

# The *Bluberi* Decision: “No” to Vote-Rigging and “Yes” to Litigation Funding

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By Philip Cho

On May 8, 2020, the Supreme Court of Canada (“**SCC**”) released its decision in *9354-9186 Québec inc. v. Callidus Capital Corp.*,<sup>[1]</sup> after hearing arguments on January 23, 2020. The appeal arose out of a proceeding under the *Companies Creditors’ Arrangement Act*<sup>[2]</sup> (the “**CCAA**”), and the decision provides guidance on two issues of great interest to the insolvency bar:

1. whether a creditor can be prevented from voting on a plan on the basis of acting with an “improper purpose”; and
2. whether a litigation funding agreement can be approved as interim financing, rather than as a plan of arrangement, which would require a vote by creditors.

The SCC answered both questions affirmatively and reinstated the decision of the motions judge (the “**Supervising Judge**”).

## Background

The CCAA applicant carried on business as Bluberi Gaming Technologies (“**Bluberi**”) and had financing arrangements with Callidus Capital Corporation (“**Callidus**”). Over the course of their relationship, the amounts owing to Callidus increased from an initial credit facility of \$24 million to an outstanding debt of \$86 million. Bluberi, in making its application for protection under the CCAA, alleged that its liquidity issues were the result of certain of Callidus’ actions. This allegation against Callidus was at the root of a \$200 million claim for damages by Bluberi against Callidus (the “**Retained Claims**”).

In the CCAA proceeding, after a sale process, Callidus purchased all of Bluberi’s assets through a credit bid, essentially paying for the assets by extinguishing its secured claim, save for a \$3 million undischarged secured claim. Callidus also filed a plan of arrangement (the “**First Plan**”) that would fund \$2.5 million (later increased to \$2.63 million) for distribution to Bluberi’s creditors, except itself, in exchange for a release from the Retained Claims. The amount offered by Callidus would have paid in full the claims of Bluberi’s former employees and creditors with claims less than \$3,000, with the balance of creditors receiving approximately 31% of the value of their claims. The vote on the First Plan did not pass, which required greater than 50% in number of creditors voting, holding greater than 2/3 in dollar value of claims. On the vote, the value of the claims of creditors voting in favour was approximately 60% and thus, despite being more than 50% of the number of creditors, did not meet the value threshold.

Soon after the First Plan failed to be approved by the creditors, Bluberi sought approval of a litigation funding agreement (“**LFA**”) with IMF Bentham Limited (now Omni Bridgeway) that would allow Bluberi to pursue the Retained Claims against Callidus. The request to the court for approval of the LFA was made under s. 11.2 of the CCAA which permits the court to authorize interim financing (new credit to an insolvent company) and, if appropriate, a super-priority charge against the assets of the insolvent company (often referred to as a Debtor-in-Possession, or DIP, loan and charge, respectively).

Callidus, in turn, sought to file a new plan offering \$2.88 million (the “**New Plan**”). The New Plan was essentially identical to the First

Plan, except that this time, Callidus filed an amended proof of claim valuing its security as *nil* so that it would be an *unsecured creditor* and could vote on the New Plan. The value of its \$3 million claim as an unsecured claim would (assuming creditors voted similarly as the first time) bring the value of claims past the 2/3 threshold required to pass.

### Acting with an Improper Purpose

In hearing Callidus' motion to submit its New Plan to the creditors for a vote, the Supervising Judge refused to allow Callidus to vote on the New Plan on the basis that it was acting for an improper purpose. There was sufficient evidence that without Callidus voting, another creditor with sufficient value would vote against the New Plan and, as such, the New Plan had no reasonable prospect of success. Therefore, the Supervising Judge dismissed Callidus' motion. The SCC upheld this decision and, in doing so, emphasized the broad discretion afforded to a CCAA supervising judge under s. 11 of the CCAA.

Section 11 of the CCAA provides that the court "may, subject to the restrictions set out in this Act, [...] make any order that it considers appropriate in the circumstances." In making orders under s. 11, the court must consider whether: (1) the order sought is appropriate in the circumstances, (2) the applicant (moving party) has been acting in good faith, and (3) with due diligence.<sup>[3]</sup>

Note that there is no express provision in the CCAA that bars a creditor from voting on a plan of arrangement, including one that it may sponsor, as Callidus was doing. In other words, nothing in the CCAA technically prevented Callidus from valuing its security as *nil* (or some other amount), and relying on the unsecured portion of its claim to vote as an unsecured creditor. This practice is not uncommon in insolvency proceedings.

Subsection 22(3) of the CCAA restricts the voting rights of a creditor who is related to the debtor company, and provides that a related creditor may vote *against*, but not *in favour of*, a plan. While arguments were made to interpret s. 22(3) to support the court's jurisdiction to bar Callidus from voting in favour of the New Plan, the SCC did not rely on this argument, as Callidus was not related to Bluberi within the meaning of the CCAA.

Instead, the SCC looked to the broad discretion granted by s. 11 of the CCAA, and noted that "[w]here a party seeks an order relating to a matter that falls within the supervising judge's purview, and for which there is no CCAA provision conferring more specific jurisdiction, s. 11 necessarily is the provision of *first resort* in anchoring jurisdiction."<sup>[4]</sup> [Emphasis added] The SCC stated that s. 11 confers on the court broad discretionary powers, so long as the discretion is exercised to "further the remedial objectives of the CCAA and [is] guided by the baseline considerations of appropriateness, good faith, and due diligence." <sup>[5]</sup> Resort to "inherent jurisdiction" will be largely unnecessary.

The "remedial objectives" include:

- providing for timely, efficient and impartial resolution of a debtor's insolvency;
- preserving and maximizing the value of a debtor's assets;
- ensuring fair and equitable treatment of the claims against a debtor;
- protecting the public interest; and,
- in the context of a commercial insolvency, balancing the costs and benefits of restructuring or liquidating the company.<sup>[6]</sup>

A party whose conduct has the effect of frustrating, undermining or running counter to these objectives will be seen as acting for an "improper purpose", and this "improper purpose" can form the basis for a judge to prevent such conduct. The role of the supervising judge in overseeing the voting regime is not limited to ensuring strict compliance, but it is also to further the goals of the CCAA.<sup>[7]</sup>

In this case, the SCC noted the Supervising Judge's familiarity with the proceedings and Callidus' conduct throughout and, in particular, the fact that he was aware that nothing had changed between the First Plan and the New Plan that should cause Callidus to

suddenly value its security as *nil*.<sup>[8]</sup> What had changed was that Bluberi had secured support for an LFA that could result in litigation against Callidus for the Retained Claims.

As a result, the SCC agreed with the Supervising Judge that it would frustrate the goals of the CCAA if Callidus were permitted to submit the New Plan, value its security as *nil*, and vote as an unsecured creditor. In the circumstances, it was not appropriate to grant the order sought by Callidus.

### Approval of LFA as Interim Financing

Litigation funding is relatively new in Canada. Litigation funding agreements have become more commonplace in class actions, but the use of litigation funding in commercial claims or in an insolvency proceeding is only starting to gain traction. Generally, a litigation funder will provide financial support (often with respect to disbursements and any adverse costs awards) in exchange for a portion of the proceeds of any successful litigation or settlement.

Interim financing in the insolvency context has become commonplace. Prior to the 2009 amendments to the CCAA, courts relied on the broad discretionary power under s. 11 to authorize interim financing and associated super-priority charges. The power to authorize interim financing is now codified in s. 11.2 of the CCAA, and the factors that are to be considered by the court are listed in subsection 11.2(4).

The SCC noted that despite being expressly provided for, interim financing is not defined in the CCAA. The SCC quoted Professor Janis Sarra who describes it as “refer[ring] primarily to the working capital that the debtor corporation requires in order to keep operating during the restructuring proceedings, as well as to the financing to pay the costs of the workout process”.<sup>[9]</sup>

With respect to Bluberi, by this time, its assets had been sold and it was no longer operating. Its only remaining asset was the Retained Claims. As a result, Callidus argued that the LFA was not interim financing, but was actually a plan of arrangement that should be voted on by the creditors. The SCC disagreed and found no error in the Supervising Judge’s decision to approve the LFA as interim financing pursuant to the CCAA.

The SCC noted that interim financing is “a flexible tool that may take on a range of forms.”<sup>[10]</sup> While it is often used in the manner described by Professor Sarra, the SCC stated that interim financing is not limited in this fashion. At its core, the SCC held, interim financing “enables the *preservation* and *realization* of the value of a debtor’s assets.”<sup>[11]</sup> [Emphasis added] The SCC noted that since Bluberi’s only remaining asset was in the form of a litigation claim that could be monetized for the benefit of creditors, the purpose of interim financing would not be to continue operating (preservation), but would be to allow Bluberi “to realize on the value of its assets.”<sup>[12]</sup>

While there have been other insolvency proceedings in which litigation funding has been approved as part of a plan of arrangement, the SCC held that, strictly speaking, the LFA proposed in *Bluberi* was neither a “compromise” nor an “arrangement” within the meaning of the CCAA. The LFA did not purport to compromise the creditors’ rights or claims, and so long as a litigation funding agreement does not contain such terms, it may be approved as interim financing.<sup>[13]</sup>

### Things to consider

The SCC’s decision in this case reaffirms the unique position of the supervisory judge in a CCAA proceeding. The combined effect of having a single judge throughout the life of a proceeding and broad discretionary powers conferred under s. 11 creates a high degree of deference for the CCAA judge. As such, the case may serve to discourage appeals from CCAA orders, which in themselves could adversely impact a restructuring process where time is often in very limited supply.

In addition, recent amendments to the CCAA, which became effective in November 2019, expressly codify good faith obligations on *all* participants in a CCAA proceeding (see s. 18.6). These amendments were not in force when the Supervising Judge made the initial decision. As such, although it mentioned the new good faith requirement, the SCC did not elaborate on how it will be interpreted. Still, this case may serve as an indication of how a court is to be guided, as it is likely that had this section been in force, it could also have provided the jurisdiction for barring Callidus from voting on the New Plan.

Finally, it will be interesting to see how litigation funding will be utilized in other insolvency proceedings now that the SCC has ruled on this issue. In this case, litigation funding was sought at the end of the process, after all of the assets had been sold and only the litigation claim remained. Could there be circumstances where a company with significant creditors seeks court protection under the CCAA, solely for the purpose of pursuing a significant commercial litigation claim? Will we see an evolution from restructuring CCAAs, to permitting liquidating CCAAs, to permitting “litigating” CCAAs? Time will tell.

[1] 2020 SCC 10 (“**Bluberi**”).

[2] RSC 1985, c C-36.

[3] *Bluberi* at para. 49.

[4] *Bluberi* at para. 68.

[5] *Bluberi* at para. 70.

[6] *Bluberi* at para. 40.

[7] *Bluberi* at para. 75.

[8] *Bluberi* at paras. 77-78.

[9] *Bluberi* at para. 85.

[10] *Bluberi* at para. 84.

[11] *Bluberi* at para. 85.

[12] *Bluberi* at para. 96.

[13] *Bluberi* at para. 102.

***The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.***

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