Lessons for Singapore from the Canadian Supreme Court's decision on third party funding agreements in insolvency situations

1 When the relief period set out in the Covid19 (Temporary Measures) Act 2020 ends on 19 October 2020, Singapore may experience a surge of restructuring and insolvency proceedings directly resulting from the financial distress caused by the pandemic.

2 Financially distressed businesses which wish to seek recovery of debts owed to them due to this crisis may not have the funding to commence litigation.

3 In the same vein, creditors who are seeking recovery from distressed companies will then have to ask themselves: Does it make commercial sense to incur the costs of litigation against an insolvent company, its directors or relevant third parties so as to realise some value on its debts?

4 Third party funding could offer a solution to this conundrum.

5 The authors will explore the state of third party funding in Singapore in insolvency situations and draw lessons from the recent Canadian decision of *9354-9186 Quebec Inc v Callidus Capital Corp.*, 2020 SCC 10 ("**Quebec**") where third party funding in an insolvency situation was sought.

The facts of *Quebec*

6 The Bluberi family of companies ("**Bluberi**") sought financing from Callidus Capital Corporation in 2012. Callidus is a distressed lender and extended $24 million to Bluberi, secured in part by a share pledge agreement. By 2015, Bluberi owed Callidus $86 million.

7 In 2017, Callidus proposed a scheme of arrangement. However, it failed to receive sufficient unsecured creditor support.

8 Five months later, Callidus proposed a second scheme of arrangement, which was virtually identical to the first. However, in the "new" scheme, Callidus valued its remaining secured claim as zero, thereby allowing itself to vote as an unsecured creditor. As a result, Callidus had the super-majority votes it needed to push through the proposed plan of arrangement in the unsecured creditor class.

9 At the same time, Bluberi sought approval of litigation financing and a super-priority litigation financing charge to permit Bluberi to pursue its claim against Callidus for causing its insolvency (the "**Claims**").

10 Under the agreement, IMF Bentham would fund Bluberi's litigation of the Claims in exchange for receiving a portion of any settlement or award after trial. In addition, IMF Bentham would receive a $20 million super-priority charge in their favour over Bluberi's assets. However, were Bluberi's litigation to fail, IMF Bentham would lose all of its invested funds.

Supreme Court of Canada's ("SCC") decision

11 The SCC delivered its decision in *Quebec* on 8 May 2020.

12 Two main issues were raised:

a. First, whether Callidus had acted improperly in proposing the "new" scheme of arrangement and ought to be excluded from voting on the scheme of arrangement; and

b. Second, whether the third party funding arrangement and super-

priority litigation charge should be approved.

13 On the first issue, the SCC held that it was improper for Callidus to circumvent the creditor democracy that the relevant Canadian statute was seeking to protect by revaluing its claim to gain strategic control over the unsecured creditor vote.

14 The SCC noted that Callidus was invited by the scheme manager (or "*monitor*" – per Canadian terminology) to vote as an unsecured creditor in the first scheme of arrangement, but Callidus refused to do so.

15 Further, none of the factual circumstances relating to Bluberi's financial or business affairs had changed in the 5-month intervening period. Hence, the identical nature of the two schemes of arrangement made it clear that Callidus was simply seeking to take a second kick at the can and manipulate the vote on the "new" scheme.

16 Moreover, Callidus' course of action was plainly contrary to the expectation that parties act with due diligence in an insolvency proceeding – which includes acting with due diligence in valuing its claims and security.

17 In light of the above, the SCC held that Callidus ought to be excluded from voting on the "new" scheme of arrangement.

18 On the second issue, the SCC noted that such interim financing (otherwise known as "debtor in possession" financing) was needed to protect the going-concern value of the debtor company while it developed a workable solution to its insolvency issues. At its core, interim financing enabled the preservation and realisation of the value of a debtor's assets.

19 Here, where there is a single litigation asset (i.e. the Claims) that could be monetized for the benefit of creditors, the objective of maximizing creditor recovery has taken centre stage. While the super-priority litigation charge afforded to IMF Bentham would subordinate the other creditors' claims, it was a necessary trade-off, and would be fair and appropriate to the creditors, as it allows the debtor to realise the value of its assets when it would be unable to do so otherwise.

20 Hence, the SCC approved Bluberi's third party funding arrangement and the super-priority litigation charge.

Lessons for Singapore

21 Financially distressed companies (and their creditors) who are seeking recovery from their debtors or other parties in Singapore can similarly consider the option of third party funding as in the case of *Quebec*. The downside of doing so, as in *Quebec*, is that the potential recovery of existing debts will be subordinated to the third party funder's recovery.

22 Third party funding in the case of insolvent situations is an established practice in Singapore. While there is no express legislation providing for third party insolvency funding (unlike in the case of international arbitration), the Singapore courts have in recent years accepted the possibility of third party funding in the insolvency context.

23 In *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 ("**Re Vanguard**"), the Singapore High Court held that a liquidator could sell an insolvent company's causes of action or even the proceeds of such causes of action without offending the doctrine of champerty, pursuant to their statutory power of sale of the property of the company under section 272(2)(c) of the Companies Act.

24 *Re Vanguard* was followed by *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* [2018] 5 SLR 1337 ("**Solvadis**"). In *Solvadis*, the Singapore High Court approved a liquidator's contract with a funder, where the liquidator assigned the

company's right of recovery of receivables as well as causes of action against certain persons who had conspired with other third parties in relation to these receivables. In return for the assignment, the company received an initial sum, to be followed by between 40-50% of the sums recovered.

25 The recent decision of *Re Fan Kow Hin* [2018] SGHC 257 extended the permissibility of insolvency funding to individual bankruptcies.

26 These cases make it clear that the Singapore courts are open to the option of third party funding in insolvency situations. Therefore, this should be an option that should be seriously considered where appropriate.

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