Court File No. – 31-2360759

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF
CURRICULUM SERVICES CANADA/
SERVICES DES PROGRAMMES D'ÉTUDES CANADA
OF THE CITY OF TORONTO, IN THE MUNICIPALITY OF TORONTO
IN THE PROVINCE OF ONTARIO

BOOK OF AUTHORITIES OF THE TRUSTEE

December 17, 2018

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3. Houlden & Morawetz, *Bankruptcy and Insolvency Analysis*, G§§140-141

4. *Linens N Things Canada Corp., Re*, 2009 CarswellOnt 2849 (S.C.J.)

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2011 ABCA 145
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2011 CarswellAlta 774, 2011 ABCA 145, [2011] 8 W.W.R. 499, [2011] A.W.L.D. 2319, [2011] A.W.L.D. 2320, 201 A.C.W.S. (3d) 807, 44 Alta. L.R. (5th) 64, 502 A.R. 360, 517 W.A.C. 360, 78 C.B.R. (5th) 81

Dancole Investments Ltd. (Appellant / Applicant) and Bill McCulloch & Associates Inc., Trustee of the Estate of House of Tools Company, a Bankrupt (Respondent / Respondent)

Elizabeth McFadyen, Jack Watson, Frans Slatter JJ.A.

Heard: February 1, 2011
Judgment: May 12, 2011
Docket: Edmonton Appeal 1003-0098-AC

Proceedings: reversing in part *Dancole Investments Ltd. v. House of Tools Co. (Trustee of)* (2010), 488 A.R. 320, 2010 ABQB 223, 2010 CarswellAlta 617 (Alta. Q.B.)

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S.K. Dhir, L.E. Miller J.A. for Respondent

Subject: Insolvency; Property; Estates and Trusts

Related Abridgment Classifications

Bankruptcy and insolvency
X Priorities of claims
X.4 Claims by landlord
X.4.e Accelerated rent
X.4.e.i Entitlement to claim
Bankruptcy and insolvency
X Priorities of claims
X.4 Claims by landlord
X.4.e Accelerated rent
X.4.e.ii Amount claimable

Headnote

Bankruptcy and insolvency --- Priorities of claims — Claims by landlord — Accelerated rent — Entitlement to claim

Debtor company agreed to lease premises from landlord for ten years from January 1, 2008 — In April 2009, debtor failed to pay rent due under lease — Landlord served notice of default — In May 2009, debtor filed assignment in bankruptcy — Trustee was appointed — Receivership order was obtained appointing interim Receiver — Pursuant to agreement with landlord, Receiver occupied leased premises from May to July 2009 and paid rent to landlord — Section 136(1)(f) of Bankruptcy and Insolvency Act allows landlord preferred claim for three months arrears of rent and accelerated rent for up to three months following bankruptcy (if specified in lease), and provides that any payment made on account of accelerated rent shall be credited against amount "payable by the trustee" for occupation rent — Landlord submitted proof of claim to Trustee claiming three months accelerated rent as provided for in lease as preferred claim under s. 136(1)(f) — Trustee reduced claim by amount paid as occupation rent by Receiver — Chambers judge upheld Trustee's disallowance of claims — Landlord appealed — Appeal allowed in part — Chambers judge erred in his interpretation of s. 136(1)(f) and in his conclusion that rent paid by Receiver constituted "amount payable by the trustee for occupation rent" and permitted reduction in accelerated rent to which landlord was otherwise entitled — No amount was payable by

Trustee for occupation rent, therefore no deduction of accelerated rent was required — Phrase "payable by the trustee" does not include payments made by Receiver — Landlord is not required to establish that it actually sustained loss to establish entitlement to accelerated rent as preferred claim under s. 136(1)(f), it need only establish that it was entitled to accelerated rent under lease — Therefore it was not inconsistent for legislature to recognize right of landlord to claim both accelerated rent and occupation rent — Nothing done by landlord destroyed its entitlement to accelerated rent by operation of lease and statutes.

Bankruptcy and insolvency --- Priorities of claims — Claims by landlord — Accelerated rent — Amount claimable

Debtor company agreed to lease premises from landlord for ten years from January 1, 2008 — In April 2009 debtor failed to pay rent — Landlord served notice of default — In May 2009 debtor filed assignment in bankruptcy — Trustee was appointed — Receivership order was obtained appointing interim Receiver — Pursuant to agreement with landlord, Receiver occupied leased premises from May to July, 2009 and paid rent to landlord — Landlord submitted proof of claim to Trustee claiming three months accelerated rent as preferred claim under s. 136(1)(f) of Bankruptcy and Insolvency Act and sought legal costs it incurred as result of defaults under lease as part of preferred claim — Trustee disallowed landlord's claim for legal costs and reduced preferred claim by amount paid as rent by Receiver — Chambers judge upheld Trustee's disallowance of claims — Landlord appealed — Appeal allowed in part on other grounds — Chambers judge made no error in concluding that legal costs are not recoverable on priority basis under s. 136(1)(f) — Not all rent that is payable under lease is entitled to s. 136(1)(f) preference — In context of s. 136(1)(f), word "rent" is used in its ordinary sense and refers to payments of rent and expenses that accrue on monthly basis, but does not necessarily include all extraordinary expenses that may be added to monthly payment in accordance with terms of lease — Further, costs and expenses incurred after bankruptcy could not be included in deciding amount of monthly accelerated rent — Wording of lease, referring to "monthly rent", included expenses incurred on monthly basis but did not include extraordinary expenses that occurred after breach — Wording referred to obligations that accrue monthly on regular basis.

Table of Authorities

Cases considered:

A. Marquette & fils Inc. v. Mercure (1975), 1975 CarswellQue 51, 10 N.R. 239, 65 D.L.R. (3d) 136, [1977] 1 S.C.R. 547, 1975 CarswellQue 51F (S.C.C.) — referred to

Bank of Montreal v. Steel City Sales Ltd. (1983), 47 C.B.R. (N.S.) 15, 148 D.L.R. (3d) 585, 57 N.S.R. (2d) 396, 120 A.P.R. 396, 1983 CarswellNS 47, 28 R.P.R. 225 (N.S. T.D.) — referred to

Canadian Petcetera Ltd. Partnership v. 2876 R. Holdings Ltd. (2010), 295 B.C.A.C. 201, 501 W.A.C. 201, 2010 CarswellBC 2852, 2010 BCCA 469, [2010] 12 W.W.R. 189, 10 B.C.L.R. (5th) 235, 70 C.B.R. (5th) 180, 96 R.P.R. (4th) 157 (B.C. C.A.) — considered

Father & Son Investments Inc. v. Maverick Brewing Corp. (2007), 38 C.B.R. (5th) 272, 83 Alta. L.R. (4th) 287, [2008] 5 W.W.R. 518, 2007 CarswellAlta 1694, 2007 ABQB 752, 439 A.R. 247 (Alta. Q.B.) — referred to

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Port Alice Specialty Cellulose Inc., Re (2005), 41 B.C.L.R. (4th) 259, 2005 BCCA 299, 2005 CarswellBC 1280, 254 D.L.R. (4th) 397, (sub nom. *Port Alice Specialty Cellulose Inc. (Bankrupt) v. ConocoPhillips Co.*) 212 B.C.A.C. 310, (sub nom. *Port Alice Specialty Cellulose Inc. (Bankrupt) v. ConocoPhillips Co.*) 350 W.A.C. 310, 11 C.B.R. (5th) 279 (B.C. C.A.) — followed

Sawridge Manor Ltd. v. Western Canada Beverage Corp. (1995), 33 C.B.R. (3d) 249, 61 B.C.A.C. 32, 100 W.A.C. 32, 1995 CarswellBC 169 (B.C. C.A.) — referred to

Shilco Industrial Sales Ltd., Re (1977), 23 C.B.R. (N.S.) 255, 1977 CarswellOnt 74 (Ont. Bktcy.) — followed

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Soren Brothers Ltd., Re (1926), 1926 CarswellOnt 31, 30 O.W.N. 12, 7 C.B.R. 545 (Ont. S.C.) — referred to

1231640 Ontario Inc., Re (2007), 37 C.B.R. (5th) 185, 2007 ONCA 810, 2007 CarswellOnt 7595, 289 D.L.R. (4th) 684, 13 P.P.S.A.C. (3d) 57 (Ont. C.A.) — referred to

1231640 Ontario Inc., Re (2008), (sub nom. *Royal Bank of Canada v. 1231640 Ontario Inc. (Bankrupt)*) 386 N.R. 393 (note), (sub nom. *Royal Bank of Canada v. 1231640 Ontario Inc. (Bankrupt)*) 253 O.A.C. 396 (note), 2008 CarswellOnt 2897, 2008 CarswellOnt 2898 (S.C.C.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

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s. 1 — considered

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s. 5(3) — considered

Words and phrases considered:

"payable by the trustee"

The primary question we must answer is whether the phrase "payable by the trustee" [in s. 136(1)(f) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3] includes payments made by the Receiver. We are of the view that it does not.

rent

In the context of [s.]136(1)(f) [of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3], the word "rent" is used in its ordinary sense and refers to payments of rent and expenses that accrue on a monthly basis, but does not necessarily include all extraordinary expenses that may be added to the monthly payment in accordance with the terms of the lease.

Further, costs and expenses incurred after bankruptcy cannot be included in deciding the amount of monthly accelerated rent.

APPEAL by landlord from judgment reported at *Dancole Investments Ltd. v. House of Tools Co. (Trustee of)* (2010), 488 A.R. 320, 2010 ABQB 223, 2010 CarswellAlta 617 (Alta. Q.B.), upholding Trustee's disallowance of landlord's claims.

***Per curiam*:**

Facts

1 The House of Tools Company agreed to lease premises from the appellant, Dancole Investments Ltd. for a period of ten years, commencing January 1, 2008. On April 1, 2009, House of Tools failed to pay the rent due under the lease and, on April 15, 2009, Dancole served a Notice of Default on House of Tools, specifying the default as the failure to pay Basic Rent, Operating Costs, Taxes and Goods and Services Tax in the amount of $48,059.37.

2 House of Tools failed to rectify its default, and on April 30, 2009, the bailiff, instructed by Dancole, attended the premises but was unable to effect seizure as no one was present. A Notice of Seizure was posted to the door of the premises at 3:21 p.m. on May 1, 2009. That same day, House of Tools obtained an order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

3 On May 12, 2009, House of Tools filed an assignment into bankruptcy effective May 13. Bill McCulloch & Associates Inc. (the "Trustee") was appointed the trustee of its estate.

4 On May 13, 2009, the Bank of America successfully applied to set aside the CCAA Order and obtained a Receivership Order pursuant to s. 47(1) of the *Bankruptcy and Insolvency Act* ("*BIA*") and s. 13(2) of the *Judicature Act*, appointing RSM Richter Inc. ("Receiver") as interim receiver of House of Tools' assets.

5 Pursuant to an agreement with Dancole, the Receiver occupied the leased premises from May 13, 2009 to July 21, 2009, and paid rent to Dancole in the amount of $111,355.15. The Receiver delivered up the premises to Dancole on July 21, 2009. The Receiver's payments for occupation rent did not include interest or other costs, such as legal costs, incurred by Dancole as a result of the breaches of the terms of the lease. The Receiver transferred to the Trustee all funds remaining after payment of the secured claim and its expenses.

6 Before entering into the agreement with the Receiver, Dancole made inquiries of the Trustee, who indicated that it had no interest in the premises, and that issues relating to occupation rent were a matter for the Receiver and Dancole. The Trustee never assumed actual possession of the leased premises. The Trustee allowed the Receiver to make its own arrangements with Dancole and to use the leased premises to carry out its work under the Receivership Order.

7 Dancole submitted a Proof of Claim to the Trustee claiming three months accelerated rent as provided for in the Lease as a preferred claim under s. 136(1)(f) of the *BIA*. Dancole also sought its legal costs as part of its preferred claim.

8 The Trustee disallowed Dancole's claim for legal costs and reduced the preferred claim by the amount paid as occupation rent by the Receiver to Dancole.

9 In an action in the Court of Queen's Bench, Dancole sought the following declarations:

(1) the rent paid by the Receiver is not to be deducted for the amount of Dancole's preferred claim under s. 136(1)(f) of the *BIA*, and

(2) the legal costs incurred by Dancole arising from House of Tools' defaults form part of the rent payable under the Lease and are to be included in the calculation of Dancole's preferred claim.

10 The chambers judge upheld the Trustee's disallowance of Dancole's claims: *Dancole Investments Ltd. v. House of Tools Co. (Trustee of)*, 2010 ABQB 223, 488 A.R. 320 (Alta. Q.B.). He concluded that Dancole was not entitled to claim a preference for accelerated rent, as Dancole had already received occupation rent from House of Tools' assets. He concluded that pursuant to s. 136(1)(f) of the *BIA*, Dancole "will not be entitled to both acceleration rent and occupation rent for the same 3 months." While the chamber judge did not consider it necessary to address the claim for legal costs as part of rent, he opined that rent, for the purposes of s. 136(1)(f), did not include irregular costs that do not accrue day-to-day, such as the legal costs in this case.

Legislation

11 Dancole's claim to priority over other creditors is defined by s. 136(1)(f) of the *BIA*:

136(1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:

. . .

(f) the lessor for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy if entitled to accelerated rent under the lease, but the total amount so payable shall not exceed the realization from the property on the premises under lease, and any payment made on account of accelerated rent shall be credited against the amount payable by the trustee for occupation rent;

12 Other relevant provisions of the *BIA* are as follows:

71 On a bankruptcy order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order or assignment, and in any case of change of trustee the property shall pass from trustee to trustee without any assignment or transfer.

. . .

73(4) Any property of a bankrupt under seizure for rent or taxes shall on production of a copy of the bankruptcy order or the assignment certified by the trustee as a true copy be delivered without delay to the trustee, but the costs of distress or, in the Province of Quebec, the costs of seizure are a security on the property ranking ahead of any other security on it, and, if the property or any part of it has been sold, the money realized from the sale less the costs of distress, or seizure, and sale shall be paid to the trustee.

. . .

146 Subject to priority of ranking as provided by section 136 and subject to subsection 73(4) and section 84.1, the rights of lessors are to be determined according to the law of the province in which the leased premises are situated.

13 The *Landlord's Rights on Bankruptcy Act*, R.S.A. 2000, C. L-5 provides:

> 1 A lessee against or by whom a receiving order or assignment is made under the *Bankruptcy and Insolvency Act* (Canada) is deemed to have made an assignment of all the lessee's property for the general benefit of the lessee's creditors before the date of the receiving order or assignment.
>
> 2 As soon as the receiving order or assignment is made
>
> > (a) the landlord of the lessee is not afterwards entitled to distrain or realize the rent by distress, ...
>
> 3 The lessee is a debtor to the landlord
>
> > (a) for all surplus rent in excess of the 3 months' rent accrued due at the date of the receiving order or assignment, and
> >
> > (b) for any accelerated rent to which the landlord may be entitled under the lease but not exceeding an amount equal to 3 months' rent.
>
> 4 Subject to section 3, the landlord has no right to claim as a debt any money due to the landlord from the lessee for any portion of the unexpired term of the lessee's lease.
>
> 5(1) The trustee is entitled to occupy and to continue in occupation of the leased premises for so long as the trustee requires the premises for the purposes of the trust estate vested in the trustee.
>
> (2) The trustee shall pay to the landlord for the period during which the trustee actually occupies the leased premises from and after the date of the receiving order or assignment a rental calculated on the basis of the lease.
>
> (3) A payment to be made to the landlord in respect of accelerated rent shall be credited against the amount payable by the trustee for the period of the trustee's occupation.

Issues

14 The appeal raises the following issues:

> Did the chambers judge err by failing to distinguish between the Receiver and the Trustee in interpreting s. 136(1)(f) of the *BIA*? Are rent payments made by the Receiver to Dancole amounts "payable by the trustee for occupation rent" under s. 136(1)(f) of the *BIA*? Are Dancole's legal costs recoverable as part of its preferred claim for accelerated rent?

Standard of Review

15 The parties agree that the issues are subject to the correctness standard, as they involve questions of law regarding statutory interpretation. To the extent that the second issue involves an interpretation of the Lease, it also is reviewable on a correctness standard.

16 The general principles regarding the appropriate statutory interpretation of the *BIA* were referenced in *Port Alice Specialty Cellulose Inc., Re*, 2005 BCCA 299 (B.C. C.A.) at paras. 25 - 27, (2005), 41 B.C.L.R. (4th) 259 (B.C. C.A.) (and recently followed by the court in *Canadian Petcetera Ltd. Partnership v. 2876 R. Holdings Ltd.*, 2010 BCCA 469, 10 B.C.L.R. (5th) 235 (B.C. C.A.) at para. 18):

> There is no dispute that the proper approach to the interpretation of s. 81.1 is that described in E.A. Driedger's *Construction of Statutes* (2nd ed. 1983), at p. 87:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

This approach has been approved by the Supreme Court of Canada in numerous cases. The Supreme Court has also said that this approach is confirmed by s. 12 of the ***Interpretation Act***, R.S.C. 1985, c. I-21, which provides that every enactment "is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects": see *Barrie Public Utilities v. Canadian Cable Television Assn.*, [2003] 1 S.C.R. 476 at para. 20; ***Bell ExpressVu Limited Partnership v. Rex***, [2002] 2 S.C.R. 559 at para. 26.

17 In interpreting the *BIA*, courts have noted that it is a commercial statute used by business people and should not be given an overly narrow or legalistic approach: see *McCoubrey, Re*, [1924] 4 D.L.R. 1227 (Alta. T.D.), at 1231-32; *A. Marquette & fils Inc. v. Mercure* (1975), [1977] 1 S.C.R. 547 (S.C.C.), at 556; *Maple Homes Canada Ltd., Re*, 2000 BCSC 1443 (B.C. S.C.) at para. 21.

Are Rent Payments From the Receiver to Dancole Amounts "Payable by the Trustee for Occupation Rent" Under s. 136(1)(f) of the BIA?

18 Dancole submits that s. 136(1)(f) of the *BIA* provides that payments of occupation rent made by or payable by the trustee are to be set off against a landlord's preferred claim for accelerated rent. In enacting the *BIA*, Parliament has made clear distinctions between the trustee in bankruptcy, and a receiver or an interim receiver appointed under ss. 46 and 47. See, for instance, ss. 14.06 and 31(1). Accordingly, Dancole argues that Parliament would have used explicit language in s. 136(1)(f) if the intent was to include occupation rent payments made by the Receiver. Dancole acknowledges that the Receiver meets the general definition of "trustee" under s. 2, as the Receiver is licensed under the *BIA*, and was appointed as interim receiver under the *BIA*. However, Dancole submits that s. 136(1)(f) refers to "*the* trustee," which refers to the trustee appointed to administer the assets of the bankrupt in the case, as opposed to "a trustee," which defines who may act as a trustee or receiver for the purposes of the *BIA*.

19 The Trustee supports the decision of the chambers judge, submitting that the principal objective of the *BIA* is to ensure equality in the distribution of the assets of the bankrupt amongst the ordinary creditors. He submits that as the accelerated rent and the occupation rent are paid out of the assets of the bankrupt, the only reasonable interpretation that meets this objective of the *BIA* is that adopted by the chambers judge. He further submits that double payment of accelerated rent out of the estate of the bankrupt is contrary to the intent of the legislation.

20 In our view, Dancole's submissions are consistent with the appropriate principles of statutory interpretation and are correct. Section 136(1)(f) of the *BIA* allows the landlord a preferred claim for three months arrears of rent and accelerated rent for a period not exceeding three months following the bankruptcy (if specified in the lease), and provides that any payment made on account of accelerated rent shall be credited against the amount "payable by the trustee" for occupation rent.

21 The primary question we must answer is whether the phrase "payable by the trustee" includes payments made by the Receiver. We are of the view that it does not.

22 The *BIA* clearly distinguishes between the legal position, the rights, duties, and obligations of the trustee in bankruptcy and the receiver. Under s. 71 of the *BIA*, upon the issuance of a receiving order appointing the trustee in bankruptcy or upon making an assignment in bankruptcy, the bankrupt's right to deal with the property ends and all of its property is immediately vested in the trustee in bankruptcy. There is no similar vesting of the bankrupt's property in the receiver. The receiver's authority to take possession of or to deal with the property depends on the terms of the court order appointing the receiver.

23 Under s. 146, the landlord's rights on bankruptcy (subject to s. 136(1)(f) priority and s. 73(4)), and the trustee's powers and obligations regarding the bankrupt's leased property are determined by provincial law: *Sawridge Manor Ltd. v. Western Canada Beverage Corp.* (1995), 61 B.C.A.C. 32, 33 C.B.R. (3d) 249 (B.C. C.A.) at para. 5. In Alberta, the *Landlord's Rights on Bankruptcy Act*, assigns all of the lessee's property to the trustee in bankruptcy prior to the date of the receiving order or assignment. All rights previously held by a landlord to enforce payment of arrears of rent and other amounts, or otherwise enforce payment, are terminated. The landlord's claim for rent due under the unexpired portion of the lease is limited to three months. The trustee has the right to occupy the leased premises and if it does so, it must pay occupation rent: see Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, (4th ed.) loose-leaf (updated to Release 9, 2010)(Toronto: Thomson Reuters Canada Limited, 2009) at 5 - 247. Although the property is vested in the trustee, the trustee who does not occupy the premises is under no obligation to pay occupation rent.

24 There are no similar legislative provisions dealing with the rights and duties of an interim receiver in respect of leased property. No legislation vests the debtor's property in the interim receiver, nor governs its use and occupation of the property. No legislation requires the interim receiver to pay occupation rent for its use and possession of the leased property under the receivership order. The property does not vest in the interim receiver. The interim receiver's liability to pay occupation rent is based entirely on the contract, express or implied, between the interim receiver and landlord. In the absence of an agreement on the part of the interim receiver to pay rent during its occupancy, the court may impose an obligation to pay reasonable rent. See *Father & Son Investments Inc. v. Maverick Brewing Corp.*, 2007 ABQB 752, 439 A.R. 247 (Alta. Q.B.) and *Bank of Montreal v. Steel City Sales Ltd.* (1983), 148 D.L.R. (3d) 585, 57 N.S.R. (2d) 396 (N.S. T.D.). Absent an agreement, express or implied there is no obligation on the interim receiver to pay occupation rent. The debtor may remain in possession of the leased premises during a receivership (*Soren Brothers Ltd., Re* (1926), 7 C.B.R. 545 (Ont. S.C.) or a court-appointed receiver (*1231640 Ontario Inc., Re*, 2007 ONCA 810 (Ont. C.A.) at paras. 22 - 28, (2007), 289 D.L.R. (4th) 684 (Ont. C.A.) (*per* Feldman J.A.), leave to appeal to SCC granted: [2008] S.C.C.A. No. 34 (S.C.C.)). The interim receiver who enters into an agreement with a landlord or who is obliged to pay rent because of its occupancy of the leased property is personally liable to pay the rent owing.

25 Although the legislature saw fit to require the deduction of accelerated rent from any occupation rent payable by the trustee in bankruptcy, it did not provide for the deduction of accelerated rent from rent payable by the receiver.

26 The Trustee submits that Dancole's interpretation would result in a conflict between the *BIA* and the *Landlord's Rights on Bankruptcy Act*, essentially permitting payment of rent in excess of three months or double rent. We do not agree. The *BIA* and the *Landlord's Rights on Bankruptcy Act* both allow the trustee to take possession of the property and pay occupation rent. The amount paid by the trustee is to be deducted from accelerated rent to which the landlord is entitled.

27 However, rent payable by the receiver for its use and occupation of the property is distinct from any accelerated rent provided by the lease, and does not arise from the same legal foundation. Accelerated rent is not based on use or occupancy of the leased property during the three months following the bankruptcy. The basis on which accelerated rent is payable is set out in Houlden and Morawetz at 5-254 - 55, as follows:

> ... accelerated rent is not in reality a sum payable in respect of three months following the bankruptcy; rather, it is a further sum equivalent to three months' rent payable in respect of the demised term by reason of its sudden termination. The amount payable is designed to compensate the landlord for the possible vacancy consequent upon the loss by the landlord of its tenant and for the loss of the right of distress.

28 Accordingly, where a trustee disclaims or surrenders the lease shortly after bankruptcy, the landlord remains entitled to the preferred claim for accelerated rent, even though the landlord is able to rent the property to a third party immediately, or at an increased rental. This conclusion is supported by the construction of the statute. Section 136(1)(f) of the *BIA*, and s. 5(3) of the *Landlord's Rights on Bankruptcy Act* both provide that the landlord must give credit for "the amount payable by the trustee" for occupation rent. This specific set-off demonstrates that the statutes contemplate

that the landlord can (in some circumstances) be entitled to the three months of accelerated rent, as well as amounts recovered for actual occupation. If the statutes contemplated a general duty to mitigate, or an implied prohibition on "double recovery," this specific qualification would not be required. Giving credit for the amount payable by the trustee would be automatic.

29 The Trustee also submits that Dancole's interpretation of the lease conflicts with the intent of the *BIA* to treat all ordinary creditors equally. It submits that s. 136(1)(f) should be narrowly interpreted as it provides exceptions to this rule. Comparing the landlord's claims to that of other ordinary creditors is problematic. Generally, the landlord has rights that exceed those of an ordinary creditor, whether they arise by virtue of contract, statute or the common law. These include the right to distrain for arrears, the right to recover damages for the unexpired term of the lease, and to provide for accelerated rent to offset damages in the event of breach.

30 The *BIA* and the *Landlord's Rights on Bankruptcy Act* represent a balancing of the rights of the landlord against the rights of the other creditors. Under the statutory scheme, the landlord's right to claim for the value of the balance of the lease is cut off at the three-month point following termination of the lease, as is the related power of the landlord to distrain on goods found on the premises: *Landlord's Rights on Bankruptcy Act*, ss. 3(b) and 4. That limits the claim that the landlord might make as an unsecured creditor, and truncates its claim against the goods found on the premises. The *quid pro quo* is that the landlord is given a preferred claim for three months of accelerated rent. The preferred status of this three month claim is intended to compensate the landlord for the loss of the value of the lease past the three-month point, and is separate and apart from any compensation the landlord may be entitled to for actual occupation of the premises. The express proviso that credit must nevertheless be given for occupation rent payable by the trustee is simply a further refinement of the balancing of rights between the landlord and the other creditors of the estate.

31 Conceptually, the argument is that Dancole is achieving a "double recovery" that should not be allowed, or that Dancole must essentially "mitigate its losses" by accounting for the rent received from the Receiver. This argument fails to recognize that the landlord is recovering for two different bundles of rights, and there is no "double recovery" for any one loss. The landlord is not required to establish that it actually sustained a loss to establish its entitlement to accelerated rent as a preferred claim under s. 136(1)(f). It need only establish that it was entitled to accelerated rent under the lease. It is therefore not inconsistent for the legislature to recognize the right of the landlord to claim both accelerated rent and occupation rent.

32 The trustee's liability for occupation rent does not arise until the estate vests pursuant to s. 71 of the *BIA* and attaches only if the trustee elects to take possession of the leased premises: Houlden and Morawetz at 5 - 251. The receiver's authority to deal with the debtor's property derives entirely from the Receivership Order issued by the Court pursuant to s. 46 and 47 of the *BIA*. In this case, the Receivership Order granted extensive powers to the Receiver to deal with House of Tools' property, including the right to take possession of the property and the discretion to deal with it. Paragraph 3(q) of the Receivership Order specifically granted the Receiver authority to enter into agreements with the Trustee regarding the occupation for any property owned or leased by the House of Tools. This provision recognizes the vesting of the estate in the Trustee, and the Trustee's right to assume occupation of the leasehold premises and potentially incur the obligation to pay occupation rent.

33 However, the Trustee refused to take possession of the leased premises, disclaimed any interest in the premises and denied any responsibility to pay occupation rent. The Trustee advised Dancole that it took no position with regard to the payment of use and occupation rent from the date of the appointment of the Receiver, as that was a matter between the Receiver and Dancole. Further, the Trustee confirmed that the Receiver had been appointed to dispose of House of Tools' assets, impliedly denying responsibility for that phase of the proceedings. Throughout, the Receiver was obliged to pay occupation rent to Dancole, and as permitted by law, was entitled to recover the amount paid for rent as costs incurred in the receivership. The occupation rent was never payable by the Trustee or anyone other than the Receiver. Because the Receiver is entitled to recover its costs, the rent paid by it to Dancole under its agreement with Dancole did not come from the estate available for ordinary creditors, and was not an expense or amount payable by the Trustee as it was never paid out of the bankruptcy estate.

34 What is said to reduce the bankruptcy estate available for equal distribution to non-preferred creditors is the three month period of accelerated rent for which Parliament has given a priority to the landlord. Nothing done by Dancole destroyed its entitlement to accelerated rent by operation of the lease and the two statutes. The non-preferred creditors are not prejudiced as a result of Dancole's statutory preference remaining in place.

35 The Receiver's ability to recover its costs from the sale of the stock and merchandise pursuant to Bank of America's secured interest also had no unfair effect on other creditors. No one disputes that the Bank of America was entitled to act under its security. The Receiver found it efficient to engage Dancole in the recovery process, as opposed to moving the stock and merchandise somewhere else. The bankrupt estate was entitle to receive only the amounts that remained after the payment of the Bank of America claim. The fact that part of the Receiver's charges related to a payment made to Dancole did not change that situation. That payment did not unfairly advantage Dancole nor did it unfairly reduce the amount remaining for the bankruptcy estate.

36 We are of the view that the chambers judge erred in his interpretation of s. 136(1)(f) of the *BIA* and in his conclusion that the rent paid by the Receiver during its occupancy of the leased premises constitutes an "amount payable by the trustee for occupation rent" and permits the reduction in the accelerated rent to which Dancole was otherwise entitled. No amount was payable by the Trustee for occupation rent, and therefore no deduction of accelerated rent was required.

37 The appeal is allowed to that extent.

Are the Landlord's Legal Costs Recoverable as Part of Its Preferred Claim for Accelerated Rent?

38 On the final ground of appeal, we are asked to consider the meaning of "rent" and "accelerated rent" in s. 136(1)(f) of the *BIA*.

39 Dancole seeks priority payment under s. 136(1)(f) for the legal costs it incurred as a result of the defaults under the lease. Dancole retained its lawyers on April 1, 2009 and incurred legal fees prior to the registration of the assignment in bankruptcy in relation to the enforcement steps taken regarding arrears of rent, the CCAA proceedings, and in preparation for the Receivership application on May 13, 2009. Additional legal fees arose after the bankruptcy. These legal costs were not expenses that accrued on a monthly basis under the terms of the lease.

40 "Rent" is defined in Article 3 of the lease to include (a) monthly basic rent, (b) House of Tools' share of operating costs and taxes, payable monthly, (c) monthly payments in relation to an HVAC system, (d) GST payable on each of these items, and (e) all such other sums of money as may be required to be paid by House of Tools under the lease.

41 Dancole relies on Articles 11. 3 and 13.1 and says that these provisions, along with Article 3.1(e), required House of Tools to pay the legal expenses so incurred and that these expenses are other sums of money required to be paid as rent under the Lease.

42 The Trustee does not dispute that legal costs may be payable as rent under the lease although the amount is not admitted. Rather, the Trustee submits that Dancole is not entitled to add these costs to its preferred claim under s. 136(1)(f), on the basis that the provision permits the recovery, on a preferred basis, of rent and expenses that accrue on a regular monthly basis, but not the recovery of unusual or extraordinary expenses. The Trustee relies on the decision in *Shilco Industrial Sales Ltd., Re* (1977), 23 C.B.R. (N.S.) 255 (Ont. Bktcy.), where Registrar Ferron concluded that rent costs that do not accrue on a day-to-day basis in the three month period preceding the bankruptcy are not to be treated as preferred claims. Accelerated rent was not in issue in that case.

43 "Rent" is not defined in the *BIA* or the *Landlord's Rights on Bankruptcy Act*. Generally, whether an item is properly included as rent is largely a function of the terms of the lease. If it establishes certain prerequisites that are to be met before the item can be claimed as rent, then those prerequisites must be met before the item may be included as rent for the purposes of the lease: *Shogun Holdings Ltd. v. Latitude 53 Realty Ltd.* (1980), 37 C.B.R. (N.S.) 134 (Alta. Q.B.).

44 However that does not resolve the matter, because not all rent that is payable under the lease is entitled to s. 136(1)(f) preference. We agree with the view expressed in *Shilco*. In the context of 136(1)(f), the word "rent" is used in its ordinary sense and refers to payments of rent and expenses that accrue on a monthly basis, but does not necessarily include all extraordinary expenses that may be added to the monthly payment in accordance with the terms of the lease.

45 Further, costs and expenses incurred after bankruptcy cannot be included in deciding the amount of monthly accelerated rent. Dancole argues that expenses actually incurred after the bankruptcy can be included in the permitted accelerated rent. We do not agree. The accelerated rent provision is found in Article 14.2 and provides that in the event of a breach, "at the option of the Landlord, the full amount of the current month's and the next three (3) months' *monthly* rent shall immediately become due and payable," [emphasis added] and allows Dancole to exercise its right of distraint and to re-enter the property. The wording of the lease, referring as it does to the "monthly rent," includes expenses incurred on a monthly basis but does not include extraordinary expenses that occur after the breach. This wording refers to obligations that accrue monthly on a regular basis, such as the basic rent, the tenant's proportionate share of operating expenses and taxes, the HVAC system monthly payments, and the GST in respect of each of these items, all of which are defined in Article 3.1(a), (b), (c) and (d). The term "monthly rent" does not include payments referred to in (e).

46 Section 136(1)(f) adopts similar terminology, referring to "arrears of rent for three months," and "accelerated rent for a period not exceeding three months." The ordinary meaning of each of these terms refers to those obligations under the lease that accrue monthly and are ascertainable on that basis.

47 The chambers judge made no error in concluding that legal costs are not recoverable on a priority basis under s. 136(1)(f).

Appeal allowed in part.

TAB 2

2015 ABCA 355
Alberta Court of Appeal

York Realty Inc. v. Alignvest Private Debt Ltd.

2015 CarswellAlta 2108, 2015 ABCA 355, [2015] A.W.L.D. 4496, [2015] A.W.L.D. 4543, 259 A.C.W.S. (3d) 619, 31 C.B.R. (6th) 98, 32 Alta. L.R. (6th) 61, 391 D.L.R. (4th) 756, 4 P.P.S.A.C. (4th) 339, 51 B.L.R. (5th) 33, 609 A.R. 201, 656 W.A.C. 201

York Realty Inc., Appellant (Applicant/Respondent) and Alignvest Private Debt Ltd., Respondent (Applicant/Respondent/Plaintiff) and Surefire Industries Ltd. (Trustee of), Respondent (Respondent/Defendant)

Marina Paperny, Peter Martin, Patricia Rowbotham JJ.A.

Heard: November 12, 2015
Judgment: November 19, 2015
Docket: Calgary Appeal 1501-0062-AC

Proceedings: affirming *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.* (2015), 39 B.L.R. (5th) 87, [2015] A.J. No. 316, 23 C.B.R. (6th) 66, 2015 CarswellAlta 485, 3 P.P.S.A.C. (4th) 308, 16 Alta. L.R. (6th) 1, 2015 ABQB 148, B.E. Romaine J. (Alta. Q.B.)

Counsel: R.T.G. Reeson, Q.C., C.T. Aitken, for Appellant
S.F. Collins, P. Kyriakakis, for Respondent, Alignvest Private Debt Ltd.
C. Prophet, for Respondent, Duff and Phelps Canada Restructuring Inc., in its capacity as trustee in bankruptcy of Surefire Industries

Subject: Civil Practice and Procedure; Corporate and Commercial; Insolvency; Property

Related Abridgment Classifications

Bankruptcy and insolvency
X Priorities of claims
X.4 Claims by landlord
X.4.j Miscellaneous
Personal property security
I Scope of legislation
I.9 Real property interests
I.9.c Charges, leases and mortgages

Headnote

Bankruptcy and insolvency --- Priorities of claims — Claims by landlord — Miscellaneous

Respondent company S sold its manufacturing facility and surrounding land to appellant realty company Y — Final statement of adjustments indicated $3,187,500 credit to Y for "Security Deposit", reducing amount of cash Y required to pay — Lease executed at same time provided that S would lease premises at minimum rent of $3,150,000 per year for first five years — S required to pay "security deposit" of $3,187,500, to be held as "security for the performance" of its obligations under lease — Lease provided for specific amounts to be credited for certain months' rent if S "not otherwise in default" and provided Y would "retain the security deposit and advance rent (if any) for its own use absolutely" — S declared bankrupt in December 2013 after short time in CCAA protection — Company A was secured creditor, holding General Security Agreement over S's assets — When Trustee disclaimed lease, no rent was owing — Trustee took position that sum was intangible personal property in which S had interest and to which A's security attached — Y argued sum was prepaid rent and became its property upon execution of lease — Bankruptcy judge concluded sum was security

deposit — He held that although lease contemplated that Y would retain sum upon S becoming subject to insolvency statute, CCAA and receivership proceedings stayed that remedy — Y appealed from this judgment — Appeal dismissed — While lease contained some indicia of intention to treat sum as prepaid rent, provisions were expressly subject to condition that tenant could not be in default — Reading lease as whole, characterization of sum as security deposit reflected parties' dominant intention — Disclaimer of lease by trustee extinguishes all rights and obligations under lease to pay rent — Right to disclaim arose on December 16, 2013 when, by court order, S was adjudged bankrupt — When trustee disclaimed lease on January 2, 2014, there were no rent arrears and no rent obligations other than accelerated rent — Pursuant to s. 136(1)(f) of Bankruptcy and Insolvency Act and ss. 3 and 4 of Alberta Landlord's Rights on Bankruptcy Act, landlord limited to accelerated rent and three months arrears of rent; no right to claim as debt any unexpired term of lease — Y's claim limited to three months accelerated rent — Parties requested bankruptcy court determine amount of set-off and matter remitted to bankruptcy court for that purpose.

Personal property security --- Scope of legislation — Real property interests — Charges, leases and mortgages

Surefire Industries sold its manufacturing facility and surrounding land to York Realty — Final statement of adjustments indicated $3,187,500 credit to York for "Security Deposit", reducing amount of cash York required to pay (sum) — Lease executed at same time provided that Surefire would lease premises at minimum rent of $3,150,000 per year for first five years — Surefire required to pay "security deposit" of $3,187,500, to be held as "security for the performance" of its obligations under lease — Lease provided for specific amounts to be credited for certain months' rent if Surefire "not otherwise in default" and provided York would "retain the security deposit and advance rent (if any) for its own use absolutely" — Surefire declared bankrupt in December 2013 after short time in CCAA protection — Alignvest Private Debt was secured creditor, holding General Security Agreement over Surefire's assets — When Trustee disclaimed lease, no rent was owing — Trustee took position that sum was intangible personal property in which Surefire had interest and to which Alignvest's security attached — York argued sum was prepaid rent and became its property upon execution of lease — Bankruptcy judge concluded sum was security deposit — He held that although lease contemplated that York would retain sum upon Surefire becoming subject to insolvency statute, CCAA and receivership proceedings stayed that remedy — York's appeal dismissed — While lease contained some indicia of intention to treat sum as prepaid rent, provisions were expressly subject to condition that tenant could not be in default — Reading lease as whole, characterization of sum as security deposit reflected parties' dominant intention — Disclaimer of lease by trustee extinguishes all rights and obligations under lease to pay rent — Right to disclaim arose on December 16, 2013 when, by court order, Surefire was adjudged bankrupt — When trustee disclaimed lease on January 2, 2014, there were no rent arrears and no rent obligations other than accelerated rent — Pursuant to s. 136(1)(f) of Bankruptcy and Insolvency Act and ss. 3 and 4 of Alberta Landlord's Rights on Bankruptcy Act, landlord limited to accelerated rent and three months arrears of rent; no right to claim as debt any unexpired term of lease — York's claim limited to three months accelerated rent — Parties requested bankruptcy court determine amount of set-off and matter remitted to bankruptcy court for that purpose — Bankruptcy and Insolvency Act, RSC 1985, c B-3, s. 136(1)(f) — Landlord's Rights on Bankruptcy Act, RSA 2000, c L-5, ss. 3, 4.

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Cases considered:

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Abraham, Re (1926), 7 C.B.R. 180 at 191, 59 O.L.R. 164 at 173, [1926] 3 D.L.R. 971, 1926 CarswellOnt 257 (Ont. C.A.) — referred to

Alignvest Private Debt Ltd. v. Surefire Industries Ltd. (2015), 2015 ABQB 148, 2015 CarswellAlta 485, 23 C.B.R. (6th) 66, 16 Alta. L.R. (6th) 1, 3 P.P.S.A.C. (4th) 308, 39 B.L.R. (5th) 87 (Alta. Q.B.) — considered

Bradley, Re (1921), 2 C.B.R. 147, 21 O.W.N. 216, 1921 CarswellOnt 31 (Ont. Bktcy.) — referred to

Champion Machine & Tool Co., Re (1971), 15 C.B.R. (N.S.) 136, 1971 CarswellOnt 59 (Ont. S.C.) — considered

Creston Moly Corp. v. Sattva Capital Corp. (2014), 2014 SCC 53, 2014 CSC 53, 2014 CarswellBC 2267, 2014 CarswellBC 2268, 373 D.L.R. (4th) 393, 59 B.C.L.R. (5th) 1, [2014] 9 W.W.R. 427, 461 N.R. 335, 25 B.L.R. (5th) 1, 358 B.C.A.C. 1, 614 W.A.C. 1, (sub nom. *Sattva Capital Corp. v. Creston Moly Corp.*) [2014] 2 S.C.R. 633 (S.C.C.) — followed

Gallant v. Veltrusy Enterprises Ltd. (1980), 28 O.R. (2d) 349, 14 R.P.R. 117, 110 D.L.R. (3d) 100, 1980 CarswellOnt 561 (Ont. Co. Ct.) — considered

Gallant v. Veltrusy Enterprises Ltd. (1981), 32 O.R. (2d) 716, 22 C.P.C. 267, 123 D.L.R. (3d) 391, 1981 CarswellOnt 377 (Ont. C.A.) — referred to

North American Life Assurance Co. v. 312486 Alberta Ltd. (1986), 47 Alta. L.R. (2d) 303, 74 A.R. 203, 1986 CarswellAlta 199 (Alta. Q.B.) — referred to

Principal Plaza Leaseholds Ltd. v. Principal Group Ltd. (Trustee of) (1996), 41 Alta. L.R. (3d) 248, [1996] 9 W.W.R. 539, (sub nom. *Principal Plaza Leaseholds Ltd. v. Principal Group Ltd. (Bankrupt)*) 188 A.R. 187, 1996 CarswellAlta 676 (Alta. Q.B.) — referred to

Sills, Re (1956), 35 C.B.R. 217, [1956] O.R. 494, 4 D.L.R. (2d) 432, 1956 CarswellOnt 42 (Ont. C.A.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

s. 136 — referred to

s. 136(1)(f) — considered

s. 146 — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

Landlord's Rights on Bankruptcy Act, R.S.A. 2000, c. L-5

s. 3 — considered

s. 4 — considered

Personal Property Security Act, R.S.A. 2000, c. P-7

Generally — referred to

s. 1(1)(tt) "security interest" — referred to

s. 4(f) — considered

s. 4(g) — considered

APPEAL by company Y from order reported at *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.* (2015), 2015 ABQB 148, 2015 CarswellAlta 485, 23 C.B.R. (6th) 66, [2015] A.J. No. 316, 39 B.L.R. (5th) 87, 16 Alta. L.R. (6th) 1, 3 P.P.S.A.C. (4th) 308, 608 A.R. 292 (Alta. Q.B.), declaring that sum paid on commercial lease was security deposit.

***Per curiam*:**

I. Introduction

1 York Realty Inc. appeals an order made in a bankruptcy proceeding. The order declared that $3,187,500 (Sum) paid pursuant to a commercial lease between York and Surefire Industries Ltd. (bankrupt) was a security deposit, not prepaid rent. In the result the Sum was a part of the estate of the bankrupt, and available for payment to the bankrupt's secured creditor, Alignvest Private Debt Ltd.

2 The bankruptcy judge did not err in characterizing the Sum as a security deposit. Because a security deposit becomes part of the estate of the bankrupt, it is unnecessary to address the second ground of appeal regarding registration of a "security interest" under the *Personal Property Security Act*, RSA 2000, c P-7 (*PPSA*), and whether the exceptions in section 4 (f) and (g) apply. We do not endorse the bankruptcy judge's reasons on this issue, nor were they necessary to the decision she was called upon to make.

3 The appeal is dismissed. The quantum of set-off is returned to the Court of Queen's Bench for determination.

II. Background

4 On February 15, 2013, Surefire sold its manufacturing facility and 40 acres of surrounding land to York. The final statement of adjustments for the property's sale shows a $3,187,500 credit to York for "Security Deposit to be paid to Purchaser by Vendor". The credit reduced the amount of cash York was required to pay Surefire for the property.

5 The lease was executed at the same time as the sale and provided that Surefire would lease the premises from York at a minimum rent of $3,150,000 per year for the first five years.

6 After a short time in *CCAA* protection, Surefire was declared bankrupt in December 2013. Alignvest is a secured creditor with a March 27, 2013 General Security Agreement over Surefire's assets.

7 When the Trustee disclaimed the lease on January 2, 2014, no rent was owing.

III. Decision on Appeal - *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148 (Alta. Q.B.)

8 While Surefire was in receivership, York applied for an order that it was entitled to retain the Sum. Alignvest applied for an order directing York to pay the Sum to the Trustee. Alignvest also applied for an order declaring the Sum to be an unregistered security interest under the *PPSA* and subordinate to Alignvest's perfected secured claim. The Trustee took the position that the Sum was intangible personal property as defined in the *PPSA* in which Surefire had an interest and to which Alignvest's security attached.

9 York argued that the Sum was prepaid rent and became its property upon execution of the lease.

10 The bankruptcy judge looked primarily at the wording of the lease and concluded that the Sum was a security deposit. She held:

> [23] I am satisfied by the provisions of the lease that the deposit cannot be characterized as prepaid rent, that it is not non-refundable in any scenario and that it is properly characterized as security to guarantee the performance by Surefire of its obligations under the lease, similar to the deposit described in *Champion Machine & Tool Co., Re* (1971), 15 C.B.R. (N.S.) 136 (Ont. S.C.)].

11 The bankruptcy judge also concluded that although the lease contemplated that York would retain the Sum upon Surefire becoming subject to an insolvency statute, the *CCAA* and receivership proceedings stayed that remedy.

12 The bankruptcy judge also found that the Sum was subject to the provisions of the *PPSA* and not excluded by section 4(g), which provides that the *PPSA* regime does not apply to "the creation of an interest in a right to payment that arises in connection with an interest in land, including an interest in rental payments payable under a lease of land, but not including a right to payment evidenced by investment property or an instrument". She found that the Sum was not a "right to payment" but security for Surefire's performance of its obligations under the lease. Consequently, she concluded that the Sum is a "security interest" subject to the *PPSA* and subordinate to Alignvest's perfected security interest, and other interests with priority over an unperfected security interest.

IV. Grounds of Appeal and Standards of Review

13 The appellant raises three grounds of appeal:

> i. The bankrupcty judge erred in characterizing the Sum as a security deposit rather than prepaid rent.
>
> ii. If the Sum is a "security interest", the bankruptcy judge erred in concluding that ss 4(f) and 4(g) of the *PPSA* did not apply, so as to exclude the Sum from registration under that *Act*.

iii. If ss 4(f) and 4(g) of the *PPSA* did not apply, then the bankruptcy judge erred in not permitting York to exercise a right of set off, either legal or equitable, against the amount claimed to the extent of the amount of rent and other damages it is entitled to claim in the bankruptcy of Surefire.

14 Interpretation of the lease involves issues of mixed fact and law. Absent an extricable error of law, the standard of review is palpable and overriding error. Extricable errors of law include "the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor": *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) at paras 49-55, [2014] 2 S.C.R. 633 (S.C.C.). "The interpretation of the lease is reviewed on a standard of reasonableness ...": *AMT Finance Inc. v. Saujani*, 2014 ABCA 385 (Alta. C.A.) at para 14.

V. Analysis

Security Deposit or Prepaid Rent

15 The appellant argues that it was the parties' intention that the Sum was a rental credit. It is common for lessors to demand the prepayment of rent for the last month or months of a lease's term: The Honourable Mr. Justice Lloyd W. Houlden, Mr. Justice Geoffrey B. Morawetz and Dr. Janis P. Sarra, *Bankruptcy and Insolvency Law of Canada*, 4th ed (Toronto: Carswell) at G§129 Prepaid Rent [*Houlden and Morawetz*]. Prepaid rent is never repayable to the tenant and an assignee has no greater right than the tenant: *Bradley, Re* (1921), 2 C.B.R. 147, 1921 CarswellOnt 31 (Ont. Bktcy.); *Abraham, Re*, [1926] 3 D.L.R. 971, 7 C.B.R. 180 (Ont. C.A.) at 191. Prepaid rent is consideration for future occupation, see generally *North American Life Assurance Co. v. 312486 Alberta Ltd.* (1986), 47 Alta. L.R. (2d) 303 (Alta. Q.B.) at paras 15-19.

16 By contrast, a security deposit is held by the lessor as security to guarantee the performance of covenants in the lease: *Champion Machine & Tool Co., Re* (1971), 15 C.B.R. (N.S.) 136, 1971 CarswellOnt 59 (Ont. S.C.). A security deposit is intended to "secure the landlord against a tenant who steals away without paying the rent for the final period of his tenancy, and it is to be returned to the tenant upon his payment of that last month's rent": *Gallant v. Veltrusy Enterprises Ltd.* (1980), 28 O.R. (2d) 349, 110 D.L.R. (3d) 100 (Ont. Co. Ct.); overturned for different reasons, (1981), 32 O.R. (2d) 716, 123 D.L.R. (3d) 391 (Ont. C.A.).

17 *Sattva* instructs that "a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": para 47.

18 The relevant provisions of the lease are Articles 6 and 10 (with emphasis):

> **6. SECURITY DEPOSIT/RENT CREDIT**
>
> (a) The Tenant will pay to the Landlord on or before the commencement of the Term of this Lease **a deposit of Three Million One Hundred Eighty Seven Thousand Five Hundred ($3,187,500.00) Dollars plus goods and services tax (the "Security Deposit"), which Security Deposit is to be held without interest by the Landlord as security for the performance by the Tenant of its obligations under this Lease.** The Landlord, in its sole discretion, may apply any portion or all of the Security Deposit during the Term on account of any sums outstanding or owing by the Tenant under this Lease, including, without limitation, Minimum Rent or Additional Rent or such sums resulting from the Tenant's breach or breaches of this Lease. After the Landlord has applied any portion of the Security Deposit as set out above, the Tenant, on demand, will pay such further money to the Landlord so that the Landlord is again holding the same amount in relation to the Security Deposit as the Landlord was holding immediately prior to the Landlord applying such sums against such defaults or breaches. Subject to the foregoing, the Security Deposit will, provided that the Tenant has paid all amounts due to the Landlord under this Lease and is not otherwise in default under the terms of the Lease, be applied during the Term, as follows ...

[$262,500 plus GST towards rent for the 13th, 14th, 28th, 29th and 60th months of the term]

(b) The Tenant shall be credited Five Hundred Thousand ($500,000.00) Dollars towards its Rent obligations during the first two (2) months of the term.

[...]

10. DEFAULT AND REMEDIES

In the event that:

a) the Tenant fails to pay any Rent or any other amount owing under this Lease when due, whether or not demanded by the Landlord; or

b) the Tenant defaults or fails to observe or perform any of its non-financial obligations under this Lease ...; or

c) **the Tenant makes a general assignment for the benefit of creditors, becomes bankrupt or insolvent**, or takes the benefit of or becomes subject to any statute that may be in force relating to bankrupt or insolvent debtors; or

d) any creditor seizes of takes control of the Tenant's property; ...

the Landlord, immediately and without prior notice being required, and without in any way restricting any of its other rights or remedies, may:

a) **retain the Security Deposit and advance rent (if any) for its own use absolutely**;

b) terminate this Lease and re-enter into possession of the Leased Premises; and

c) claim greater damages for breach of this Lease ...

In addition to payment of the then current Rent, and without prejudice to the Landlord's right to claim greater damages, the Rent for the next ensuing three months shall immediately become due and payable and be deemed to be in arrears upon such default, general assignment, bankruptcy, insolvency or other event of default.

19 The lease contains some indicia of an intention to treat the Sum as prepaid rent. The appellant's main submission is that, unlike a security deposit, at the end of lease term, there is nothing left to return to the tenant. Notably, Articles 6(a)(i) through (vi) state that specific amounts shall be credited for the 13th, 14th, 25th, 49th, 60th and 175-180th months' rent if the tenant is "not otherwise in default". To this extent, Article 6 supports the appellant's contention that the Sum could be characterized as prepaid rent. But, critically, the condition precedent to a rental credit is that the tenant must have met all its obligations under the lease before such credit would apply.

20 The appellant contends that there is no possible event in which the Sum could be returned to the tenant. The bankruptcy judge posited at least one scenario: termination by the landlord in the event of the premises being destroyed by fire (Clause 23).

21 The appellant also contends that the payment of GST is inconsistent with the Sum constituting a security deposit. It says that security for an obligation to be performed is not a good or service which gives rise to the payment of GST.

22 Other indicia support an intention that the Sum be treated as a security deposit. First, Article 6 defines the Sum as a "Security Deposit" and states it "is to be held as ... by the Landlord *as security for performance* by the Tenant of its obligations under this Lease". Second, the lease makes a distinction between the "Security Deposit" in Article 6(a) and the "Rent Credit" in Article 6(b), indicating an intention to treat the concepts differently. This is supported by the Statement of Adjustments, prepared for the closing of the sale, which describes the $500,000 as "prepaid rent" and the

$3,187,500 as a security deposit. Thirdly, in the event the landlord is required to apply any portion of the Sum towards rent arrears or other defaults, the tenant is required to make a payment such that the landlord was "again holding the same amount in relation to the Security Deposit ...". The notion of replenishing the Sum is inconsistent with the concept of prepaid rent. Prepaid rent is generally a set sum to which the landlord is entitled upon execution of the lease, and not an account that requires replenishment.

23 Parts of Article 10 are also relevant. It speaks of the right to retain the "Security Deposit and advance rent (if any)". Again, the wording appears to draw a distinction between the two concepts. Article 10(a), (b) and (e) permit the landlord to retain the "Security Deposit" if the tenant fails to pay rent or other amounts owing, defaults or fails to perform its non-financial obligations or abandons or threatens to abandon the premises. In other words, the primary purpose evidenced by this Article is that the Sum was intended to "secure the landlord against a tenant who steals away", to borrow from *Gallant*.

24 In summary, while there are arguably some aspects of the lease that suggest prepaid rent, those provisions are expressly subject to the condition that the tenant cannot be in default of its obligations. It is reasonable to conclude that the characterization of the Sum as a security deposit reflects the parties' dominant intention.

25 Cases which have considered this issue are helpful but not determinative as each lease is worded differently. The appellant submits that we ought to apply two Ontario Court of Appeal decisions: *Abraham, Re*, [1926] 3 D.L.R. 971, 1926 CarswellOnt 257 (Ont. C.A.); and *Sills, Re* (1956), 4 D.L.R. (2d) 432, 1956 CarswellOnt 42 (Ont. C.A.). The bankruptcy judge stated that the terms of this lease were similar to those in the more recent decision in *Champion Machine & Tool Co., Re* and distinguishable from those *Abraham, Re*, in part because of *Abraham, Re*'s lease terms and because *Abraham, Re* predated the statutory ability of the trustee to disclaim the lease. The appellant contends that this is an extricable error of law because the bankruptcy provisions regarding disclaimer were enacted in 1921, in advance of the 1923 lease at issue in *Abraham, Re*. Although the bankruptcy judge was in error when she concluded that *Abraham, Re* predated the statutory ability of a trustee to disclaim the lease, this is not an error which affected the result of her decision. The lease at issue in *Abraham, Re* provided that the $1000 deposit could be used as a rebate of rent at the end of the term or that if the tenant was in default, the landlord had the option to declare the deposit forfeit and retain entire amount as liquidated damages. In either event the tenant would not and could not receive any portion of the deposit. The wording of the lease in *Sills, Re* is similar. In this case Article 10 provides that, upon default, York is only entitled to retain a certain amount of the deposit and advance rent "if any". In addition to the "then Current Rent, and without prejudice to the Landlord's right to claim greater damages, the Rent for the next ensuing three months shall immediately become due and payable." Moreover there is no indication that the lease in *Abraham, Re* contained language similar to that in the present lease for which the deposit is to "secure the performance of the tenant's obligations."

26 In contrast the lease in *Champion Machine & Tool Co., Re* provided that the sum "shall be held by the Lessor as security to guarantee the due performance of each and all covenants herein contained on the part of the Lessee; and said deposit shall be retained by the Lessor and become the property of the Lessor in the event of a breach by the Lessee of any of the covenants herein contained; in the absence of any such breach or default by the Lessee, the deposit money shall be applied to rent for the last month of the term herein.". Although the language of the lease in *Champion Machine & Tool Co., Re* is not identical to this lease, the wording certainly bears a greater similarity. In any event, the bankruptcy judge's decision focussed primarily on the wording of the lease at issue and not on leases considered in other cases. We find no reviewable error in her consideration of *Champion Machine & Tool Co., Re*.

27 In conclusion on this issue, there were some indicia in support of each of the proposed characterizations; security deposit and prepaid rent. Reading the lease as a whole, the bankruptcy judge determined that the Sum ought to be characterized as a security deposit. Our role is to determine whether there was palpable and overriding error in the bankruptcy judge's conclusion. No reviewable error has been demonstrated.

28 Given the conclusion that the Sum is not prepaid rent and therefore not the property of the appellant, it is unnecessary to address the second ground of appeal regarding registration of a "security interest" under the *PPSA*, and

whether the exceptions in section 4 (f) and (g) apply. That said, however, we do not endorse the bankruptcy judge's decision on this issue, nor was it necessary to the decision she was called upon to make.

York's Entitlement in the Bankruptcy - Set-Off

29 The appellant's third ground of appeal contends that the bankruptcy judge erred in failing to consider its right of set-off. This argument was not raised in the court below. However, the parties made written and oral submissions on appeal, and invited us to address the issue. We do so.

30 Disclaimer of a lease by a trustee extinguishes all rights and obligations under the lease to pay rent. After a lease is disclaimed, a landlord cannot claim damages for the rent for the balance of the term: *Principal Plaza Leaseholds Ltd. v. Principal Group Ltd. (Trustee of)* (1996), 188 A.R. 187, [1996] 9 W.W.R. 539 (Alta. Q.B.). Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt are applied in priority of payment: *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 136.

31 The right to disclaim arose on December 16, 2013 when by court order Surefire was adjudged bankrupt. When the Trustee disclaimed the lease on January 2, 2014, there were no rent arrears. Consequently, as of January 2, 2014 there were no rent obligations (beyond accelerated rent).

32 The nature and extent of a landlord's claim for rent and damages for the unexpired term of a lease are determined by the law of the province in which the leased premises are situated: *Bankruptcy and Insolvency Act*, s 146; *Houlden and Morawetz* at G§141. The preferential claim of the landlord is determined by section 136(1)(f) of the *Bankruptcy and Insolvency Act* in association with sections 3 and 4 of the *Landlord's Rights on Bankruptcy Act*, RSA 2000, c L-5. Those sections provide that a landlord is limited to accelerated rent, arrears of rent three months immediately preceding the bankruptcy, and no right to claim as a debt any unexpired term of the lease. As the appellant had not exercised its rights under Article 10 before the order was made, the statutory remedies set out above limit the appellant's ability to enforce Article 10(c). In the result the claim is limited to three months accelerated rent.

33 In addition, the landlord is entitled to damages incurred to repair the property. The parties expressed a preference for having the bankruptcy court determine the amount of set-off and we so direct.

VI. Conclusion

34 The appeal is dismissed. The appellant's set-off claim is to be determined in accordance with our direction in the preceding paragraph.

Appeal dismissed.

TAB 3

HMANALY G§140
Houlden & Morawetz Analysis G§140

Houlden and Morawetz Bankruptcy and Insolvency Analysis

THE BANKRUPTCY AND INSOLVENCY ACT

Part V (ss. 136-147)
L.W. Houlden and Geoffrey B. Morawetz

G§140 — Disclaimer and Surrender of Lease by the Trustee

G§140 — Disclaimer and Surrender of Lease by the Trustee

See ss. 136, 137, 138, 139, 140, 140.1, 141, 141, 143, 144, 145, 146, 147

(1) — *Generally*

For the effect of a disclaimer and surrender of a head lease by a trustee in bankruptcy on a sub-lease, see *ante* G§132 "Sub-Lessees".

For the right to disclaim or surrender a lease and the effect of a surrender or disclaimer, resort must be had to provincial law: s. 146. See also s. 30 of the *BIA,* which sets out the powers exercisable by the trustee with the permission of inspectors.

A party taking the position that a lease has been surrendered must specifically plead surrender: *Crystalline Investments Ltd. v. Domgroup Ltd.* (2004), 2004 CarswellOnt 219, 2004 CarswellOnt 220, [2004] S.C.J. No. 3, 2004 SCC 3, 184 O.A.C. 33, 46 C.B.R. (4th) 35, 316 N.R. 1, 234 D.L.R. (4th) 513, 16 R.P.R. (4th) 1 (S.C.C.).

For the form of a disclaimer under s. 38 of the *Commercial Tenancies Act* of Ontario, see Precedent 83 under Precedents in vol. 5.

The Ontario Court of Appeal gave direction on the legal effect of a notice of repudiation of lease given during a *CCAA* proceeding, for a debtor that subsequently became bankrupt. The court emphasized the distinction between a lease termination and a repudiation: *Re TNG Acquisition Inc.*, 2011 CarswellOnt 8039, 107 O.R. (3d) 304, 81 C.B.R. (5th) 151, 2011 ONCA 535 (Ont. C.A.). For a discussion of this judgment, see N§187 "Application to Leases".

The Alberta Court of Appeal dismissed the appeal of the landlord of a commercial lease. The lower court had concluded that a certain sum paid to the landlord by the bankrupt tenant was a security deposit, not prepaid rent. The security deposit became part of the estate of the bankrupt. An issue relating to set-off was returned to the lower court for determination: *York Realty Inc. v. Alignvest Private Debt Ltd.*, 2015 CarswellAlta 2108, 31 C.B.R. (6th) 98, 2015 ABCA 355 (Alta. C.A.). For a discussion of this judgment, see F§63(19) "Necessity for a Security Interest".

(2) — *Meaning of Disclaimer and Surrender*

A surrender and a disclaimer of a lease are different things. A disclaimer is a unilateral act on the part of the trustee terminating the lease. A surrender involves the giving up of the lease with the consent of the landlord; it is a consensual act: *Office Specialty Mfg. Co. v. Eastern Trust Co.* (1931), 13 C.B.R. 166, 3 M.P.R. 526 (N.B. C.A.); *Berkley Property Management Ltd. v. Garden City Plaza Ltd.* (1995), 32 C.B.R. (3d) 258, 29 Alta. L.R. (3d) 434, 171 A.R. 128, 1995 CarswellAlta 274 (Master); *Targa Holdings Ltd. v. Whyte,* 21 C.B.R. (N.S.) 54, [1974] 3 W.W.R. 632, 44 D.L.R. (3d) 209 (Alta. C.A.) The delivery of possession by the trustee to the landlord and the landlord's assumption of possession

effect a surrender of a lease by operation of law: *New Regina Trading Co. v. Canadian Credit Men's Trust Assn.*, [1934] S.C.R. 47, 15 C.B.R. 207, [1934] 1 D.L.R. 630.

(3) — *What constitutes a Surrender or Disclaimer*

The following acts have been held to constitute a surrender or disclaimer:

• giving a letter to a landlord that the trustee was surrendering possession of the leased premises and the landlord putting a new lock on the premises: *Office Specialty Mfg. Co. v. Eastern Trust Co.* (1931), 13 C.B.R. 166, 3 M.P.R. 526 (N.B. C.A.);

• the landlord demanding possession of the leased premises and the trustee in bankruptcy acquiescing and surrendering possession: *New Regina Trading Co. v. Canadian Credit Men's Trust Assn.*, [1934] S.C.R. 47, 15 C.B.R. 207, [1934] 1 D.L.R. 630.

(4) — *What Does Not Constitute a Surrender or Disclaimer*

The following acts have been held not to constitute a surrender or disclaimer of a lease:

• advertising assets for sale and stating in the advertisements that tenderers would have to make arrangements with the landlord for leasing and possession of the demised premises: *Whiteley v. Clarkson* (1933), 14 C.B.R. 306 (Ont. C.A.);

• handing over of keys to the leased premises by the trustee and the acceptance of the keys by the landlord without prejudice to the landlord's rights: *Re Panther Lead Co.*, [1896] 1 Ch. 978, 65 L.J. Ch. 499, 3 Mans 165, 44 W.R. 573.

(5) — *Time for Delivering Disclaimer or Making a Surrender*

Like the election to retain a lease, the right to disclaim or surrender a lease runs from the date of the filing of the assignment in bankruptcy or from the date of a bankruptcy order: *Targa Holdings Ltd. v. Whyte*, 21 C.B.R. (N.S.) 54, [1974] 3 W.W.R. 632, 44 D.L.R. (3d) 209 (Alta. C.A.). The disclaimer or surrender should be made within three months of the date of the filing of the assignment or the making of a bankruptcy order.

(6) — *Effect of the Trustee Entering into Possession*

Under s. 38 of the *Commercial Tenancies Act* of Ontario, the trustee has a right at any time before electing to retain the lease, by notice in writing, to surrender possession or disclaim the lease. The entry into possession of the leased premises and the occupation of them by the trustee are not under s. 38 deemed to be evidence of an intention on the part of the trustee to elect to retain the premises, and the trustee may give a disclaimer or surrender possession notwithstanding that the trustee has entered into possession of the leased premises.

(7) — *Approval of Inspectors*

A trustee may validly surrender or disclaim a lease without the consent of the inspectors: *Office Specialty Mfg. Co. v. Eastern Trust Co.* (1931), 13 C.B.R. 166, 3 M.P.R. 526 (N.B. C.A.). The better practice is to have the approval of the inspectors: s. 30(1)(k). If the approval is not obtained before surrendering or disclaiming the lease, the trustee should as soon as possible have the inspectors ratify its actions: *Office Specialty Mfg. Co. v. Eastern Trust Co., supra.*

If, because of conflict of interest, a majority of inspectors are unable to approve the activities of the trustee in disclaiming or surrendering a lease, the trustee can apply for directions under s. 34: *Re Salok Hotel Co.* (1967), 11 C.B.R. (N.S.) 95, 62 W.W.R. 268, 66 D.L.R. (2d) 5 (Man. Q.B.), affirmed (1967), 11 C.B.R. (N.S.) 158, 62 W.W.R. 705, 66 D.L.R. (2d) 14n (Man. C.A.).

(8) — *Effect of Surrender or Disclaimer*

The legal effect of a surrender or disclaimer is the same. When the trustee surrenders possession or gives a disclaimer of a lease, all the rights and obligations that vested in the trustee upon the making of the receiving order or the filing of

the assignment are terminated: *Cummer-Yonge Invt. Ltd. v. Fagot,* 8 C.B.R. (N.S.) 62, [1965] 2 O.R. 152, 50 D.L.R. (2d) 25 (H.C.), affirmed, [1965] 2 O.R. 157n, 8 C.B.R. (N.S.) 62n, 50 D.L.R. (2d) 30n (C.A.); *Re Vrablik* (1993), 17 C.B.R. (3d) 152, 1993 CarswellOnt 192 (Ont. Gen. Div.); *Re Salok Hotel Co.* (1967), 11 C.B.R. (N.S.) 95, 62 W.W.R. 268, 66 D.L.R. (2d) 5 (Man. Q.B.), affirmed (1967), 11 C.B.R. (N.S.) 158, 62 W.W.R. 705, 66 D.L.R. (2d) 14n (Man. C.A.). The liability of the trustee to pay occupation rent comes to an end: *Re Mussens Ltd.,* 14 C.B.R. 479, [1933] O.W.N. 459 (S.C.). After a disclaimer or surrender, there is no right in Ontario to claim damages for the unexpired portion of the lease: see *post* G§141 "Damages Claimed by Landlord for Unexpired Portion of Lease after Surrender or Disclaimer of Lease by Trustee".

If the trustee has surrendered or disclaimed the lease, the trustee has no rights subsequently to elect to retain the lease: *Re Niki's Palace Restaurant Ltd.* (1983), 48 C.B.R. (N.S.) 236 (Ont. S.C.).

The registrar upheld the disallowance of a landlord's proof of claim for damages suffered as a result of disclaimer of a lease. Section 146 of the *BIA* provides that, subject to the priority of claims set out in s. 136 and the provisions of s. 73(4), the rights of landlords shall be determined according to the laws of the province in which the premises are situated. Here, the rights of the landlord were codified in ss. 38 and 39 of the *Commercial Tenancies Act* (*CTA*). While s. 38 provides for a preferential claim that is similar to s. 136 of the *BIA,* s. 39 of the *CTA* specifies that the trustee has the further right, at any time before so electing, by notice in writing to the landlord, to surrender possession or disclaim any such lease. The trustee allowed the claims provided for in s. 38 of the *CTA* and s. 136 of the *BIA*, specifically, three months arrears of rent and three months of accelerated rent, together with other entitlements as being rent under the lease. The trustee could disclaim the lease and if so, the tenant is in the same position as if the lease had been surrendered with the consent of the lessor, which means no further liability on the part of the lessee to pay rent and no suggestion that by failing to pay rent the tenant was committing a breach of covenant and liable for liquidated or unliquidated damages. Neither the *BIA* nor the *CTA* that govern rights in these matters provides for the type of claim advanced. The registrar concluded that the trustee had properly disallowed the portions of the landlord's proof of claim and the appeal was dismissed: *Re Linens N Things Canada Corp.* (2009), 2009 CarswellOnt 2849, 53 C.B.R. (5th) 232 (Ont. S.C.J.).

(9) — *Termination of a Lease by an Interim Receiver*

Although an interim receiving order gives the interim receiver of an assignee of a lease power to terminate existing agreements, the interim receiver has no power to terminate the obligations of the original lessee to the lessor. The relationship between the lessor and the original lessee has no connection with the insolvency of the assignee: *J.P. Morgan Canada v. Maxlink Canada Inc.* (2002), 31 C.B.R. (4th) 40, 2002 CarswellOnt 333, 155 O.A.C. 351 (Ont. C.A.).

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HMANALY G§141
Houlden & Morawetz Analysis G§141

Houlden and Morawetz Bankruptcy and Insolvency Analysis

THE BANKRUPTCY AND INSOLVENCY ACT

Part V (ss. 136-147)
L.W. Houlden and Geoffrey B. Morawetz

G§141 — Damages Claimed by Landlord for Unexpired Portion
of Lease after Surrender or Disclaimer of Lease by Trustee

G§141 — Damages Claimed by Landlord for Unexpired Portion of Lease after Surrender or Disclaimer of Lease by Trustee

See ss. 136, 137, 138, 139, 140, 140.1, 141, 141, 143, 144, 145, 146, 147

By virtue of s. 146 of the *Bankruptcy and Insolvency Act,* the nature and extent of the landlord's claim for rent and damages for the unexpired portion of a lease are determined by the law of the province in which the leased premises are situated. The preferential claim of the landlord is determined by s. 136(1)(f) of the Act. If, by provincial law, after the trustee has surrendered or disclaimed a lease, there is a claim for rent or damages in addition to the preferred claim under s. 136(1)(f), the claim will only be an unsecured claim in the bankruptcy: *Re Gingras Automobile Ltée,* [1962] S.C.R. 676, 4 C.B.R. (N.S.) 123, 34 D.L.R. (2d) 751.

Under the *Commercial Tenancies Act* of Ontario when a trustee surrenders or disclaims a lease, a landlord has no claim for the rent for the remainder of the term of the lease. The surrender or disclaimer terminates all rights and obligations under the lease to pay rent: *Re Mussens Ltd.,* 14 C.B.R. 479, [1933] O.W.N. 459 (S.C.); *Re Smith* (1933), 14 C.B.R. 335 (Ont. S.C.); *Re Vrablik* (1993), 17 C.B.R. (3d) 152, 1993 CarswellOnt 192 (Ont. Gen. Div.); *Peat Marwick Thorne Inc. v. Natco Trading Corp.* (1995), 31 C.B.R. (3d) 119, 22 O.R. (3d) 727, 44 R.P.R. (2d) 207, 1995 CarswellOnt 55 (Ont. Gen. Div. [Commercial List]).

In *Re Ted Weale Ltd.,* 32 C.B.R. 206, [1952] O.W.N. 560, [1952] 3 D.L.R. 839 (S.C.), a landlord tried to file a claim as an unsecured creditor in respect of four promissory notes given by the tenant at the time of signing the lease, which were to cover the rent for the last four months of the lease. The trustee disclaimed the lease. The registrar found that this claim was an attempt to claim damages for the unexpired portion of the lease and disallowed the claim.

The provincial law is the same in Manitoba as in Ontario. The surrender or disclaimer of a lease by a trustee extinguishes all rights and obligations under the lease to pay rent, and a landlord cannot, after the surrender or disclaimer, claim damages for the rent for the balance of the term: *Re Salok Hotel Co.* (1967), 11 C.B.R. (N.S.) 95, 62 W.W.R. 268, 66 D.L.R. (2d) 5 (Man. Q.B.), affirmed (1967), 11 C.B.R. (N.S.) 158, 62 W.W.R. 705, 66 D.L.R. (2d) 14n (Man. C.A.).

The law in Alberta is the same as in Ontario. The surrender of disclaimer of a lease by a trustee extinguishes all rights and obligations under the lease to pay rent, and a landlord cannot, after the surrender or disclaimer, claim damages for the rent for the balance of the term: *Berkley Property Management Ltd. v. Garden City Plaza Ltd.* (1995), 32 C.B.R. (3d) 258, 29 Alta. L.R. (3d) 434, 171 A.R. 128, 1995 CarswellAlta 274 (Master); *Principal Plaza Leaseholds Ltd. v. Principal Group Ltd. (Trustee of),* 41 Alta. L.R. (3d) 248, [1996] 9 W.W.R. 539, 188 A.R. 187, 1996 CarswellAlta 676 (Q.B.).

The law would appear to be the same in British Columbia as it is in Ontario, Manitoba and Alberta. See *KKBL No. 297 Ventures Ltd. v. Ikon Office Solutions Inc.* (2003), 47 C.B.R. (4th) 251, 2003 CarswellBC 2598, 2003 BCSC 1598, 16

R.P.R. (4th) 29, 21 B.C.L.R. (4th) 163 (B.C.S.C.); *West Shore Ventures Ltd. v. KPN Holdings Ltd.* (2001), 198 D.L.R. (4th) 520, [2001] 5 W.W.R. 209, 88 B.C.L.R. (3d) 95, 25 C.B.R. (4th) 139, 39 R.P.R. (3d) 155, 152 B.C.A.C. 55, 2001 CarswellBC 725, 250 W.A.C. 55, 2001 BCCA 279, [2001] B.C.W.L.D. 654, [2001] B.C.J. No. 713 (B.C.C.A.) and *Peat Marwick Thorne Inc. v. Natco Trading Corp., supra.*

Under Québec law, where a trustee abandons a lease, it is uncertain whether the landlord has a claim for damages for the remainder of the term after the abandonment. The length of the damage claim may depend on the economic situation and the particular circumstances of the property in which the leased premises are located, and would likely include a period sufficient to prepare the premises for a new tenant. Under earlier caselaw, if the landlord relet the premises, any such claim was wiped out and in ordinary cases, damages was not generally given for more than three months rent in advance, during which time it is expected that the lessor would find a new tenant: *Re Eftaxias* (1962), 3 C.B.R. (N.S.) 152 (Que. S.C.).

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TAB 4

2009 CarswellOnt 2849
Ontario Superior Court of Justice

Linens N Things Canada Corp., Re

2009 CarswellOnt 2849, 177 A.C.W.S. (3d) 493, 53 C.B.R. (5th) 232

In the Matter of the Bankruptcy of Linens 'N Things Canada Corp., of the City of Toronto, in the Province of Ontario

Reg. S.W. Nettie

Heard: May 7, 2009
Judgment: May 22, 2009
Docket: Estate No. 31-1121528

Counsel: James Klein for Appellant
Aubrey Kauffman, Graham Phoenix for Respondent / Trustee

Subject: Insolvency; Property

Related Abridgment Classifications

Bankruptcy and insolvency
IX Proving claim
IX.2 Disallowance of claim
IX.2.c Appeal from disallowance
IX.2.c.i General principles
Real property
V Landlord and tenant
V.13 Surrender
V.13.a Express surrender
V.13.a.ii Miscellaneous

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — Appeal from disallowance — General principles

Bankrupt was big box retailer of household linens and other items — Bankrupt made assignment into bankruptcy — At time of assignment, creditor was landlord of one of bankrupt's locations — Trustee occupied demised premises for approximately two months — Trustee disclaimed lease of premises — Creditor, in its proof of claim, claimed to be due from bankrupt amount, in aggregate, of $3,886,933.15 — Trustee disallowed amount of $3,693,984 claimed on account of costs of building structure, amounts provided under lease as tenant's allowance, and leasing commission — Creditor appealed — Appeal dismissed — Trustee properly disallowed those portions of creditor's proof of claim — Creditor characterized its disallowed claim as one for damages for breach of contract contained in lease — Only breach complained of by creditor was of covenant to pay rent — Effect of s. 39 of Commercial Tenancies Act ("CTA") was that effect of surrender or disclaimer by trustee was as if there was consensual surrender of lease — In other words, it was at end, and no claim for damages could possibly be founded from such cessation of obligations under lease — Neither CTA nor Bankruptcy and Insolvency Act provided for type of claim advanced.

Real property --- Landlord and tenant — Surrender — Express surrender — Miscellaneous

Bankrupt was big box retailer of household linens and other items — Bankrupt made assignment into bankruptcy — At time of assignment, creditor was landlord of one of bankrupt's locations — Trustee occupied demised premises for approximately two months — Trustee disclaimed lease of premises — Creditor, in its proof of claim, claimed to be due from bankrupt amount, in aggregate, of $3,886,933.15 — Trustee disallowed amount of $3,693,984 claimed on account

of costs of building structure, amounts provided under lease as tenant's allowance, and leasing commission — Creditor appealed — Appeal dismissed — Trustee properly disallowed those portions of creditor's proof of claim — Creditor characterized its disallowed claim as one for damages for breach of contract contained in lease — Only breach complained of by creditor was of covenant to pay rent — Effect of s. 39 of Commercial Tenancies Act ("CTA") was that effect of surrender or disclaimer by trustee was as if there was consensual surrender of lease — In other words, it was at end, and no claim for damages could possibly be founded from such cessation of obligations under lease — Neither CTA nor Bankruptcy and Insolvency Act provided for type of claim advanced.

Table of Authorities

Cases considered by *Reg. S.W. Nettie*:

Highway Properties Ltd. v. Kelly, Douglas & Co. (1971), 1971 CarswellBC 274, [1972] 2 W.W.R. 28, 17 D.L.R. (3d) 710, 1971 CarswellBC 239, [1971] S.C.R. 562 (S.C.C.) — distinguished

Mussens Ltd., Re (1933), 1933 CarswellOnt 52, 14 C.B.R. 479, [1933] O.W.N. 459 (Ont. S.C.) — followed

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Generally — referred to

s. 73(4) — referred to

s. 135 — pursuant to

s. 136 — considered

s. 146 — referred to

Commercial Tenancies Act, R.S.O. 1990, c. L.7

s. 38 — considered

s. 39 — considered

APPEAL by creditor from partial disallowance of its proof of claim by trustee of bankrupt's estate.

***Reg. S.W. Nettie*:**

1 This was the appeal by Roundhouse Centre Windsor Inc. (the "Appellant") of the partial disallowance of its December 29, 2008, proof of claim by RSM Richter Inc., trustee of the Estate of Linens' N Things Canada Corp. (the "Trustee"), on or about February 20, 2009.

2 The appeal is pursuant to the provisions of s. 135 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA").

Facts

3 Linens' N Things Canada Corp. (the "Bankrupt") was a big box retailer of household linens and other items. On October 31, 2008, it made an assignment into bankruptcy, pursuant to the provisions of the BIA. At the time of the assignment, the Appellant was the landlord of the Bankrupt's location at the Round House Centre, in Windsor, Ontario.

4 The Trustee occupied the demised premises until December 29, 2008. The Trustee disclaimed the lease of the premises, by way of notice dated January 16, 2009, effective that date.

5 The demised premises included a standalone structure, various landlord improvements to it, and a significant tenant's allowance. The Appellant also incurred in letting the premises certain leasing costs. All of these were as provided for in the lease.

6 The Appellant, in its proof of claim, claimed to be due from the Bankrupt the amount, in the aggregate, of $3,886,933.15. This included a claim in the amount of $3,693,984.00 for build cost of the structure, tenant allowance and

leasing commission. The proof of claim also included certain other amounts which were disallowed by the Trustee, but which amounts have now been agreed to as properly disallowed.

7 What remains in dispute is the propriety of the Trustee's disallowance of the $3,693,984.00 on account of the costs of building the structure; amounts provided under the lease as tenant's allowance; and the commission paid on the lease itself by the Appellant.

Analysis

8 Section 146 BIA provides that, subject to the priority of claims set out in s. 136 BIA, and the provisions of s. 73(4) BIA, the rights of landlords shall be determined according to the laws of the Province in which the demised premises are situated. In the case at bar, that is Ontario.

9 The law in Ontario as to the rights of a landlord is codified, and has been for many, many, years, in what are now sections 38 and 39 of the *Commercial Tenancies Act*, R.S.O. 1990, chapter L.7 (the "CTA"). While s. 38 CTA provides for a preferential claim which mirrors s. 136 BIA, it is s. 39 CTA which is of most concern on this appeal. That section provides as follows:

> The person who is assignee, liquidator or trustee has the further right, at any time before so electing, by notice in writing to the landlord, to surrender possession or disclaim any such lease...

10 The Trustee's position, in partially disallowing the proof of claim, is that it has allowed the claims provided for in s. 38 CTA and s. 136 BIA, being that of three months arrears of rent, and three months of accelerated rent (the lease having contained an acceleration clause), together with certain other entitlements by way of charge backs, outstanding at the time of the bankruptcy, as being rent under the lease, or, alternatively, as being actually due and quantified under the lease at the time of bankruptcy. The Trustee's position is that it is not required to allow the claim for damages which the Appellant alleges it is suffering as a result of the disclaimer of the lease.

11 What is the claim of the Appellant? Put succinctly, it is that it built an expensive purpose built building for the Bankrupt, in what to others is seen as a less than valuable location at its Round House Centre, and bargained to recover its costs of so doing, together with some element of profit, over a 10 year and 6 month period of demise under the lease. It advances the same argument with respect to the tenant allowance and the leasing commissions which it paid in letting the building to the Bankrupt. The Appellant claims that it cannot lease this building to anyone else -for a variety of reasons. Even if I accept this to be true, and that the costs of erecting, improving and leasing this building are a complete loss, the question is whether or not that is a claim provable in bankruptcy.

12 The Appellant has gone to great lengths at the hearing to characterize its disallowed claim as one for damages for breach of the contract contained in the lease. It has taken great pains not to claim that any part of the disputed amount is rent, as it accepts that it can only claim rent in accordance with s. 136 BIA and s. 38 CTA.

13 The Appellant relies upon the decision of the Supreme Court of Canada in *Highway Properties Ltd. v. Kelly, Douglas & Co.*, [1971] S.C.R. 562 (S.C.C.) for the proposition that a lease of real property is both a lease and a contract. Flowing from this is the finding in that decision that a landlord may have recourse not only to its rights as a landlord, but for contractual damages for breach of the contract which is the lease.

14 While I take no issue with the decision in *Highway Properties*, and it is clearly binding, it is also entirely distinguishable on the facts. The circumstances of the breach of the lease in *Highway Properties* were that the tenant therein repudiated the lease. There was no insolvency, and no applicability of s. 146 BIA or anything like sections 38 and 39 CTA.

15 Counsel spent considerable time on argument about whether the lease, which provides in its language a reservation to the Appellant of all of the Appellant's rights at law and equity for breach of the lease, was sufficient to contract out

of the provisions of sections 38 and 39 CTA, and whether or not a lease could provide for payback to a landlord, as damages, of an amount representing the unrealized costs of erecting a building for a tenant, or the like.

16 While such an argument is appealing, both the Dominion and Provincial Parliaments have spoken in determining that a trustee in bankruptcy may surrender or disclaim a lease. The effect of such is as if the parties had consensually ended the lease.

17 As pointed out in *Mussens Ltd., Re*, 1933 CarswellOnt 52 (Ont. S.C.), at paragraph 6, the language used in the predecessor of s. 39 CTA, which is for our purposes identical to the present day language in s. 39 CTA, means "that whether the lessor is or is not willing the [trustee] may surrender possession or disclaim the lease, and that if he does so surrender possession or disclaim the lease the tenant...shall be in the same position as if the lease had been surrendered with the consent of the lessor. Of course if the lease were surrendered with the consent of the lessor there could be no suggestion of any further liability on the part of the lessee to pay rent and no suggestion that by failing to pay rent the tenant was committing a breach of covenant and was rendering himself liable for liquidated or unliquidated damages."

18 As in *Mussens* the only breach complained of by the Appellant is of the covenant to pay rent. I concur with the learned Chief Justice in *Mussens* that the effect of what is now s. 39 CTA is, whether in liquidation, as in *Mussens*, or in bankruptcy, the effect of a surrender or disclaimer by a trustee in this Province is as if there was a consensual surrender of the lease. In other words, it is at an end, and no claim for damages can possibly be founded from such a cessation of obligations under the lease. As Chief Justice Rose said in paragraph 7 of *Mussens*, a trustee under this section is given a statutory right to commit a breach of the insolvent's obligations under the lease.

19 According to the Chief Justice, the then corresponding provisions of the similar United Kingdom statute provided that any person injured by the exercise of the surrender or disclaimer of a lease under that statute shall be deemed a creditor to the extent of such injury. If s. 39 CTA contained such deeming language, then it seems to me that the Appellant would have the claim which it seeks to advance.

20 The Ontario statute did not provide for such a damage claim and deemed creditor status 76 years ago, and it does not do so today. The Dominion Parliament, in exercising its jurisdiction over bankruptcy law in the Dominion, has wholly left it up to the Provinces to determine the rights of lessors in these circumstances, and the Provincial Parliament has not seen fit to provide for the type of damage claim advanced by the Appellant. One can imagine that this is so because the vast majority of landlords are either amply compensated by a reduced but preferred claim for unpaid rent and future loss of rent, capped at three months worth, or there is generally no issue as the estates of commercial tenants in bankruptcies most often have no funds to pay claims of any type, so it matters little as to the quantum of a landlord's claim. In this case, I am advised that there may be sufficient funds in the Estate to provide a dividend to ordinary unsecured creditors - making the outcome of the appeal significant to the Appellant.

21 Be that as it may, neither of the statutes which govern rights in these matters provides for the type of claim advanced. Even more, the CTA and its predecessors, has been found for the better part of a century to have the effect of a consensual ending of the lease, and the cases recognize that this is a statutorily permitted breach for which there is no damage remedy, beyond the s. 38 CTA and s. 136 BIA preferred claim.

22 Accordingly, I find that the Trustee has properly disallowed the portions of the Appellant's proof of claim which it did, and the within appeal is dismissed.

23 Counsel are to be thanked for their very helpful briefs.

24 As to costs, counsel have suggested brief written submissions following the release of these Reasons, not to exceed one page. I find this appropriate. Counsel should contact the Bankruptcy Office at Toronto to arrange for their submissions to be forwarded to me, within 45 days hereof.

Appeal dismissed.

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IN THE MATTER OF THE BANKRUPTCY OF
CURRICULUM SERVICES CANADA/
SERVICES DES PROGRAMMES D'ÉTUDES CANADA
OF THE CITY OF TORONTO, IN THE MUNICIPALITY OF TORONTO
IN THE PROVINCE OF ONTARIO

Court File No. – 31-2360759

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

PROCEEDING COMMENCED AT
TORONTO

BOOK OF AUTHORITIES OF THE TRUSTEE

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