

BROKEN BREAK FEE: INVESTOR'S CLAIM FOR A BREAK FEE DENIED IN CCAA PROCEEDING

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A recent decision of the British Columbia Supreme Court serves as a reminder to take special care when structuring commercial transactions where the counterparty is in financial distress. In *League Assets Corp. Re.*,^[1] an investment firm claimed a break fee on a deal that failed to close when the seller filed for protection under the *Companies' Creditors Arrangement Act*.^[2] The court dismissed the claim on the basis that the conditions to trigger the break fee were not met, notwithstanding that as a practical matter, the CCAA proceeding appears to have been an impediment to the conditions being fulfilled.

Background

In May of 2013, ANB Canada Inc. and IGW Industrial Limited Partnership entered into an agreement of purchase and sale for a commercial property IGW owned. IGW's obligation to carry out the transaction was conditional upon ANB obtaining certain regulatory approvals and having the transaction close before the end of the year, among others conditions (the "Vendor's Conditions"). If IGW terminated the transaction for reasons other than the Vendor's Conditions not being satisfied, ANB was entitled to a \$500,000 break fee.

Six months later, before closing, IGW filed for creditor protection under the CCAA. As usual, the initial order provided for a stay of execution on rights against IGW, and prevented ANB from taking any steps that would negatively affect any of IGW's rights under the agreement of purchase and sale. Upon its filing, IGW was also subject to section 32 of the CCAA requiring it to follow a specific process before any agreement, including the agreement with ANB, could be validly disclaimed.

December 31, 2013 came and went, and the agreement between ANB and IGW did not close. Further, ANB did not pursue any discussions with the Monitor or apply to the Court to force a completion of the agreement. Later, in accordance with the claims process order, ANB claimed the break fee as a result of the agreement's alleged termination.

Decision of the Court

The Court denied the claim, ruling that no break fee was payable.

ANB's claim turned on whether IGW terminated the agreement for reasons other than the Vendor's Conditions not being satisfied. ANB claimed that termination had been affected by the express notice of IGW's CEO and IGW's and the Monitor's implied conduct.

While the Court reviewed the alleged express notice and implied conduct, it held that such notice and conduct could not have resulted in a valid repudiation by IGW of the agreement with ANB. Rather, because IGW was subject to the CCAA, statutory provisions and provisions of the initial order meant to protect stakeholders applied. ANB's agreement with IGW could be validly terminated only if the procedure in section 32 of the CCAA was followed.

Section 32 of the CCAA provides that, so long as the monitor approves, a debtor company may – on notice given in the prescribed form and manner to the other parties to the agreement and the monitor – disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under the Act. Regulation 14 of the *Companies' Creditors Arrangement Regulations* sets out the required form and manner of notice. IGW had not given notice of repudiation through the prescribed form as required by s. 32 CCAA. Further, the Monitor had not consented to the disclaimer. As such, the Court concluded that there had been no valid repudiation.

In the end, the Court found that the termination of the agreement arose solely by reason of the non-fulfillment of the Vendor's Conditions and ANB's claim was dismissed.

Challenges of Dealing With a CCAA Debtor

There were principally two unfulfilled Vendor's Conditions that resulted in the termination of the agreement between IGW and ANB. First, ANB did not get regulatory approval of the deal. Second, the deal did not close before December 31, 2013.

As ANB explained in a letter to IGW after the CCAA filing, it was very unlikely that the requisite regulatory approval could have been obtained for the transaction because of IGW's insolvency. On the record, no one contracted this view. And with respect to the closing by the end of 2013, objectively speaking it would have been an optimistic target once IGW obtained protection under the CCAA. In short, it seems that upon IGW's CCAA filing, there was little ANB could do to protect its break fee.

A break fee is designed to protect the costs of a party that invests material time and expense into negotiating the transaction and carrying out requisite due diligence. Generally, a break fee will be payable where the deal does not go through for reasons outside the party's control. In *League Assets (Re)*, it was arguably the insolvency of the vendor that broke up the deal, and yet the purchaser got nothing for the time and expense invested into the transaction. Likely, the purchaser expected something more than that.

The decision thus serves as a reminder that the prospect for an insolvency filing by a party accepting an obligation to pay a break fee ought to be considered in any commercial transaction. The terms of the deal might then be crafted so that the break fee is payable where closing is no longer practically, even if it is perhaps still technically, possible on the terms and schedule anticipated when the deal documents were signed.

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[1] *League Assets Corp. Re*, 2016 BCSC 2262[ps2id id='1' target='']

[2] *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36[ps2id id='2' target='']

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.

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