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Creditor Democracy - The Supreme Courtâ€™s Reasons in Callidus

In *Back to Methuselah*, George Bernard Shaw famously wrote that an election was “as bad as a battle except for the blood”. That is perhaps dramatic in the context of the *Companies’ Creditors Arrangement Act* (“**CCAA**”), but certainly a creditor vote can be a tense and contested affair. Such was the case when Callidus Capital Corp (“**Callidus**”), an asset-based or “distressed lender” and secured creditor, made a “second kick at the can” to approve a plan of arrangement already rejected by unsecured creditors, and found itself barred from voting on the plan for having acted for an “improper purpose”.

The Supreme Court of Canada’s decision in *354-9186 Québec inc. v Callidus Capital Corp* confirms that a CCAA supervising judge has a broad discretion under the express provisions of the CCAA, to further the remedial objectives of the CCAA. That discretion is informed by the extensive knowledge of the case gained by the supervising judge, with the assistance of an independent and impartial court-appointment monitor. That discretion is to be given a high degree of deference, and appellate intervention is limited to cases in which the supervising judge has erred in principle or exercised that discretion unreasonably.

The Supreme Court also affirmed the advantages of utilizing litigation funding arrangements in advancing the interests of CCAA stakeholders and clarified that third-party litigation funding can qualify as interim financing under Section 11.2 of the CCAA, making litigation funding more easily obtainable by not requiring a vote of approval in the context of a plan of arrangement.

Background

The company at issue was Bluberi Gaming (“**Bluberi**”), a provider of casino gaming machines, which was petitioned into CCAA in 2015. Bluberi sold almost all of its assets in 2017, and the proceeds were used to extinguish most of the secured claims held by Callidus. After the sale, the sole remaining asset that unsecured creditors could look to was Bluberi’s claims against Callidus for its alleged role in causing Blueberi’s financial difficulties. Bluberi asserted these claims to be worth more than $200 million and sought the Court's approval for a financing facility to fund the litigation.

The day before the hearing to approve the litigation financing, Callidus put forward its own plan of arrangement. Callidus would fund $2.63 million to Bluberi, to fully satisfy the claims of Bluberi's former employees, and creditor claims worth less than $3,000. Larger claims would receive on average 31 cents on the dollar. In exchange Callidus would receive a full release from Bluberi's claims.

A vote was held. Under Section 6 of the CCAA, a plan of arrangement must receive a "double majority", being a majority of the number of class members, representing 2/3 of the value of claims. Callidus, a secured creditor, did not vote, but one hundred unsecured creditors voted as follows:

	In Favour	**Against**
Number of Creditors	92	8
Value of Claims	$3,450,882 (59.22%)	$2,375,913 (40.78%)

While a majority of the unsecured creditors supported the plan, a smaller group of larger claims holders withheld enough support that the plan could not pass.

Bluberi then proceeded to arrange litigation funding, eventually entering into an agreement with IMF Bentham Limited (now Omni Bridgeway Limited), a well-known litigation funder. Under the arrangement, Bentham would fund Bluberi's litigation against Callidus in exchange for a portion of any settlement or award. Bentham's interests in any settlement or award would be secured by a $20 million super-priority charge on Bluberi's assets. If the litigation failed, Bentham would lose all of its invested funds. In response, Callidus re-attempted to put its plan of arrangement to another vote. Aside from slightly increasing its offer to $2.88 million, the second plan of arrangement was virtually identical to the first, but this time Callidus sought to vote alongside the unsecured creditors. To do so, Callidus filed an amended proof of claim, valuing the security attached to its remaining $3 million in claims at nil, effectively putting it into the class of unsecured creditors. If the Court were to permit Callidus to vote as an unsecured creditor, the size of Callidus' claim effectively guaranteed a second approval vote would succeed.

But the Superior Court would not allow Callidus to vote, finding that it was acting with an "improper purpose": "It is one thing to let the creditors vote on a plan submitted by a secured creditor, it is another to allow this secured creditor to vote on its own plan in order to exert control over the vote for the sole purpose of obtaining releases."

Because Callidus would not be allowed to vote, the supervising judge determined that the second plan had no reasonable prospect for success and would not be voted on. With respect to Bentham's litigation funding, the Superior Court held that because it was not a plan of arrangement, it could, and would be, approved without a vote, with the support of Bluberi and the Monitor.

Callidus, and certain unsecured creditors, successfully appealed at the Quebec Court of Appeal. But on January 23, 2020 the Supreme Court of Canada restored the Superior Court's decisions, with reasons released on May 8, 2020.

The Court's Discretion to Bar a Creditor from Voting in Furtherance of an Improper Purpose

The Supreme Court rejected a strained interpretation of the CCAA advanced by the appellants that would have automatically barred any sponsor of a plan of arrangement from voting on their own plan. Instead the Court relied on section 11 of the CCAA, which sets out the Court's general powers, as conferring the jurisdiction on a supervising judge to bar a creditor from voting where they are specifically found to be acting for an "improper purpose".

It is notable that the Supreme Court describes this power as almost entirely discretionary, but not boundless, needing to be exercised in furtherance of the remedial objectives of the CCAA and with three baseline considerations in mind: (1) that the order sought is appropriate in the circumstances, and (2) that the applicant has been acting in good faith and (3) with due diligence.

Still, as the Court's guidance remains broad, it will fall on to the supervising judges to exercise this discretion, based only on the considerations arising from the particular cases and circumstances before them.

Litigation Funding as Interim Financing

The Quebec Court of Appeal held that Bentham's litigation funding could not be interim financing under the CCAA, because it was not connected to Bluberi's commercial operations. The Supreme Court disagreed, noting that while conventional interim financing is designed to "keep the lights on", in the case at bar, where there was a single litigation asset to be monetized for creditors, litigation funding served the basic purpose of interim financing. The question was whether the financing arrangement at issue had the objectives of enabling “the preservation and realization of the value of a debtor's assets”.

The Supreme Court also overturned the Quebec Court of Appeal’s finding that the Bentham litigation funding agreement was a plan of arrangement. The Supreme Court reasoned that the litigation financing arrangement was no different than any other interim financing that requires payment of fees and interest. While the cost of interim financing may reduce the amount available to be distributed to creditors, it does not alter or compromise the terms of the creditors' indebtedness or their legal rights. Rather the litigation funding was a means by which the “pot of gold” available to creditors could be bigger or smaller, but without compromising any creditor’s right to their share.

The Court adopted the reasoning of the Ontario Court of Appeal in *Re Crystallex*, that a debtor-in-possession financing facility consisting of a litigation funding agreement was not an “arrangement or compromise” because the creditors were not party to the agreement, and no creditors' rights were taken away or limited in any way. All of their rights remain unaffected.

Conclusion

In many ways Callidus fell victim to a strategy of being insufficiently aggressive at the first creditors’ vote, and then overly aggressive at the second. It was noted by the Court that at the first vote, the Monitor would have allowed Callidus to vote “the portion of its claim, assessed by Callidus, to be an unsecured claim”. Doing so might well have been enough to carry a close creditor vote for Callidus’ plan of arrangement. But having failed to win the first vote, the Court would not countenance Callidus’ attempt to override the result, and conduct a new process that was obviously manipulated to guarantee a victory.

The Supreme Court’s broad interpretation of a supervising judge’s powers should be a caution to creditors and stakeholders that, while they are entitled to act and vote in their self-interest, the Court retains a broad discretion to ensure that its process must serve broad remedial objectives of the CCAA, including the concept of basic fairness which it said “permeates Canadian insolvency law and practice”.

Finally, the Supreme Court noted the increasing use of third-party litigation funding arrangements, and confirmed they may be approved as interim financing in CCAA proceedings, when they would promote the specific Section 11.2(4) factors applicable to the particular case.