

A photograph of the Supreme Court of Canada building, a large, light-colored stone structure with a dark green, gabled roof and multiple dormers. The building is set on a green lawn with some fallen leaves. Two flagpoles with Canadian flags are visible on either side of the building. The sky is clear and blue.

Supreme Court of Canada

Affirms Litigation Funding as a Tool for Insolvency Practitioners

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In today's economic climate, insolvency practitioners must be diligent in preserving an estate's assets and creative in identifying unrealized value. Insolvent entities occasionally have claims that, if properly resourced and advanced, could yield value for creditors and other stakeholders. However, litigation is uncertain and expensive.

Recent guidance from the Supreme Court of Canada has opened the door to litigation funding as a means of maximizing estate value while minimizing cost and risk. Given the close economic integration between Canada and the U.S., as well as Canada's role as a global leader in the resources sector, legal action in Canada may be an untapped asset in many U.S. and other foreign bankruptcy and insolvency matters.

This article sets out scenarios in which litigation funding may be a suitable tool for advancing a claim in Canada and the judicial guidance on how it can be used to maximize an estate's value.

Options for Pursuing Litigation

In the ordinary course, most companies prefer to avoid litigation, so when facing difficulties, they may not be inclined to see claims as unrealized assets. But potential claims arise in a range of circumstances, including matters:

- Arising from business in the usual course, such as breach of contract or theft of corporate opportunity
- Related to the events that led to the financial distress, such as breach of directors' fiduciary duties or transfer under value
- Associated with the insolvency proceeding itself, such as fraudulent conveyances or unfair preferences

Litigation may be the only remaining asset, or it may be one of many to be assessed by the insolvency practitioner and its counsel. In either

case, claims are potential assets that should not be ignored if the goal is to help creditors and other stakeholders maximize recovery. Whether the estate is being liquidated or restructured, these claims might yield returns and add value to the estate.

Investigating and advancing litigation is expensive. The costs include retaining legal counsel and outside experts, *e.g.*, forensic investigators or asset tracers. In Canada and other "loser pays" jurisdictions, a litigant must also reserve money for any adverse costs awards¹ if the claim is unsuccessful.

Insolvency practitioners can consider a number of avenues to pursue the claim. First, when acting in the role of bankruptcy trustee or court-appointed monitor, they may use the insolvent entity's own money. This may not be an option when there are insufficient funds in the estate or where risk-averse creditors do not want to take a chance of exhausting the estate's limited funds. Creditors may prefer an early and definitive distribution over one that requires waiting for the outcome of uncertain litigation.

Second, they can retain counsel on a contingency fee basis. This can be challenging in Canada, where relatively few sophisticated commercial litigators are willing to act on a contingency fee basis. It also does not assist with out-of-pocket expenses, including experts and security for costs, nor does it mitigate against the risks of an adverse costs award.

Third, where a bankruptcy trustee is unwilling to advance litigation in the estate's name, a creditor or group of creditors can choose to advance the action at their own cost. If they do so, any return belongs solely to the creditors that advanced the claims. This requires sufficient funds and appetite among the creditors.

continued on page 18



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continued from page 17

In many instances, none of these options is viable and potential claims are abandoned. The contingent asset is not realized, and creditors receive less return than might have been possible. Prudent insolvency practitioners in matters that involve Canada now have another tool to consider before resigning themselves to this outcome.

Bluberi v. Callidus

In *Bluberi*,² Canada’s highest court provided guidance to insolvency practitioners on several important questions, though for global insolvency practitioners, the most important one was: Can litigation funding be approved by a court as interim financing pursuant to the Companies’ Creditors Arrangement Act (CCAA)?³

Bluberi was undergoing restructuring pursuant to the CCAA. As part of its efforts, it intended to assert a claim against its former lender, Callidus, alleging that it caused Bluberi’s demise. Bluberi lacked the funds to advance that claim and sought funding. The company entered into a litigation funding agreement (LFA) with the authors’ firm⁴ whereby the firm agreed, subject to CCAA court’s approval, to pay Bluberi’s legal fees and disbursements, in exchange for a portion of any proceeds of the litigation against Callidus. If the litigation was unsuccessful, the firm would lose its investment and pay any costs orders.

The court-appointed monitor supported the funding arrangement, and Bluberi moved for the court’s approval of the LFA. Callidus opposed the LFA and brought its own cross-motion that proposed an alternative course of action for court approval.

The court approved Bluberi’s LFA, holding that it was “the only avenue that [could] potentially allow for any meaningful recovery for the creditors.” The court also decided it was not necessary to get creditor approval for the financing arrangement, because the LFA was a form of interim financing and such financings can be approved by the court without a vote of creditors.

The Quebec Court of Appeal overturned the lower court, but the Supreme Court of Canada unanimously restored the lower court’s decision. In so doing, the Supreme Court issued the following guidance:

1 The objectives of the CCAA are to maximize creditor recovery, preserve going-concern value where possible, sustain jobs and communities affected by the firm’s financial distress, and enhance the credit system generally. The goal of any interim financing within this restructuring is to preserve and realize the value of a debtor’s assets.

2 The CCAA achieves these objectives by giving a “unique supervisory role” to a single judge. That judge “acquires extensive knowledge and insight into the stakeholder dynamics and the business realities of the proceedings.”

3 The supervising judge has broad discretion to make orders in furtherance of the remedial objectives of the CCAA and respond to the circumstances of the case, including the judge’s fact-specific inquiry into whether to approve interim financing. Judicial orders reached after considering fairness to all parties and the objectives of the CCAA are entitled to deference.

As a result, the Supreme Court deferred to the discretion of the

supervising judge, who recognized interim financing in the form of an LFA would do more than “keep the lights on”—it could increase the pool of assets available to all the creditors. Moreover, interim financing is not ipso facto a plan of arrangement requiring a creditor vote, so the CCAA judge could approve the LFA without a vote of approval from creditors.

Finally, the Supreme Court endorsed the idea that a litigation claim can be a “pot of gold”⁵ and dispute financing can enable the debtor to find value that would not otherwise be achievable. This was consistent with the idea that interim financing is a flexible tool that can take different forms to achieve the CCAA’s objectives.

Building on Bluberi

The guidance in *Bluberi* has opened the door (or given additional comfort) to insolvency practitioners who want to explore litigation to increase an estate’s assets. Two examples of ways in which litigation can be pursued within an insolvency follow, and given the creativity and flexibility permitted by the CCAA, more will likely emerge over time.

*Northern Pulp (Supreme Court of British Columbia, September 2020)*⁶ concerns a large pulp mill in Nova Scotia, which is currently shut down as it seeks a restructuring solution to its financial problems. Interim financing was sought to enable the company to pursue the restructuring; without the financing, the mill will likely go into receivership or bankruptcy, yielding nothing for the majority of stakeholders.

Unlike in *Bluberi*, the proposed financing did not have the sole purpose of funding litigation (or potential litigation). However, it did include, as part of a broader financing,

funds to advance possible litigation against the province of Nova Scotia, which is also a secured creditor.

The court-appointed monitor supported this financing. Nova Scotia opposed it and questioned whether it had been included simply to improve the debtors' negotiating position.

The court approved the interim financing, including the portion to advance litigation. It noted the *Bluberi* holding that funding to preserve a litigation asset may be appropriate if it is intended to preserve and realize upon that asset for the benefit of the stakeholders. In approving this funding, the court also granted the interim lender a superpriority over the entirety of the debtors' assets, not just over litigation proceeds.

This decision affirms that litigation financing can be a tool on its own or one used in conjunction with others for realizing assets in an insolvency. Litigation should only be commenced after careful consideration, which often requires an investment of time and capital to do properly. Litigation financing also gives practitioners the flexibility to obtain funds and take time to explore potential claims.

In *Re Sears Canada Inc.* (Superior Court of Ontario (Commercial List), September 2020), the debtor had some assets to pursue litigation but doing so would delay (or deplete) the distribution to creditors. The court approved the appointment of a law firm to investigate litigation claims arising out of significant dividends that were paid in the years prior to Sears' CCAA filing and subsequent liquidation.

The law firm identified potential litigation, and the court then appointed a retired judge as a litigation trustee to advance the litigation for the benefit of the stakeholders. The court also mandated the litigation trustee to consider and report on possible funding arrangements for any litigation.⁷

The creditors were offered the opportunity to opt out of the litigation and receive an immediate payment, protecting their payout but foregoing any share of any settlement/award from the litigation. The litigation proceeded as directed by the litigation trustee and resulted in a significant settlement, to the benefit of the creditors that did not opt out of the litigation.



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What Next?

The availability of litigation funding for insolvency matters is helpful as companies explore their options in the current economic climate. Where a matter crosses into Canada, practitioners have an additional tool to realize assets without depleting existing resources. Given the Supreme Court of Canada's confirmation in *Bluberi* of the flexibility of insolvency legislation in Canada—and the deference to be accorded to the supervising court in exercising its discretion in approving bespoke proposals under that legislation—one can expect more creative arrangements in the future. ■

¹In most Canadian jurisdictions, the unsuccessful party in litigation must pay a portion of the other side's legal fees and out-of-pocket expenses. In some circumstances, the litigant may be required to pay such costs in advance to court by posting "security for costs."

²9354-9186 Québec Inc. v. Callidus Capital Corp., 2020 SCC 10 (Bluberi).

³The CCAA is often considered the Canadian equivalent of Chapter 11 of the U.S. Bankruptcy Code.

⁴Omni Bridgeway Capital (Canada) Ltd., then operating as Bentham IMF Capital Limited.

⁵*Bluberi*, para. 111.

⁶1057863 B.C. Ltd. (Re), 2020 BCSC 1359.

⁷cfcanada.fticonsulting.com/searscanada/docs/Order%20Re_%20Litigation%20Investigator%20dated%20March%202%202018.pdf