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Court of Appeal Upholds Termination Clause in RESOP Contract – Contract Terminated Automatically on Bankruptcy Does Not Violate Stay Provisions Under the Bankruptcy and Insolvency Act

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By Maria Gonzalez

On July 2, 2020, the Court of Appeal for Ontario (the "**Court**") released its decision in *Hutchingame Growth Capital Corporation v. Independent Electricity System Operator*.[1] The Court held that a clause in a contract which provided for the automatic termination of the contract upon bankruptcy of one of the contracting parties did not violate the stay provisions under section 69.3 of the *Bankruptcy and Insolvency Act* (the "*BIA*").[2]

BACKGROUND

Greenview Power ("**Greenview**") entered into a Renewable Energy Standard Offer Program Contract (the "**RESOP Contract**") with the Ontario Power Authority, whose successor is the Independent Electricity System Operator (the "**IESO**"). Under the RESOP Contract, Greenview was to build a renewable energy facility and supply electricity for 20 years commencing in 2010. Aird & Berlis LLP acted for the IESO in dealing with the day-to-day issues relating to the RESOP Contract. However, Ottawa Counsel acted for the IESO with respect to the initial trial and appeal.

Greenview did not meet the original or revised deadlines for completion of the project. To save the project, Hutchingame Growth Capital Corporation ("**HGC**") purchased a portion of Greenview's secured debt and assumed its effective control.

In 2013, HGC entered into a Waiver and Amending Agreement (the "**Agreement**") with Greenview, the IESO and Greenview's other secured creditors. The Agreement waived specified events of default under the RESOP Contract and set a new completion date for 2015. In 2014, Greenview went bankrupt and the RESOP Contract was terminated.

HGC had the option of reviving the RESOP Contract under a provision in the Contract, which allowed a secured creditor to step into the bankrupt's shoes. HGC did not exercise this option and instead tried to assign the RESOP Contract, and its rights under it, to Truestar Investments Ltd. ("**Truestar**"). The assignment required HGC to give notice to the IESO and to cure any outstanding defaults. HGC did not meet these requirements.

Sea to Sky, another one of Greenview's secured creditors, entered into an agreement to sell Greenview's assets, including its interest in the RESOP Contract, to Truestar. The trustee obtained a vesting order from the bankruptcy court approving the purchase. The IESO maintained that the RESOP Contract terminated when Greenview went bankrupt.

HGC brought an action for breach of contract and negligent misrepresentation against the IESO. The action was dismissed. HGC appealed. The Court dismissed the appeal.

REASONING

GREENVIEW'S BANKRUPTCY TERMINATED THE RESOP CONTRACT

The RESOP Contract stated that if a generator files a proposal under the *BIA* or makes an assignment in bankruptcy, the Contract is automatically terminated and the IESO does not need to provide notice of termination.

HGC challenged this provision on the basis that: (1) it was superseded by the Agreement; (2) it violated the automatic stay imposed by s.69.3 of the *BIA*; and (3) it contravened the common law "anti-deprivation rule". The Court rejected all three of these arguments.

1. The Agreement Did Not Supersede the RESOP Contract

The Court agreed with the trial judge that the terms of the Agreement only applied to new obligations contained in that agreement. The 30-day cure period for a breach set out in the Agreement did not invalidate the termination provision of the RESOP Contract. In reaching the Agreement, the parties did not discuss what would happen if Greenview went bankrupt. Moreover, the text of the termination provision was unambiguous

2. The Termination Provision Was Not Invalid Under s.69.3 of the BIA

The Court upheld the reasoning of the trial judge and noted that the automatic stay under s.69.3 of the *BIA* only prevents creditors from pursuing claims against the insolvent person. In this case, the termination of the RESOP Contract upon bankruptcy was not for the recovery of a claim.

The Court also noted that the automatic stay of proceedings in bankruptcy has never been interpreted to prevent a contracting party from terminating an agreement between it and the debtor. The presence of express provisions having that effect under the *Companies' Creditors Arrangement Act*[3] and in the restructuring provisions of the *BIA* illustrate that the automatic stay under s.69.3 was not intended to apply to the termination of executory contracts. If the stay was intended for this purpose, those provisions would not be necessary. The termination provision in the RESOP Contract was valid.

While not considered by the Court in this case, the Toronto Commercial List model receivership order contains similar stay provisions, which prevent creditors from commencing or continuing proceedings against the debtor under receivership, and suspends all rights and remedies against the debtor, the receiver or affecting the property under receivership. However, in the case of a receivership, such proceedings and enforcement actions against the debtor may be commenced or continued with the written consent of the receiver.

3. The Termination Provision Did Not Violate the "Anti-Deprivation Rule"

The Court noted that the anti-deprivation rule invalidates contractual provisions that remove assets that would otherwise be available to creditors in the event of insolvency. The Court distinguished the case at bar from a series of cases in which the bankruptcy had the effect of depriving a creditor of a valuable asset. In this case, the IESO received no financial benefit from the termination provision of the RESOP Contract and did not remove any value from the reach of Greenview's creditors to its benefit. The anti-deprivation rule did not apply.

The Court also held that the rights of HGC as a secured creditor were not prejudiced by the termination provision in the RESOP Contract. HGC had the option to revive the terminated agreement within 90 days of the bankruptcy and could have exercised its rights against Greenview's assets. The Court further noted that clauses which operate to terminate executory agreements and eliminate a debtor's opportunity to perform a contract do not necessarily result in a deprivation of value that would prejudice creditors.

THE ASSIGNMENT & VESTING ORDER WERE NOT EFFECTIVE

The Court agreed with the trial judge that HGC could not have assigned its interest in the RESOP Contract without having provided notice to the IESO and curing its defaults. If HGC wanted to assign its interest to Truestar, it first had to revive the RESOP Contract.

The Court also held that the vesting order did not vest the RESOP Contract in Truestar. Since the RESOP

Contract terminated once Greenview became bankrupt, there was nothing left of the Contract to vest in Truestar.

THE IESO DID NOT BREACH ITS CONTRACTUAL OBLIGATIONS

Having established that the notice provision of the Agreement did not apply to the RESOP Contract, the Court held that the IESO did not breach its contractual obligation by failing to provide HGC with notice of the termination. The language of the termination provision in the RESOP Contract was clear and the effects should have been obvious to HGC.

The Court also held that the IESO did not breach the duty of good faith in contractual performance by failing to disclose the termination to HGC. Referencing the trial judge, the Court noted that the duty of honesty in contractual performance does not impose a duty of loyalty or disclosure. It also does not require a party to forgo advantages flowing from the contract.

Likewise, the fact that the IESO remained silent while waiting for the 90-day period in which HGC could have revived the RESOP Contract to expire did not constitute a breach of the duty of good faith nor a breach of contract.

THE IESO WAS NOT NEGLIGENT

The Court upheld the reasoning of the trial judge who found that HGC failed to prove that the IESO made any statement which was untrue, inaccurate or misleading, and that HGC relied on such statement to its detriment.

[1] *Hutchingame Growth Capital Corporation v. Independent Electricity System Operator,* 2020 ONCA 430.

[2] *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3.

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

Author

Maria Gonzalez
Summer Student
T 416.863.1500

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