

Recent Case: Rights of a Commercial Landlord as a Creditor in Bankruptcy of Tenant

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On April 27, 2020, the Ontario Court of Appeal released its decision in [Curriculum Services Canada/Services Des Programmes D'Etudes Canada \(Re\), 2020 ONCA 267](#) (“Curriculum”). This case addresses a commercial landlord’s rights as a creditor in the bankruptcy of its tenant following the disclaimer of the lease by the trustee in bankruptcy.

By way of background, it is worth noting that:

- Under the [Bankruptcy and Insolvency Act](#), R.S.C. 1985, c. B-3 s. 136(1)(f) (“BIA”), a landlord has a priority claim (“Preferred Claim”) for:
 - (i) arrears of rent for a period of three months immediately preceding the bankruptcy (the “Rental Arrears Portion”, with arrears older than three months being unsecured claims); and
 - (ii) if provided for in the lease, three months’ worth of accelerated rent (the “Accelerated Rent Portion”, which must be offset by occupation rent paid by the trustee).

This Preferred Claim is limited to the net realization value from property on the leased premises after satisfaction of secured claims on that property. The BIA does not, however, specifically address a landlord’s claims for the unexpired terms of the lease or any inducements or other benefits provided to the bankrupt tenant under the lease.

- Under s. 136(3) of the BIA, where the realization is less than the amount of the Preferred Claim, a landlord may claim the unrecovered balance as an unsecured creditor.
- In the seminal case of [Highway Properties Ltd. v. Kelly Douglas and Co. Ltd.](#), [1971] S.C.R. 562 (S.C.C.) (“Highway Properties”), the Supreme Court of Canada introduced the concept that a landlord, who terminates the lease of a defaulting tenant, is entitled to claim damages equal to the rent that would have been payable for the unexpired term of the lease (“Future Damages”), less the rentable value of the premises for that period of time.

Following the tenant’s bankruptcy in *Curriculum*, the landlord filed a proof of claim in bankruptcy, asserting both a Preferred Claim (relying on the BIA) and an unsecured claim for Future Damages

(relying on the principles stated in *Highway Properties*). The trustee in bankruptcy disclaimed the lease and allowed the Rental Arrears Portion of the Preferred Claim, without addressing the Accelerated Rent Portion of the Preferred Claim. Further, the trustee disallowed the landlord's unsecured claim for Future Damages on the basis that the law deems "the disclaimer of a lease in Ontario by a trustee in bankruptcy as a consensual surrender of the lease by the tenant to the landlord, and consequently no claim for damages can be found on the cessation of obligations under the lease."

Not surprisingly, the landlord appealed the trustee's decision to the Ontario Superior Court of Justice, arguing that the landlord's losses flowing from the disclaimer of lease are contractual damages and "should be treated equally with any contractual damages potentially suffered by any of Curriculum's other creditors." The Superior Court sided with the trustee and dismissed the landlord's appeal.

The landlord appealed again. The Ontario Court of Appeal allowed the appeal in part, to allow the landlord to rank as an unsecured creditor for the Accelerated Rent Portion of its Preferred Claim, relying on Section 136(1)(f) of the BIA. However, the Court found that the disclaimer of the Lease by the trustee in bankruptcy operated to end the tenant's obligations under the Lease and dismissed the landlord's claim to rank as an unsecured creditor to recover Future Damages.

The Court of Appeal explained that *Mussens Ltd., Re*, [1933] O.W.N. 459 (Ont. S.C.) ("*Mussens*") "stands for the principle that, under Ontario law, the trustee of a bankrupt tenant is permitted by statute to bring an end to the lease, and all future obligations of the tenant thereunder, by surrendering possession of the leased premises or disclaiming the lease within three months of the bankruptcy."

The Court found that while it would not support an interpretation of *Mussens* that would characterize a disclaimer as a consensual surrender for all purposes, [*Crystalline Investments Ltd. v. Domgroup Ltd.*](#), [2004] 1 S.C.R. 60 (S.C.C.) left intact the rule articulated in *Mussens* that on disclaimer of a commercial lease by its trustee, an Ontario landlord has no claim as an unsecured creditor in the bankrupt tenant's estate for Future Damages, except to recover the Accelerated Rent Portion of the Preferred Claim, which is specifically provided for by statute.

Further, while *Highway Properties* recognized that a lease is also a contract, and provided for a landlord's option to accept a tenant's repudiation and sue for Future Damages, the case did not address a situation of bankruptcy or insolvency and the remedies for a tenant's repudiation do not apply once a trustee has disclaimed the lease.

We were relieved to see the Ontario Court of Appeal allow the landlord's Preferred Claim in its entirety (both the Rental Arrears Portion and the Accelerated Rent Portion). However, we question the correctness in law of the decision regarding Future Damages in light of the Supreme Court's decision in *Highway Properties*. Additionally, we do not understand why the landlord would be



entitled to claim as an unsecured creditor for the Accelerated Rent Portion of its Preferred Claim, which clearly includes post-disclaimer obligations, but not for Future Damages. Unfortunately, since the landlord chose not to appeal to the Supreme Court, the Court of Appeal's decision in *Curriculum* is now binding law in Ontario, and it will be relied upon by trustees in bankruptcy to reject a landlord's unsecured claim for Future Damages.

If you have any questions or would like to obtain legal advice on leasing bankruptcy and insolvency issues, please contact any lawyer in our [Commercial Leasing Group](#).

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