

ASSIGNING CONTRACTS IN CANADIAN INSOLVENCY PROCEEDINGS

Posted on July 18, 2014

Categories: [Insights](#), [Publications](#)

Canadian restructuring and liquidation legislation provides struggling companies and bankruptcy trustees with powerful tools to restructure their affairs and maximize value for stakeholders. For example, in the right circumstances valuable contracts can be assigned, on notice to the counterparties, to buyers prepared to pay well for the rights conferred under the contracts. In such circumstances, the counterparty's bargained for right to withhold its consent to an assignment can be effectively overridden by court order. The recent decision of the Supreme Court of British Columbia in *Barafield Realty Ltd. v. Just Energy (B.C.) Limited Partnership* highlights the importance of proper notice.^[1]

The Barafield Realty Case

In *Barafield Realty*, the defendants acquired natural gas supply contracts pursuant to an asset purchase agreement entered into by the debtor in connection with its restructuring proceedings under the *Companies' Creditors Arrangement Act* ("CCAA").^[2] The contracts contained clauses that expressly prohibited assignment of the contracts without the consent of the counterparties. Other clauses permitted either party to terminate the contract upon the insolvency of the other party. The plaintiffs, who were counterparties to the contracts, were not given notice of the debtor's CCAA proceedings or the acquisition of the contracts by the defendants. The consent of the plaintiffs was not obtained or even sought – perhaps as a result of the significant number of customer contracts at issue.

After the plaintiffs were informed of the assignment they initiated litigation to terminate the contracts and seek damages from the defendants. The defendants argued that that the vesting order, which approved the assignment of the contracts, and the provisions of the CCAA, eliminated the need for the defendants to obtain the plaintiffs' consent or to notify them of the proceedings.

The court rejected these arguments and held that the CCAA, the *Bankruptcy and Insolvency Act* ("BIA"),^[3] and the wording of the vesting order did not alter the contractual rights of the plaintiffs. Among other things, the court held that CCAA proceedings generally cannot alter the contractual rights of third-parties without notice.

Statutory Guidance

The *Barafield Realty*, CCAA proceedings were commenced in 2008. In 2009, the CCAA and the BIA were amended to provide that a court may make an order assigning an agreement upon notice to each party to that agreement to any person who is specified by the court and agrees to the assignment.^[4] As such, it is now clear that courts have the jurisdiction to make an order assigning certain pre-filing contracts provided the counterparties are given adequate notice. These provisions do not apply to post-bankruptcy or CCAA filing agreements, collective bargaining agreements, eligible financial contracts (i.e. derivatives and certain other financial agreements) or to rights and obligations that are not assignable by reason of their nature.

In deciding whether or not to exercise its discretion to approve a proposed assignment, the court is to consider, among other things: a) whether in a CCAA proceeding the CCAA monitor approved the assignment; b) whether the person to whom the rights and obligations are to be assigned would be able to perform the obligations; and c) whether it would be appropriate to assign the rights and obligations to that person. A court may not make an order approving the assignment unless it is satisfied that all monetary defaults in relation to those agreements will be remedied on or before a date fixed by the court.

In Practice

When obtaining a vesting order it may be possible to obtain court ordered protections relating to the assignment. For example, clarification that provisions in the contract that purport to entitle the solvent counterparty to terminate the contract or that impose onerous terms on the assignee are not enforceable where they arise solely by virtue of the debtor's financial condition or the court ordered assignment.

Because the statutory provisions were enacted only relatively recently, courts have not had many opportunities to interpret the provisions in reported decisions. As a result, there remains some uncertainty as to how the provisions will be applied. For example: a) what constitutes a "monetary default"; b) exactly what rights and obligations are "not assignable by their nature"; and c) when is it appropriate for a court to assign rights and obligations to a specified person?

What is very clear is that counterparties that do not receive proper notice of the application to approve the assignment may not be bound by the assignment and may be permitted to terminate the contracts based on the insolvency of the assignor. Purchasers who intend to benefit from the assignment of such contracts must take care to ensure that proper notice is given.

by Adam Maerov and Mitchell Allison, Student-at-Law

[1] *Barafield Realty Ltd. v. Just Energy (B.C.) Limited Partnership*, 2014 BCSC 945 [*Barafield Realty*].

[2] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [CCAA];

[3] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [BIA].

[4] *CCAA*, *supra* note 2 at s 11.3; *BIA*, *supra* note 3 at s 84.1.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2014