**File No. _____**

# SUPREME COURT OF CANADA

**(ON APPEAL FROM A JUDGMENT OF THE COURT OF APPEAL OF QUÉBEC)**

BETWEEN:

**9354-9186 QUÉBEC INC. (FORMERLY BLUBERI GAMING TECHNOLOGIES INC.)**

**9354-9178 QUÉBEC INC. (FORMERLY BLUBERI GROUP INC.)**

**APPLICANTS**
(Respondents)

- and -

**CALLIDUS CAPITAL CORPORATION**

**INTERNATIONAL GAME TECHNOLOGY**

**DELOITTE S.E.N.C.R.L.**

**LUC CARIGNAN**

**FRANÇOIS VIGNEAULT**

**PHILIPPE MILLETTE**

**FRANCIS PROULX**

**FRANÇOIS PELLETIER**

**RESPONDENTS**
(Appellants)

(Style of cause continues next page)

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## APPLICATION FOR LEAVE TO APPEAL

**(Article 40(1) of the *Supreme Court Act* and Rule 25 of the *Rules of the Supreme Court of Canada*)**

- and -

**ERNST & YOUNG INC.**

**IMF BENTHAM LIMITED**

**BENTHAM IMF CAPITAL LIMITED**

**SMT HAUTES TECHNOLOGIES**

**INTERVENERS**
(Impleaded Parties)

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## APPLICANTS' FACTUM

## INTRODUCTION

1. Legal systems governed by the rule of law are founded on common pillars, notably: everyone is accountable under the law for their actions; checks and balances protect minority interests against the tyranny of the majority; and "[t]here cannot be a rule of law without access [to justice]"[1]. Courts are at the centre of this edifice: they are endowed with all the powers necessary to uphold these values.

2. These principles percolate through our entire legal structure. Insolvency law is no exception. In particular, the *Companies Creditors' Arrangement Act*, R.S.C., 1985, c. C-36 ("***CCAA***") confers upon courts the "broad and flexible authority" to achieve the remedial purpose of the *CCAA*; to protect the integrity of its own process; to impose adherence to "baseline considerations" such as "appropriateness, good faith, and due diligence"; and to create conditions for "a reorganization that is fair to all", including through counteracting abuse by a majority of creditors.[2] These principles are at the heart of the proposed appeal.

3. The Applicants (or "**Debtors**" or "**Bluberi**") are under *CCAA* protection. Their only asset is a $228 million claim against Respondent Callidus Capital Corporation ("**Callidus**", a subsidiary of Catalyst Capital Group Inc.) for damages they allege having suffered as a consequence of Callidus' predatory lending behaviour towards them—behaviour that caused the Debtors to require *CCAA* protection in the first place.[3]

4. Callidus wanted to proffer a plan of arrangement whereby it would pay under $3 million to the Debtors' other creditors. The *quid pro quo*? A release from the Debtors' $228 million

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1 *B.C.G.E.U. v. British Columbia (Attorney General)*, [1988] 2 S.C.R. 214, at p. 230 ("***B.C.G.E.U.***"), cited in *Trial Lawyers Association of British Columbia v. British Columbia (Attorney General)*, 2014 SCC 59, at para. 38. See also *Hryniak v. Mauldin*, 2014 SCC 7, at para. 1.

2 *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, at paras. 19, 60, 70 and 77 ("***Century Services***").

3 Judgment of the Superior Court, 2018 QCCS 1040 (the "**QSC decision**"), at paras. 60-62.

claim against Callidus. Callidus would thus buy itself a release "from creditors who have no interest in the awarding of such releases" [4] for a little over 1% of the value of the claim.

5. The Québec Superior Court ("**QSC**") expressed reservations but allowed Callidus to present its plan. The creditors rejected Callidus' plan. Then, Callidus asked the QSC for a second kick at the can – this time, with the intention to vote in favour of its own plan, thus overruling the concerns of the dissenting minority creditors and ensuring its plan's success.

6. The QSC refused. It held that "Callidus' behavior is contrary to the 'requirements of appropriateness, good faith, and due diligence'" and that to allow Callidus to put its thumb on the scale in favour of its own release would be to sanction "an improper purpose" and "would amount to a substantial injustice" (QSC decision, at paras. 48 and 56). Rather, the QSC held that the Debtors, who had secured the necessary financial support to bring a lawsuit, should be allowed to bring their claim and hold Callidus to account for its actions.

7. The Québec Court of Appeal ("**QCA**") disagreed. It held that the QSC did not have jurisdiction to prevent Callidus from advancing a plan of arrangement "whose clear and transparent purpose"[5] was to allow Callidus to escape any prospect of accountability for its role in the Debtors' demise, or to preclude Callidus from casting the decisive vote in favour of its own release. The net result: rather than a court of law, it is an assembly of creditors bought out by Callidus that effectively decides the merits of the Debtors' claims against Callidus, with Callidus holding the swing vote. "[T]he rule of law is replaced by a rule of men and women who decide who shall and who shall not have access to justice"[6].

8. In coming to its decision, the QCA adopted a *rules-based* approach, rather than a *principled* approach, to the court's role under the *CCAA*. Rather than safeguarding the judicial discretion that underpins the flexible and purposive powers of a *CCAA* court, the QCA held that the QSC could not take into account factors like appropriateness, good faith and "broader

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4 QSC decision, at para. 44.

5 Judgment of the Court of Appeal, 2019 QCCA 171 (the "**QCA decision**"), at para. 63: "The clear and transparent purpose of Callidus in proposing the plan is to obtain a release from the Respondents' claim against it, or, in other words, to settle the threatened lawsuit."

6 *B.C.G.E.U.*, at p. 230.

public interest"[7] principles when deciding whether to call a creditors' meeting. Instead, when a creditor like Callidus abides by the strict letter of the *CCAA*, the QSC has no power to interfere. By coming to that result, not only did the QCA commit errors of law, but it removed the ability of *CCAA* courts to intervene when strict adherence to the letter of the law is used to promote lawlessness in the commercial realm.

9. This case raises fundamental questions of insolvency law, questions that have never been addressed by this Court. What is a plan of arrangement? Does litigation funding meet its definition? Can a creditor vote on its own plan? If so, should it vote in the same class as the other creditors? When do creditors share a "commonality of interest" that allows them to vote in the same class? Should that term be interpreted *broadly* (which may lead to fragmentation of classes and result in tyranny of the minority), *narrowly* (which may lead to tyranny of the majority), or *purposively*? Can a plan of arrangement's sole purpose be to provide a third-party release that covers wilful misconduct? Does the court have jurisdiction to preclude a creditor from voting on a plan if it finds that it thereby pursues an "*improper purpose*"? Can the motivations behind a vote ever be questioned? Can the court consider principles such as accountability and access to justice when making orders?

10. Callidus admits that these questions are of the utmost importance to the practice of insolvency law throughout this country. Not only have appellate courts in different provinces – and elsewhere – offered inconsistent responses, but this Court has never had the opportunity to tackle core issues related to the presentation of plans of arrangements under the *CCAA*, let alone opine on governance issues in relation thereto. The Applicants submit that these are all matters of public and national importance.

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[7] *Century Services*, at para. 60.

## PART I – STATEMENT OF FACTS

11. The findings of fact of the first judge, at paragraphs 1 to 26 of his judgment, are not contested.[8] They are summarized below.

12. The Debtors specialized in electronic gaming machines. Their sole shareholder was Mr. Gérald Duhamel, through a family trust.

13. In August 2012, Callidus granted credit facilities of $24 million to the Debtors, ostensibly to help them evolve to a new business model. By 2015, approximately $86 million was owed (of which about half were in interest and fees). The business was in a tail spin.

14. The Debtors later concluded that Callidus had a hidden agenda and misrepresented their intentions. "Bluberi management strongly believed that Callidus had deliberately consumed the equity value of the Debtors with a view to ultimately owning the business" (QSC decision, at para. 40) through a wrongful "*loan to own*" strategy. The QSC said about this claim: "Obviously, at this stage, it is not possible to opine on the likelihood of success of the Debtors' claim. However, the steps that they have taken so far and the extent of the arguments they have submitted, appear to be serious." (QSC decision, at para. 62).

15. On November 12, 2015, the QSC issued an initial *CCAA* order in favour of the Debtors (the "**Initial Order**"). Callidus opposed same, alleging that the Debtors were not cash flow insolvent, a "submission [which] was in complete contradiction" with the position it took upon seizing the Debtors' voting shares (QSC decision, at para. 39). The QSC later found that the motivation behind this reversal of position, Callidus' general lack of transparency and its attempt "to exhaust Mr. Duhamel financially" was clear: Callidus wanted to prevent the Debtors from pursuing their claim against it (QSC decision, at paras. 40-41).

16. The only grievance that the QCA has against this finding of fact – that Callidus acted in bad faith (QSC decision, at para. 48) – is that, in coming to that conclusion, the first judge "relied

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[8] Appellant Callidus Capital Corporation's Memorandum (QCA), May 30, 2018, at para. 6, **Application for Leave to Appeal (hereinafter "A.L.A."), vol. III, p. 139.**

on affidavits and evidently, his impressions formed during the course of the *CCAA* process, which he supervised." (QCA decision, at para. 66). That is *precisely* his domain.[9]

17. In February 2017, the Debtors' assets were sold to Callidus for $134 million, an amount settled through a reduction of Callidus' debt (of which the vast majority represented interest and fees), except for a portion of $3 million. This residual debt would eventually become instrumental to Callidus' attempt to vote in favour of its own release from the Debtors' claim (or block any alternative plan of arrangement). Of note: the asset purchase agreement explicitly reserved the Debtors' claims against Callidus.

18. On September 11, 2017, the Debtors filed its first application for the approval of an interim financing that would allow it to pursue its claims against Callidus.

19. On September 18, 2017, on the eve of the hearing on the Debtors' application, and without any notice, Callidus filed a plan of arrangement. It offered $2 million (later amended to $2.5 million) to the Debtors' other creditors in exchange for a release from the Debtors' claim against Callidus. Callidus had never before shown any interest in the other creditors' plight. It is not contested that its sole motivation was to block the Debtors' claim (QSC decision, at para. 44, QCA decision, at para. 63).

20. On December 15, 2017, the plan was voted down. SMT Hautes Technologies ("**SMT**"), which held 36.7% in value of the voting claims, along with some former employees of Bluberi, all voted against the plan, blocking the 66 2/3% requirement under section 6 *CCAA*. Callidus, as a secured creditor, did not try to cast its vote and tip the scales.

21. On February 6, 2018, the Debtors applied for the approval of their litigation funding agreement ("**LFA**") with IMF Bentham Limited ("**Bentham**"), a publicly traded litigation

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9 *North American Tungsten Corporation Ltd. v. Global Tungsten and Powders Corp.*, 2015 BCCA 390, at paras. 9-10; *Resurgence Asset Management LLC v. Canadian Airlines Corporation*, 2000 ABCA 149, at para. 42; *Pacific National Lease Holding Corporation*, 15 CBR (3d) 265, at paras. 30-32.

funder with a track record of almost 20 years and a 91% success rate.[10] Bentham and Dentons LLP, then counsel to the Debtors, both concluded that the Debtors' claim against Callidus warranted taking an important financial risk. This spelled bad news for Callidus.

22. In response, on February 12, 2018, Callidus filed a motion to present a substantially identical plan, but for an increase in amount by $250,000. The motion had the support of a group of nine creditors whose legal fees are to be paid by Callidus under the second plan – namely, the other Respondents on this application.[11] SMT announced to the QSC that it would not change its vote, meaning that the second plan was doomed to failure. That is, unless Callidus were allowed to claim that its $3 million claim was unsecured and thus vote with the other creditors. This vote would flip the result, override the concerns of the minority creditors, and allow Callidus to grant itself a release from the Debtors' claim.

23. The QSC found that it would be "both unfair and unreasonable" to allow Callidus to buy "releases from creditors who have no interest in awarding such releases" and "to exert control over the vote for the sole purpose of obtaining releases" (QSC decision, at paras. 44-47). It concluded that "Callidus' behavior is contrary to the 'requirements of appropriateness, good faith, and due diligence'", that it "intends to use its vote for an improper purpose and that it should not be allowed to do so" (QSC decision, at para. 48).

24. The QCA disagreed. It held that the QSC did not have the jurisdiction to deny Callidus the right to vote in favour of its own release: "The exercise of discretion, <u>which is not legally available</u>, is an error in principle to which deference is not due by an appellate court" [our emphasis] (para. 59). The QCA overturned the findings of the QSC and held that "obtaining a release through a plan of arrangement even for […] plan sponsors is not improper", even when the release is of such breadth as to prevent accountability for the creditor who allegedly orchestrated the insolvency to acquire the going concern at a steep discount.

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10 Debtors' Application for the issuance of an order extending the stay of proceedings and for an order authorizing litigation funding and a litigation financing charge, February 6, 2018, at para. 61, **A.L.A., vol. II, p. 196**; Exhibit P-4, at p. 11, **A.L.A., vol. IV, p. 67.**

11 QSC decision, at para. 26. Incidentally, by paying the legal fees of the creditors who support the plan, the plan creates an unlawful distinction between them and other creditors.

## PART II – QUESTIONS IN ISSUE

25. The proposed appeal raises several questions of insolvency law which, by Callidus' own admission, are "of the utmost importance" to the practice of law throughout this country[12]:

**(a) Can a creditor vote on the *CCAA* plan it sponsors?**

Callidus admits that this is "the first time that this question is raised before a Court of Appeal since the addition of section 22(3) *CCAA*"[13]. Section 22(3) provides that a creditor who is related to the debtor may not vote in favour of a plan of arrangement. The reason is clear: in doing so, the creditor could favour the interests of the debtor, rather than its interests *qua* creditor. Its interests would be misaligned with those of other creditors and its vote could upset the delicate balancing of interests needed when approving *CCAA* plans.

The same rationale should apply to any creditor who sponsors a plan, irrespective of its relationship to the debtor. The creditor who is a plan sponsor always pursues an objective which is different from that of the other creditors: whereas the other creditors typically seek the best payout, the sponsor does not want to obtain a payment from itself, but rather something that is worth even more than the consideration it is offering to the other creditors. In such cases, the plan sponsor should not dilute the votes of the other creditors.

**(b) Can a creditor who sponsors a *CCAA* plan vote in the same class as the other creditors?**

This question is a subset of the previous one: if a creditor is allowed to vote on its own plan, in what class should it vote? Does the plan sponsor have a "commonality of interest" with its fellow creditors (section 22(2) *CCAA*)? In particular, is there a "commonality of interest" between the plan sponsor and the other creditors when the former's only "interest" is to obtain a release, whereas the latter's only "interest" is typically to obtain a payment on their claim? One would think that *poser la question, c'est y répondre*.

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12 Application for Leave to Appeal from a Judgment rendered under the Companies' Creditors Arrangement Act, April 5, 2018 at para. 25(b), (c), (d), (e) and (f), **A.L.A., vol. III, pp. 118-119.**

13 *Ibid*., at para. 25(b), **A.L.A., vol. III, p. 118.**

However, the case law is fickle. Some courts hold that the "commonality of interest" test should be read strictly, whereby only *legal* interests should be considered. Others have found that broader *economic* interests should be taken into account. Most if not all hold that if the plan treats creditors differently, they should vote separately (it is the case here: Callidus gets a release, the other creditors get a cash payment). In any case, the case law's hesitation on this question is problematic to the practice of insolvency law.

**(c) Does a *CCAA* court have jurisdiction to prevent a creditor from voting on a plan, and if so in what circumstances?**

Once again, Callidus recognizes that "it is of the utmost importance to confirm the right of the creditor to vote on a plan of arrangement sponsored by it regardless of its reasons to exercise its right to vote, or alternatively, to determine the criteria, if any, that the courts must consider in determining whether or not to allow a creditor a right to vote on a plan sponsored by it"[14]. The Applicants agree that this question requires appellate guidance.

The QCA held that while this jurisdiction exists under the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 ("***BIA***")[15], it does not exist under the *CCAA* (paras. 59-61). This runs against this Court's jurisprudence, which encourages harmonization of both regimes (*Century Services*, at para. 24). It also turns the regimes on their head: the "key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion" (*Century Services*, at para. 14). Finally, it disregards the "broad and flexible authority [of] the supervising court" to uphold "the requirements of appropriateness, good faith, and due diligence" (*Century Services*, at paras. 19 and 70).

**(d) Does a *CCAA* court have jurisdiction to authorize litigation funding without a vote of the creditors?**

Again, Callidus itself agrees that "it is of the utmost importance to clarify the conditions applicable to the approval of a third party litigation funding, in particular in *CCAA* matters […]. These types of agreements are relatively new to the practice and are likely to

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14 *Ibid.*, at para. 25(b), **A.L.A., vol. III, p. 118.**

15 *Laserworks Computer Services Inc. (Re)*, 1998 NSCA 42 ("***Laserworks***").

be seen more and more, hence the importance to submit this matter to [the QCA]"[16], and, the Debtors add, to this Court. The QCA itself notes that "'[c]ompromise' or 'arrangement' are not defined terms in the *CCAA*" (QCA decision, at para. 79), and the definition adopted by the QCA contradicts that of the Ontario Court of Appeal ("**OCA**") in *Crystallex (Re)*, 2012 ONCA 404 ("***Crystallex***"). How that conflict is resolved will have a momentous impact on the practice of insolvency law. This Court's guidance is needed.

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## PART III – ARGUMENT

## I. THE SPONSOR'S RIGHT TO VOTE ON ITS PLAN

### A. THE SPONSOR'S RIGHT TO VOTE *PER SE*

26. Can a creditor vote on the plan it sponsors? As basic as it seems, this question is a novel one. Its resolution is of paramount importance to insolvency law.

27. The question stems from section 22(3) *CCAA*, which is almost a carbon copy of section 54(3) *BIA*. The provisions respectively read as follows:

| | |
|---|---|
| 22(3) *CCAA*: A creditor who is related to the company may vote against, but not for, a compromise or arrangement relating to the company. | 54(3) *BIA*: A creditor who is related to the debtor may vote against but not for the acceptance of the proposal. |

28. The rationale for that rule is clear: the debtor and the creditors do not share the same interests. The debtor will generally seek the survival of its operations, whereas creditors will look to secure the greatest financial outcome for themselves, without regard to the debtor's survival. To allow a creditor who is related to the debtor to vote with other creditors on an arrangement or proposal would be unfair: the debtor would be able to upend the will of the creditors and divert the vote in favour of its own interests.

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[16] Application for Leave to Appeal from a Judgment rendered under the Companies' Creditors Arrangement Act, April 5, 2018 at para. 25(f), **A.L.A., vol. III, pp. 118-119.**

29. But what if a creditor sponsors a plan of arrangement under the *CCAA*? Like the debtor, the creditor who sponsors a plan pursues an interest which differs from that of the other creditors. That interest may be to lead the restructuring of an industry[17], to purchase the debtor's assets[18] or to secure a release from legal liability, according to the QCA. It is axiomatic that a creditor does not sponsor a plan in order to obtain a payment from itself.

30. It should flow logically that, for the very reasons that a creditor related to the debtor should not vote on its proposal or arrangement, a creditor should not vote on the plan of arrangement it sponsors. The creditors should be allowed to judge whether the plan that is presented to them is in their best interest, without having their votes diluted by interference from the sponsor of the plan, who pursues an interest fundamentally distinct from theirs.

31. There is a blind spot in the law whose origin seems clear. Section 54(3) *BIA* was introduced in a statutory scheme that only allows proposals emanating from a restricted list of persons identified at section 50(1) *BIA*, including the debtor, but *from which creditors are excluded*. Section 54(3) *BIA* was then reproduced at section 22(3) of the *CCAA*.[19] Yet, the fact is that *creditors* are also allowed to propose an arrangement under the *CCAA*. So, does a similar limit apply to creditors as it does to debtors or those related to the debtors? The question has never been addressed before (see QSC decision, at para. 54).

32. The history of *CCAA* practice is replete with examples of blind spots in the law being "flesh[ed] out" by the courts: "[t]he *CCAA* is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme."[20] If it were not for judge-made law, there would be no debtor-in-possession (DIP) financing[21], no interest stops rule in

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17 *Canadian Airlines Corp. (Re)*, 2000 ABQB 442 ("***Canadian Airlines***").

18 *Re Canwest Global Communications Corp.*, 2010 ONSC 4209 ("***Canwest***").

19 This amendment followed a recommendation made in the report of the Standing Senate Committee on Banking, Trade and Commerce (*Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*, (Ottawa: Senate of Canada, 2003), at page 151).

20 *Metcalfe & Mansfield Alternative Investments II Corp., (Re)*, 2008 ONCA 587 ("***Metcalfe***"), at para. 44, leave to appeal to this Court denied (CSC No. 32765).

21 *Re United Used Auto & Truck Parts Ltd*. (2000) 16 C.B.R. (4th) 141 (B.C.C.A.).

*CCAA* proceedings[22], and the list goes on.[23] Ironically, if it were not for judge-made law, Callidus would not be able to obtain the third-party release it covets (*Metcalfe*, at para. 43).

33. Is the court's inherent jurisdiction broad enough to prevent a creditor from voting on the plan it sponsors, even if there is no specific rule to that effect in the *CCAA*? Would it not be on all fours with the rationale advanced in sections 22(3) *CCAA* and 54(3) *BIA*? Would it not further one of the objectives of the integrated insolvency regime of the *CCAA* and *BIA*, which is to preserve the integrity of the creditors' vote? These arguments have not yet been addressed in the case law[24] and call out for guidance from this Court.

### B. THE MORE STRAIGHTFORWARD ARGUMENT: CALLIDUS IS A "RELATED PARTY"

34. Then there is the more prosaic question of whether Callidus is "related" to Bluberi. If it is, then it cannot vote in favour of its plan, no matter how section 22(3) *CCAA* is construed.

35. The QCA found that Callidus was not "related" to Bluberi. In doing so, the QCA rightly concluded that a creditor is related to the debtor under section 22(3) *CCAA* if they are "related persons" under section 4 *BIA*. However, the QCA failed to consider sections 4(2) and 4(3)(c) *BIA*, which hold that two persons are related if one controls the other, and one will be deemed to control the other if it "has a right under a contract, in equity or otherwise,

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22 *Re Nortel Networks Corp*., 2015 ONCA 681.

23 The *CCAA* did not originally contemplate the appointment of a monitor: *Re Northland Properties Ltd.*, (1988) 69 C.B.R. 266 (B.C.S.C.). It was amended in 1997 to make the appointment of a monitor mandatory. Courts have authorized the assignment of contracts despite contractual restrictions to same: *Re Playdium Entertainment Corp*., (2001) 31 CBR (4th) 302 (O.N.S.C.). This power was codified in the 2009 amendments (see section 11.3 *CCAA*). In *Asset Engineering LP v. Forest & Marine Financial Limited Partnership*, 2009 BCCA 319, the British Columbia Court of Appeal found that, while a limited partnership is not a "debtor company" within the meaning of the *CCAA*, it can nonetheless benefit from a stay of proceedings under the *CCAA*. Courts have also authorized the sale of all or substantially all the assets of the debtor outside of a plan of arrangement (see *Re Consumers Packaging Inc.*, [2001] O.J. No. 3736, leave to appeal dismissed, [2001] O.J. No. 3908). This power was codified in the 2009 amendments (see section 36).

24 *Canadian Airlines* allowed Air Canada to vote on the plan it sponsored after having concluded that it did not thereby act in bad faith. This should not be the end of the analysis.

either immediately or in the future and either absolutely or contingently, […] to control the voting rights in an entity" [our emphasis].

36. These provisions apply squarely in this case. To guarantee the loan, "the shares of [Bluberi] had been pledged and delivered to Callidus"[25]. If Bluberi defaults on the loans, Callidus may "prohibit" Mr. Duhamel from exercising "the right to vote the Investment Property, at which time [Callidus] will have the right to exercise the rights and powers related to such Investment Property including, without limitation the right to vote"[26].

37. Under this provision, Callidus could, "in the future" or "contingently", that is upon the "occurrence and continuance of an Event of Default", "control the voting rights in" Bluberi. This meets the test of section 4(3)(c) *BIA* head-on, making Callidus a creditor "related to" Bluberi.[27] On its own, this argument should have resulted in the dismissal of the appeal. But the QCA failed to consider section 4(3) *CCAA* and to distinguish between the *existence* of a right and the *exercise* of that right.[28] This Court should intervene.

## II. THE TEST ON CLASSIFICATION OF CREDITORS

### A. "COMMONALITY OF INTEREST"

38. From a policy perspective, this question is related to the previous one: it is concerned with conflicting interests when voting on a plan. In 2009, section 22 *CCAA* codified (another) judge-made rule on the separation of creditors into classes for the purpose of the vote:

> 22 (2) For the purpose of subsection (1), creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest […] [our emphasis]

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25 *Bluberi Gaming Technologies Inc./Bluberi jeux et technologies inc. (Arrangement relatif à)*, 2015 QCCS 5373, at para. 7.

26 Section 7.1 of the deed of hypothec and letter from Callidus dated November 7, 2015 (respectively exhibits P-8C and P-6 in support of the Application for the Issuance of an approval and vesting order and for extension of the stay of proceedings, **A.L.A., vol. II, pp. 56ff**).

27 L.W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *The 2018-2019 Annotated Bankruptcy and Insolvency Act*, (Toronto: Carswell, 2018), at p. 25.

28 QCA decision, at paras. 52-56.

39. *Sovereign Life Assurance Co. v. Dodd* (1892), [1891-4] All E.R. Rep. 246, [1892] 2 Q.B. 573 (C.A.) ("***Dodd***") is often cited for its statement of the "commonality of interest" test: "if a different state of facts exists with respect to different creditors, which may affect their minds and judgments differently, they must be separated into different classes."[29]

40. This suggests that the interests to be taken into account are not limited to *legal* interests. In the present case, the plan sponsor wants a release and the other creditors want the best recovery possible. Is that a "state of facts" that affects their "minds and judgments differently"? The answer may appear evident at first; however, a review of appellate case law shows divergent views on the question. For instance, in *Stelco*, the OCA approves this statement made in *Canadian Airlines*:

> 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.[30] [our emphasis] (para. 23)

41. Callidus argued that, under such a strict interpretation of section 22(2) *CCAA*, its *legal* interest as a creditor is the same as that of the other creditors. It should thus vote in the same class. The QCA accepted this argument without considering whether a broad, strict or purposive interpretation of the "commonality of interest" test should be followed:

> [74] In this case, Callidus is both a creditor and a plan sponsor. Upon valuation of its security, it should vote with the ordinary creditors. The plan is a settlement of proposed litigation targeting it. In such capacity, it is only natural that it receives a release. The crossover between the two capacities is that it has renounced to participation in the dividend. I see nothing in this state of affairs to justify an order that Callidus exercise its voting rights in a separate and distinct class of ordinary creditors. [our emphasis]

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29 At pp. 249-250. Cited approvingly in *Stelco Inc. (Re)*, (2005) 15 C.B.R. (5th) 307 (OCA) ("***Stelco OCA***"), at para. 21, affirming [2005] OJ No. 4814 ("***Stelco OSC***"). See also *Re San Francisco Gifts Ltd.*, 2004 ABQB 705 ("***San Francisco QB***") leave to appeal refused at 2004 ABCA 386 ("***San Francisco CA***"), where Topolniski J. considers interests broader than specific legal interests, including "the business situation of the creditors, and the practical effect on them of a failure of the plan." (para. 12). See also *Les Oblats de Marie Immaculée du Manitoba (Re)*, 2004 MBQB 71, at paras. 61-63. See also *Re Hawk Insurance Company Ltd*, [2001] EWCA Civ 241, **A.L.A., vol. IV, pp. 82ff.**

30 See also *SemCanada Crude Company (Re)*, 2009 ABQB 490, at para. 38. This stricter interpretation of the test is based on section 22(2)(d) *CCAA*.

42. This leads to an illogical result: if creditors who have different "remedies available to [them] in the absence of the compromise" (section 22(2)(c) *CCAA*), yet share an interest in obtaining the best recovery, are presumed unable to "consult together with a view to their common interest" (*Dodd* at p. 251, **A.L.A., vol. IV, pp. 126-127**), then how can Callidus, who wants a release, and the other creditors, who want a payment of their debt, enter into such consultations?

43. Unlike the QCA's decision, other cases have held that they cannot. In *San Francisco CA*[31], the court held that in "determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of the plan" [our emphasis]. These are not "legal interests that a creditor holds *qua* creditor in relationship to the debtor company". They are broader interests. And on all fronts, Callidus and the other creditors fail to meet the test:

(a) the plan clearly does not treat Callidus and the other creditors equally: if creditors who receive cash and those who receive other benefits are divided in separate classes[32], then *a fortiori* a creditor who receives a release and no payment should not vote with creditors who receive a payment and no release;

(b) the business situation of Callidus has nothing in common with that of the other creditors: Callidus has controlled the operations and finances of the Debtors, bought the Debtors' operations as a going concern, faces a $228 million lawsuit initiated by the Debtors and is sponsoring a plan that would allow it to obtain a release from same. The other creditors are only looking to recover amounts owing to them; and

(c) The difference in the practical effect of a failure of the plan on Callidus versus the other creditors could hardly be starker: Callidus would have to defend a $228 million lawsuit based on serious allegations of wilful misconduct, while the other creditors would support the lawsuit as an avenue for them to recover their claims.

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31 See Conrad J.A.'s reasons at paras. 12-15. See also *Ge Canada Finance Holding Company (Re)*, 2008 NBQB 144, at paras. 67-68. This is true even in other jurisdictions. See for example *UDL Argos Engineering and Heavy Industries Ltd v. Li Oi Lin*, [2001] HKCFA 19 ("***UDL***") (Hong Kong), **A.L.A., vol. IV, p. 189ff.**

32 *U.S. Steel Canada Inc. (Re)*, 2017 ONSC 1967, at paras. 13-14.

44. A broader interpretation of the notion of "interest" is also more consistent with other provisions of the *CCAA*. We run full circle with the first question here: why does section 22(2) *CCAA* preclude a creditor related to the debtor from voting in favour of a plan – regardless of its *legal* interest *qua* creditor – if not for the interests or motivations it shares with the debtor, as opposed to the other creditors?[33] If the *CCAA* takes into account a person's motivations to vote, then courts should not feel compelled to ignore them – absent bad faith[34], which the QSC *did* find to apply here – when interpreting the term "interest".

45. The debate is not exclusive to Canada. For instance, the New Zealand Supreme Court recently adopted a broad interpretation of the commonality test in *Trends Publishing International Limited v. Advicewise People Limited*, [2018] NZSC 62, **A.L.A., vol. IV, p. 155**:

> [66] […] If all creditors share a common interest in maximising the return on their debts and can be expected to vote accordingly (which will usually be the case), differences between them (whether in terms of rights or interests) will be of no practical moment. […]
>
> [67] But where, on the other hand, such common interest as the creditors share is, for some creditors, outweighed by other considerations, the working assumption may well be displaced. In that situation, the votes of the creditors can no longer be taken to represent the best interest of all members of the class. Where creditors whose pre-compromise rights and interests are materially the same are treated differently under the proposed compromise, however, separate classes will almost certainly be required. Also relevant will be the benefits and drawbacks of the proposal for particular creditors or groups of creditors. Allowance must therefore be made for the possibility that creditors might, by reason of other interests in a company (for instance as shareholders or directors), not share the same class-promoting view as other creditors.[35] [our emphasis]

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33 See also section 109(6) *BIA*.

34 *Stelco OCA*, at para. 23, citing *Canadian Airlines* at para. 31.

35 The New Zealand Court of Appeal, for its part, noted that while "a precise test turning on legal rights could make it easier to advise on and plan for creditors compromises, and help avoid a plethora of possible classes, the cases demonstrate the danger of such a dogmatic rights-based approach" [our emphasis] (*Trends Publishing International Limited v. Advicewise People Limited*, [2017] NZCA 365, at para. 55, **A.L.A., vol. IV, p. 185-188.**). Note that this debate also takes place in other jurisdictions: see *UDL Argos*, *supra* note 30, **A.L.A., vol. IV, pp. 189ff** and *First Pacific Advisors LLC v. Boart Longyear Ltd*, [2017] NSWCA 116 (Australia), **A.L.A., vol. IV, p. 81.**

46. The Applicants suggest that this is the proper application of the commonality test. Indeed, a "fair, large and liberal construction and interpretation"[36] of section 22(2) *CCAA* would allow courts to prevent injustices and uphold "the requirements of appropriateness, good faith, and due diligence". Given the "flexibility which is [the *CCAA*'s] genius – there can be no fixed rules that must apply in all cases"[37]. Courts should thus be able to prevent a "tyranny of the minority" (through an excessive number of classes) *and* to prevent a "tyranny of the majority" (which would flow from a strict interpretation of section 22).[38]

## III. THE COURT'S POWER TO PREVENT AN IMPROPER PURPOSE

47. Quite apart from classification issues and whether a sponsor can vote on its plan, the QCA held that while the QSC would have had jurisdiction, under the *BIA*, to prevent Callidus from voting for an "improper purpose", the QSC did not have this power under the *CCAA*:

> [59] Improper purpose developed as a reason for a court to exercise its jurisdiction to dismiss or stay a petition for a bankruptcy order under what is now Sections 43(7) and 43(11) BIA, even though the basic prerequisites (debt and act of bankruptcy) for the making of such an order are present. The discretion arises from the statute. Improper purpose in filing the petition is a reason to exercise the discretion; it is not the source of the existence of the discretion in law. The exercise of discretion, which is not legally available, is an error in principle to which deference is not due by an appellate court. [our emphasis]

48. The QCA declined to follow the precedent laid out by the Nova Scotia Court of Appeal in *Laserworks* as "exhibit[ing] some harmony with the general scheme of bankruptcy law", whereas the "[d]ynamic of a vote on an arrangement under the *CCAA* is different." (QCA decision, at para. 61).

49. This different treatment of powers under the *BIA* and *CCAA* runs against the direction promoted by this Court in *Century Services* "towards harmonizing aspects of insolvency law

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36 *Interpretation Act*, R.S.C., 1985, c. I-21, section 12. See also *Metcalfe*, at para. 44.

37 *Stelco OCA*, at para. 22. See also *Metcalfe*, at para. 44.

38 *Stelco OSC*, at para. 15. The Hong Kong Court of Final Appeal similarly noted in *UDL* that "the risk of empowering the majority to oppress the minority" must be "balanced against the opposite risk of enabling a small minority to thwart the wishes of the majority".

common to the two statutory schemes [*CCAA* and *BIA*] to the extent possible" (para. 24).[39] It also conflicts with the fact that the "key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion" (para. 14) [our emphasis], and not the opposite.

50. Prior to the QCA decision, it was trite that a court had the discretion to convene a meeting of the creditors (section 4 *CCAA*) and could refuse to exercise same if the proposed plan was not "fair and equitable"[40]. That is what the QSC did: it held that Callidus' attempt to "exert control over the vote" was "unfair and unreasonable" and refused to convene the creditors' meeting it sought (para. 47). The QCA decision questions that jurisdiction.

51. The QCA also held, in *obiter*, that even if the QSC had the jurisdiction to prohibit Callidus from voting on its plan, "its application should be reserved for the clearest of cases" (para. 62). It further held that Callidus' conduct in this case – which the QSC found to be in bad faith (QSC decision, at para. 49) – did not meet this stringent test. If this inflexible test were maintained, the "broad and flexible authority [of] the supervising court" would be in shackles, preventing it from upholding "the requirements of appropriateness, good faith, and due diligence [which] are baseline considerations that a court should always bear in mind when exercising *CCAA* authority" (*Century Services*, at paras. 19 and 70).

52. In the final analysis, the purpose of insolvency law is to "allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors" or alternatively, "the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules" (*Century Services*, at para. 12; see also paras. 59 and 70). The goal is to avoid a liquidation process which "destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated

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39 See also *Nortel Networks Corporation (Re)*, 2015 ONCA 681, at paras. 34-36; and *Dundee Oil and Gas Limited (Re)*, 2018 ONSC 1070, at para. 14.

40 *Federal Gypsum Company (Re)*, 2007 NSSC 384, at paras. 3-6; *Target Canada Co. (Re)*, 2016 ONSC 316, at paras. 68-72; *Crystallex International Corp. (Re)*, 2013 ONSC 823, at para. 9; *Doman Industries Ltd. (Re)*, 2003 BCSC 376, at para. 8.

the social evil of devastating levels of unemployment" (*Chef Ready Foods Ltd. v. Hongkong Bank of Canada*, 4 C.B.R. (3d) 311 (B.C.C.A.), at p. 318, cited in *Metcalfe*, at para. 50).

53. This is not the purpose sought by Callidus' plan: there is no attempt to preserve a going concern, nor any orderly liquidation of the Debtors' assets. The Debtors' only significant asset is a claim against Callidus for having "destroyed the shareholders' investment", and Callidus uses the *CCAA* process to rid itself of this claim by "buying releases from creditors who have no interest in the awarding of such releases" (QSC decision, at para. 44).

54. The contrast with *Metcalfe* is plain. The case concerned the *CCAA* proceedings related to the Asset Backed Commercial Paper liquidity crisis. The plan, which was needed "to restore confidence in the financial system in Canada" (para. 118), included third-party releases. The OCA held that in order to be in "keeping with [the] scheme and purpose" of the *CCAA* (para. 69), "there must be a reasonable connection between the third-party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third-party release in the plan" (para. 70). The OCA concluded that "the claims to be released are rationally related to the purpose of the Plan". The purpose of the plan? No less than ensuring "the financial viability of the Canadian ABCP market itself" (para. 53). This clearly aligned with the "remedial purpose of the CCAA" (para. 50).

55. In the instant case, the release is not connected to a broader restructuring that otherwise achieves the remedial purpose of the *CCAA*. Rather, the release is the "sole", "clear and transparent purpose" of the plan of arrangement concocted by Callidus (QSC decision, at para. 47; QCA decision, at para. 63). It is submitted that the QSC was right to conclude that this did not conform with the "scheme and purpose" of the *CCAA*, or in other words, that it pursued an "improper purpose". But there is more.

56. Even in a case as important as *Metcalfe*, where the proposed plan was important for the viability of the financial markets as a whole, the third-party releases comprised an exclusion for fraud. Here, the release sought by Callidus must include fraud and wilful misconduct, otherwise it would serve no purpose. To our knowledge, the Callidus plan would thus, if sanctioned, be the first contested plan of arrangement to contain a release for fraud and wilful

misconduct.[41] Is this in the public interest? Is it permitted under the *CCAA*? This is an important governance issue which should be addressed by this Court.

## IV. LITIGATION FUNDING IN THE CONTEXT OF INSOLVENCY

57. On this question alone, the QCA decision threatens to destabilize the practice of insolvency law. In particular, the notion of "plan of arrangement" – and whether it applies to litigation funding – is now drastically different in Ontario and Québec.

58. The conflict is between the OCA decision in *Crystallex* and the QCA decision. The cases are very similar. In both cases, the debtors' only "significant" asset was a claim which, if successful, would repay all creditors (*Crystallex*, at paras. 4, 16 and 82). In both cases, the debtors sought interim funding to finance their legal claims, which solution was contested by some of their respective creditors, who wished to pursue an alternative avenue for recovery. In both cases, "[t]he primary issue [was] the scope of financing the supervising judge can or should approve, without the sanction of creditors" (*Crystallex*, at para. 1). Yet, they arrived at diverging definitions of a "plan of arrangement" and inconsistent results:

(a) in *Crystallex*, the OCA concluded that a plan of arrangement has to compromise the creditors' claims. Litigation funding is *not* a plan if it does "not compromise the terms of [their] indebtedness or take away any of their legal rights" (para. 93);

(b) in the judgment below, the QCA concluded the opposite: a plan of arrangement does *not* have to compromise the creditors' claims. According to the QCA, "the process undertaken to satisfy" the claims, including the litigation funding sought by the Debtors, is also a plan of arrangement (QCA decision, at para. 85).

59. The QCA refused to follow the *Crystallex* precedent based on the fact "that both the debtor company and the noteholders in Crystallex wanted the arbitration to be pursued" (para. 80).

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41 All other sanctioned plans of arrangement incorporating third party releases comprised exclusions for fraud, gross negligence or wilful misconduct: see, *inter alia*, *Canwest*, at para. 30. That the release sought herein is not "fair and reasonable" is also consistent with sections 11.51(4) and 11.8(3) *CCAA*.

This is circular: all the Debtors' other creditors would logically have "wanted the [litigation] to be pursued", but for Callidus offering to buy a release from them.

60. The QCA further held that "[w]e are faced with two possible and competing sources of creditor recovery – i.e. litigation or the offer of settlement of that litigation by Callidus", whereas "[t]he only competing interests in Crystallex were as between the debtor (together with the DIP lender) and the noteholders as to who would finance the litigation." This is a distinction without a difference: if the creditors in *Crystallex* did not expect a different return under their preferred course of action versus the interim financing, why would they have contested the latter? In both cases, "there was a choice of recovery for the creditors" (para. 91). In *Crystallex*, the matter was not put to a vote, yet here it should be?

61. Finally, the QCA's determination of what constitutes a "plan of arrangement" could have sweeping consequences. Unless this Court resolves the case law conflict, would an Ontario debtor wishing to proceed to an orderly liquidation of its assets be able to do so with the court's sole authorization (section 36 *CCAA*), while a Québec debtor would need a formal vote of the creditors to do so? Would such an inconsistency apply to cases involving non-litigation related DIP financing? The risks from such inconsistent interpretation of the *CCAA* are obvious: plans of arrangements under the same legislation could lead to different requirements in Canada's two most populous provinces. This threatens the predictable and stable application of insolvency law, and calls out for this Court's attention.

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## PART IV – COSTS

62. The Applicants will seek costs against the Respondents.

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## PART V – ORDER SOUGHT

63. Applicants request that this Court grant its Application for leave to appeal from the decision of the QCA rendered on February 4, 2019.

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Montréal, April 4, 2019

Jean-Philippe Groleau.

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## PART VI –TABLE OF AUTHORITIES

**Legislation** **Paragraph(s)**



**Jurisprudence**

**Jurisprudence** ***(cont'd)***

**Jurisprudence** ***(cont'd)***



**Doctrine**



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