

# CORPORATE RESTRUCTURING MEETS INTELLECTUAL PROPERTY: QUEBEC SUPERIOR COURT OVERTURNS DISCLAIMER NOTICE AND ISSUES THE FIRST CANADIAN INTERPRETATION OF USAGE RIGHTS UNDER THE CCAA

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In the *Endoceutics* case<sup>[1]</sup>, the Superior Court recently clarified the application of section 32 of the *Companies' Creditors Arrangement Act*<sup>[2]</sup> ("CCAA"), recognizing that the debtor's right to resiliate a contract is far from absolute. The contract resiliation must be genuinely beneficial to the restructuring. Where intellectual property rights are involved, it is also important to consider the fact that the right of use survives the resiliation, which may affect the benefit that the debtor hopes to derive from the resiliation.

The Court took the opportunity to issue the first-ever decision concerning the statutory protection afforded by section 32(6) of the CCAA with regard to the right to use intellectual property. Per the Court, this section would allow the Court to examine the co-contractor's compliance with its contractual obligations before confirming its continued right of use following a contract resiliation. This interpretation differs from that in force in the United States for the application of the similar protection available under section 365(n) of the *Bankruptcy Code*, for which only compliance with the payment of royalties seems to be required.

## Context

Endoceutics Inc. ("**Endoceutics**") is a Quebec-based company that held the licensing rights to a pharmaceutical product distributed worldwide through local distributors.

In 2022, given its low profitability and high level of debt, Endoceutics initiated a restructuring process under which the production plant was sold to a third-party company owned by former employees, while the intellectual property was transferred to Cosette Pharmaceutical Inc. ("**Cosette**"). Under the terms of the contract with Cosette, Cosette undertook to pay an additional sum of \$10 million in the event that the debtor, Endoceutics, terminates its distribution agreement with the U.S. distributor and succeeds in preventing the application of its statutory right of use under section 32(6) of the CCAA. The debtor therefore sent a notice of resiliation under section 32 of the CCAA, accompanied by a notice of contractual default invoking failures in the

marketing of the product that would justify setting aside the protection of the intellectual property rights.

### **Resiliation at the discretion of the Court**

Section 32(2) of the CCAA allows companies to send a notice of contractual resiliation to facilitate their restructuring. Decisions rendered under this section recognize the broad discretion of the debtor and the monitor in this matter, so much so that they usually grant the resiliation.

In its most recent decision in the Endoceutics matter, however, the Superior Court nonetheless confirmed that the right of resiliation is not absolute and that, in the event of opposition, it is up to the Court to exercise its judicial discretion to assess whether the resiliation should be granted, as provided for in paragraph 4 of section 32:

**32(4)** In deciding whether to make the order, the court is to consider, among other things,

- a. whether the monitor approved the proposed disclaimer or resiliation;
- b. whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and;
- c. whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

The Court points out that the criteria in section 32(4) of the CCAA are not exhaustive. It states:

[95] In this matter, the Court exercises judicial discretion. It must base its analysis on the three stated criteria and other factors that it deems relevant and appropriate.

[96] It must be a global assessment that proves to be fair and reasonable, and which takes into account all stakeholders without being limited solely to the interests of the debtors and those of the opposing co-contractor.

[Our translation]

In the case at hand, the Court concluded that Endoceutics had failed to convince the Court that "the restructuring would be more successful with (rather than without) the resiliation" [our translation]<sup>[3]</sup>. To reach his decision, the judge who heard the case notably took into account the opinion of the Monitor on the proposed resiliation, which is valued but does not automatically bind the Court<sup>[4]</sup>. Furthermore, considering that the plant and jobs had been saved due to a transaction that had occurred prior to sending the notice of resiliation, the evidence did not demonstrate that the resiliation would have a beneficial effect on the restructuring efforts<sup>[5]</sup>. Taking into account the various factors relevant to the case, notably the fact that the distributor's rights would be preserved under section 32(6) of the CCAA despite the resiliation of the

contracts<sup>[6]</sup>, the Court set aside the notice of resiliation that had been issued.

### **Statutory use of an intellectual property right**

Section 32(6) of the CCAA provides legislative protection to intellectual property rights holders by maintaining their right to use said intellectual property, despite the resiliation, occurring in the course of a restructuring, of the agreement that granted them such a right. The section states that "the resiliation does not affect the party's right to use the intellectual property — including the party's right to enforce an exclusive use [...], as long as the party continues to perform its obligations under the agreement in relation to the use of the intellectual property".

Canadian courts had never before had occasion to interpret these terms. In *Arrangement relatif à Endoceutics inc.*, the Superior Court affirmed that the application of section 32(6) of the CCAA cannot be limited solely to compliance with financial obligations. In the Court's view, the "contractual obligations" referred to in the section go beyond the mere payment of the agreed-upon royalties. Thus, the Court offers an interpretation that diverges from the one in force in the United States for the application of the similar protection offered by section 365(n) of the *Bankruptcy Code*, which appears to only require compliance with the payment of royalties. In so doing, the Quebec Superior Court paved the way for courts to examine the co-contractor's compliance with contractual obligations before confirming the maintenance of its right of use following a resiliation.

In the specific context of the case at hand, contractual obligations, as defined by section 32(6) of the CCAA, also included the obligation to provide the "commercially reasonable efforts" of development to which the U.S. distributor subscribed<sup>[7]</sup>. In analyzing the evidence, the Court recognized that the distributor had in fact complied with its contractual marketing and distribution obligations. Thus, even if the resiliation of the distribution agreement requested by the debtor had been granted, it would not have affected the U.S. distributor's right to use the property right previously granted to it, or even the right to enforce its exclusive use.

### **Key takeaways**

- The right to resiliate contracts in restructuring proceedings is not absolute, and the Court retains broad discretion;
- The interests of all stakeholders, not just those of the debtor and the implicated co-contractor, must be taken into account;
- The Court's novel interpretation of what constitutes the "obligations under the agreement in relation to the use of the intellectual property", as defined by section 32(6) of the CCAA, is not limited to the obligation to pay the agreed royalties, but could encompass compliance with other contractual

obligations; and

- The application of this principle remains contextual and does not apply as a general rule to all situations involving the use of a technology license<sup>[8]</sup>.

[1] *Arrangement relatif à Endoceutics inc.*, [2024 QCCS 1482](#).

[2] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

[3] *Arrangement relatif à Endoceutics inc.*, supra note 1, at para. 129.

[4] *Id.* at paras. 99-100.

[5] *Id.* at para. 113.

[6] *Id.* at para. 130.

[7] *Id.* at para. 153.

[8] *Id.* at para. 145.

by [Joséane Chrétien](#), [Sidney Elbaz](#), and [Eva Langrais](#)

### **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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