SCC opens doors to litigation funding in insolvency proceedings

May 15, 2020

On May 8, 2020, the Supreme Court of Canada (SCC) released its reasons for the decision rendered in 9354-9816 Québec Inc. et al. v. Callidus Capital Corporation, et al on January 23, 2020. The SCC unanimously allowed the appeal from the Québec Court of Appeal's decision, reinstating an order allowing third-party litigation funding in insolvency proceedings.

Background

In November 2015, a consortium of entities which manufactured, distributed, installed and serviced electronic casino gaming machines (Bluberi) sought protection under the *Creditors' Companies Arrangement Act* (CCAA). In those CCAA proceedings, Bluberi made an application to the court for approval of:

- Litigation funding from Bentham IMF Capital, now Omni Bridgeway Capital (Canada) Limited (Bentham) that was secured against Bluberi's assets; and
- The placement of a $20 million super-priority charge (Litigation Financing Charge) in favour of Bentham.

Callidus Capital Corporation (Callidus), a secured creditor, and certain unsecured creditors contested Bluberi's application on the ground that the third-party litigation funding agreement (LFA) was a plan of arrangement and, as such, had to be submitted to a creditors' vote.[1]

SCC's reasons

Writing for the majority, Chief Justice Wagner and Justice Moldaver held the CCAA provides judges with broad discretion to render any order appropriate in the circumstances, subject only to the restrictions set out in the CCAA. This broad discretion includes the ability to approve interim financing of the debtor, which may come in a variety of different forms. Where the only asset of the debtor is a litigation claim, as in Bluberi's case, third-party litigation funding would further the purpose of interim financing by allowing the debtor to realize on the value of that asset and increase recovery for its creditors.

A supervising judge, given his or her expertise and knowledge of the insolvency file, must be afforded deference. Whether a LFA should be approved as interim financing is a case-specific inquiry that should weigh the factors enumerated in subsection 11.2(4) of the CCAA and the remedial objectives of the CCAA more generally.

In reinstating the supervising judge's decision to approve Bluberi's litigation funding agreement, the SCC held the supervising judge had properly considered the objectives of the CCAA, the fairness to all stakeholders and the particular circumstances of the case. Given the supervising judge's role and familiarity with the proceedings, the judge would also have given due consideration to the factors set out in the CCAA which are used in the determination of whether to approve interim financing, including whether the financing would facilitate a viable arrangement and if any creditor would be placed at a disadvantage.

The SCC held that the LFA did not amount to a plan of arrangement needed to be approved by a creditors' vote. A plan of arrangement under the CCAA must entail some compromise of creditors' rights. A LFA does not necessarily involve such compromise; as a form of interim financing, it serves the purpose of allowing the debtor to realize on its litigation claim. At its core, interim financing enables the preservation and realization of the value of a debtor's assets. The fact that Bentham may take a share in the litigation proceeds does not change the fact that the creditors have an entitlement to those proceeds. If those proceeds are sufficient, the creditors will be paid in full. If there is a shortfall, a subsequent plan of arrangement will determine how the proceeds will be distributed.

With respect to the lower court's finding of an improper purpose, the SCC held that the supervising judge correctly exercised his jurisdiction under section 11 of the CCAA. Specifically, Callidus' initial plan of arrangement failed to receive sufficient creditor support. Despite this, Callidus proposed another, virtually identical, plan of arrangement and also sought the supervising judge's permission to vote on this new plan in the same class as Bluberi's unsecured creditors, on the basis that its security was worth nil. The SCC agreed Callidus was attempting to strategically value its security to acquire control over the outcome of the creditors' vote, and thereby circumvent the creditor democracy that the CCAA protects.

Finally, the SCC held that the Litigation Financing Charge over Bluberi's property in favour of the Bentham did not convert the LFA into a plan of arrangement, even where it subordinated the security interests of other creditors' to that of Bentham. The CCAA expressly provides for the supervising judge to grant such security without creditor approval.

Significance of the decision

The SCC's decision is particularly significant as it is the first time the issue of litigation funding has been considered by the highest court in Canada. Importantly, it brings much-needed clarity to the rules governing third-party litigation funding in the context of insolvency proceedings. The SCC's decision is an important reminder of core principles in the conduct of liquidating CCAA proceedings.

The decision confirms for the first time at the SCC level that the CCAA can be used in appropriate circumstances as a process to liquidate the assets and business of a

debtor, and is not limited to compromise and arrangement of debt proceedings. The decision solidifies third-party litigation funding as an acceptable form of interim financing to be approved by the supervising judge on a case-by-case basis.

It should be noted that although LFAs will not generally be subject to creditor approval, there are instances where such approval will be required. Supervising judges have the discretion to determine that the agreement should be packaged with a plan of arrangement and submitted to a creditor's vote. The supervising judge may also determine whether the agreement contains terms that convert it into a plan of arrangement, such as terms of distribution of litigation proceeds among creditors.

Lastly, the SCC noted the recent amendment to subsection 11.2(5) of the CCAA, which was not applicable in Bluberi's case, may restrict a supervising judge's ability to approve a LFA as interim financing at the time of granting an initial order.

[1] Please see BLG's previous article for additional background of the case.

The authors want to acknowledge the contribution of Kevin Lambie and Charlotte Chien, both articling students.

By

Hugo Babos-Marchand, Tyler McNaughton, Katie Archibald

Expertise

Insolvency & Restructuring, Financial Services, Renewable Energy

---

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749