposal, it would amount to allowing them a "second kick at the can" and the chance to manipulate the vote on the new plan (*Bluberi*, para 78). The SCC noted that the supervising judge had been the sole presiding judge over the case for several years, made 25 orders and received 14 reports (*Bluberi*, para 77). He was intimately familiar with the parties and the proceedings and as such should have been afforded a level of deference by the QCCA relative to his knowledge.

On the second question concerning the characterization of the LFA, the SCC held that the LFA should be approved as interim financing and did not qualify as a "plan of arrangement" which would have had to go to a creditors' vote (*Bluberi,* para 99; CCAA, ss 4-5). The supervising judge made no error in approving the LFA as interim financing pursuant to section 11.2 of the CCAA (CCAA, s 11.2). The breadth of a supervising judge's discretion to approve interim financing is apparent from the wording of section 11.2(1) and does not mandate any standard form or terms (*Bluberi*, paras 97-112). Third party litigation funding may, in appropriate cases, be one such form of interim financing (*Bluberi*, paras 85, 90). The Court found no principled basis upon which to restrict supervising judges from approving such agreements as interim financing in appropriate cases (*Bluberi*, para 96).

Implications

While the SCC did not provide in-depth commentary or analysis on LFAs generally, it did confirm that Canadian jurisprudence has held that such arrangements are "not *per se* illegal" (*Bluberi*, para 96). This statement and the decision as a whole bring much-needed clarity to rules governing third-party litigation funding and the unanimity of the decision represents a green light to litigation funding in insolvency proceedings.

Additionally, the SCC opined that "[f]urther guidance may be drawn from other areas in which third party litigation funding agreements have been approved" (*Bluberi*, para 97). This statement can be read as an endorsement by the Court of the preceding jurisprudence dealing with LFAs in lower courts. The SCC specifically cited *Crystallex (Re)*, 2012 ONCA 404 (https://www.ontariocourts.ca/decisions/2012/2012ONCA0404.pdf) , as an authority for the notion that LFAs can be construed as interim financing (*Bluberi*, para 98). The Court's affirmation of *Crystallex (Re)* in stating that LFAs do not necessarily constitute a "plan of arrangement" (which would require a creditors' vote) is significant and helps pave the way for the further development of litigation funding in Canada.

These statements from the SCC are important as LFAs have historically been avoided by litigants due to concerns of funders being threatened with champerty (an agreement in which a party with no direct interest in a lawsuit agrees to finance it and share the proceeds if the lawsuit is successful) and/or maintenance suits. These were defined as crimes under the *Criminal Code (https://laws-lois.justice.gc.ca/eng/acts/c-46/)* , RSC 1985, c C-46, until 1953, but they remain torts in many common law jurisdictions in Canada.

In an insolvency context, LFAs need to be in furtherance of CCAA objectives such as realizing an asset to maximize creditor returns. In the *Bluberi* case, the approval of the LFA fell squarely within the remedial objectives of the CCAA and this provided valid grounds for the supervising judge to approve its use as interim financing. The SCC found that the LFA funder's motives were not officious meddling, nor were they stirring up strife.

The SCC unanimously affirmed the broad discretion of supervising judges based on section 11 of the CCAA. A supervising judge can exercise their discretion to prevent a creditor from voting on a plan of arrangement if the creditor is acting for "an improper purpose". Quoting *3004876 Nova Scotia Ltd v. Laserworks Computer Services Inc.*, 1998 NSCA 42 (https://decisions.courts.ns.ca/nsc/nsca/en/12539/1/document.do) , the SCC wrote "[a]n improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament" (para 71). This provides clarity that, in spite of amendments which have codified certain practices under the Act, the CCAA continues to afford a large measure of discretion to judges to supervise restructuring and liquidation efforts.

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