

Financial Services Flash

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Champerty and Maintenance Revisited: Considering the Assignment of Litigation by Companies in Receivership

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On May 1, 2015, the Alberta Court of Appeal rendered its decision in *1773907 Alberta Ltd. v. Davidson*, 2015 ABCA 150, and allowed an appeal permitting an action, brought in the name of an insolvent company, to proceed, notwithstanding that the company had assigned this claim to a third party. As will be discussed, the assignment of an action to a third party is often found to be caught by the doctrines of champerty and maintenance, and the decision by the Court serves to identify where such an assignment will be permitted.

The insolvent company, Silverado Oilfield Ventures Ltd., commenced an action against a former employee to recover allegedly misappropriated funds. Before the action could be conclusively prosecuted, Silverado became insolvent and a receiver was appointed pursuant to the terms of a creditor's security agreement. The receiver subsequently negotiated a court-approved sale of Silverado's assets to 1773907 Alberta Ltd. ("**177 Ltd.**"). The assignment expressly included the action. Upon being notified of this assignment, the defendants brought an application for an order striking and summarily dismissing the claim as being vexatious and an abuse of process. The chambers judge granted the application, finding the assignment to be tainted by champerty and maintenance and pursued exclusively for the improper motive of profit.

The Court of Appeal referred [at para. 20] to *Black's Law Dictionary's* definition of champerty as "a bargain made by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered." Maintenance is similarly defined by *Black's Law Dictionary* as the process of "maintaining, supporting or promoting the litigation of another." These doctrines prevent the prosecution of claims by strangers, i.e. non-parties to the action, and third-party funding for bringing or maintaining actions where such third party lacks a legitimate interest in the claim. Assignments tainted by champerty and maintenance have traditionally been held to be void.

In allowing the appeal, the Court followed the decisions of McBain J. in *Weltco Properties Ltd. v. Retlaw Group International Inc.* (1991), 116 A.R. 198 ("**Weltco**"), and McLachlin J.A., as she then was, in *Fredrickson v. Insurance Corp. of British Columbia* (1986), 28 D.L.R. (4th) 414 (B.C.C.A.) ("**Fredrickson**") to evaluate the claims of champerty and maintenance. *Weltco* established the specific elements that must be proven where champerty is alleged, as well as situations in which an assignment of an action will not be overturned. In *Fredrickson*, McLachlin J.A. articulated the following test for a permitted assignment [at para. 37]:

An assignment of a cause of action for non-personal tort is generally valid if the assignee has a sufficient pre-existing interest in the litigation to negate any taint of champerty or maintenance. In determining if this test is met, the court should look at the totality of the transaction: *Trendtex*, per Lord Roskill at p. 531. A property interest ancillary to the cause of action assigned is sufficient to support an assignment, but not essential. A genuine pre-existing commercial interest will suffice. The term “commercial interest” is used in the sense of financial interest; it need not arise from commercial dealings in the narrow sense.

The Court noted that, although the transaction between the receiver and 177 Ltd. was not a share purchase agreement, 177 Ltd. had effectively acquired all of the assets of Silverado for the purpose of carrying on its business, and the action was specifically identified in the asset purchase agreement. Consequently, a recovery on the wrongfully converted funds of Silverado would properly form part of the assets being acquired by 177 Ltd. The Court determined that there was no improper motive for 177 Ltd. to profit from the fruits of the action and that 177 Ltd.’s motive was [at para. 56] better characterized as “a desire to enforce rights for which [177 Ltd.] paid valuable consideration.”

A key takeaway from the Court’s decision is that, where a claim forms part of a package of assets acquired by a purchaser, the courts will hold that the property and commercial interests gained in this larger transaction provide the necessary interest permitting the purchaser to continue the action. In the context of receiverships, the Court also provides useful guidance [at para. 42] that there is a presumption that “assignments by receivers are made for legitimate commercial purposes, particularly if they have received court approval.” Accordingly, where a representative of the receiver swears in an affidavit that the offered price is fair and reasonable, the assignment of the action forms part of a sale of related assets, and the court approves the sale, an assignment of an action to a purchaser will generally be held to be valid and will not be tainted by champerty or maintenance.

There are also compelling public policy arguments in favour of permitting the assignment of such an action in a receivership context. First, the assignment of effectively all of the assets of a business in a receivership should not be a shield for the benefit of a defendant to an action that seeks the recovery of allegedly misappropriated funds. Moreover, there is a greater benefit to all stakeholders by preferring the public policy of fostering maximum realization of an insolvent company’s assets for the benefit of creditors over public policy concerns with respect to champerty and maintenance. Requiring a receiver to pursue uncertain litigation for a number of years serves no public benefit where there is a purchaser prepared to assume such risk and immediately convert the action to an appropriate purchase price for the benefit of creditors. Finally, the action serves to recover funds that, but for the alleged actions of the defendants, would have formed part of the assets contemplated in the sale. The purchaser of such assets should therefore retain a valid interest in the claim, notwithstanding the assignment.

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