CITATION: In the Matter of the Bankruptcy of Curriculum Services Canada, 2019 ONSC 1114
COURT FILE NO.: 13-2360759
DATE: 20190215

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF
Curriculum Services Canada/Services Des Programmes D'Etudes Canada
of the City of Toronto
in the Province of Ontario

BEFORE: Madam Justice V.R. Chiappetta

COUNSEL: *Catherine Francis*, for the Appellant Medallion Corporation as authorized agents for 280 Richmond Street West Limited

Alex Ilchenko, for the Trustee, RSM Canada Limited

APPEAL HEARD: January 21, 2019

ENDORSEMENT

Background

[1] Pursuant to a Lease dated May 26, 2017 (the "Lease"), Curriculum Services Canada/Services Des Programmes D'Etudes Canada (the "Tenant" or "Curriculum") rented the sixth floor of 150 John Street West, Toronto, Ontario (the "Premises") from Medallion Corporation. Medallion Corporation is the authorized agent for 280 Richmond Street West Limited (the "Landlord"). Curriculum went bankrupt in March 2018. The Landlord brought this claim in April 2018 under s. 136 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") for three months' accelerated rent and the unexpired portion of the term of the Lease.

[2] The Lease was for 8,322 square feet of space at the Premises for a term of ten years and six months, commencing on July 1, 2017 and expiring on December 31, 2027, with basic rent payable as follows:

(i) Months 1-42: $21.50 per square foot per annum;
(ii) Months 43-78: $23.50 per square foot per annum; and
(iii) Months 79-126: $25.50 per square foot per annum.

[3] In addition to basic rent, the Tenant was required to pay additional rent as defined in the Lease. Section 16 of the Lease deals with defaults and remedies. Section 16.1 reads in relevant part:

If any of the following shall occur:

...

(f) Tenant, any assignee or a subtenant of all or substantially all of the Premises makes an assignment for the benefit of creditors or becomes bankrupt or insolvent or takes the benefit of any statute for bankrupt or insolvent debtors or makes any proposal, assignment, arrangement or compromise with its creditors or Tenant sells all or substantially all of its personal property at the Premises other than in the ordinary course of business (and other than in connection with a Transfer requiring Landlord's consent and approved in writing by Landlord), or steps are taken or action or proceedings commenced by any person for the dissolution, winding up or other termination of Tenant's existence or liquidation of its assets (collectively called a "**Bankruptcy**");

(g) a trustee, receiver, receiver-manager, manager, agent or other like person shall be appointed in respect of the assets or business of Tenant or any other occupant of the Premises;

...

then, without prejudice to and in addition to any other rights or remedies to which Landlord is entitled hereunder or at law, the then current and the next three (3) months' Rent shall be forthwith due and payable and Landlord shall have the following rights and remedies, all of which are cumulative and not alternative, namely:

(i) to terminate this Lease in respect of the whole or any part of the Premises by written notice to Tenant (it being understood that actual possession shall not be required to effect a termination of this Lease and that written notice, alone shall be sufficient); if this Lease is terminated in respect of part of the Premises, this Lease shall be deemed to be amended by the appropriate amendments, and proportionate adjustments in respect of Rent and any other appropriate adjustments shall be made;

...

(v) to obtain damages from Tenant including, without limitation, if this Lease is terminated by Landlord, all deficiencies between all amounts which would have been payable by Tenant for what would have been the balance of the Term, but for such termination, and all net amounts actually received by Landlord for such period of time;

> (vi) to suspend or cease to supply any utilities, services, heating, ventilating, air conditioning and humidity control to the Premises, all without liability of Landlord for any damages, including indirect or consequential damages, caused thereby;
>
> (vii) to obtain the Termination Payment from Tenant;
>
> (viii) if this Lease is terminated due to the default of Tenant, or if it is disclaimed, repudiated or terminated in any insolvency proceedings related to Tenant (collectively "Termination"), to obtain payment from Tenant of the value of all tenant inducements which were received by Tenant pursuant to the terms of this Lease, the agreement to enter into this Lease or otherwise, including, without limitation, the amount equal to the value of any leasehold improvement allowance, tenant inducement payment, rent free periods, lease takeover, Leasehold Improvements or any other work for Tenant's benefit completed at Landlord's cost or any moving allowance, which value shall be multiplied by a fraction, the numerator of which shall be the number of months from the date of Termination to the date which would have been the natural expiry of this Lease but for such Termination, and the denominator of which shall be the total number of months of the Term as originally agreed upon.

[4] On March 28, 2018, Curriculum filed an Assignment for the General Benefit of Creditors (the "Assignment"). Amy Coupal, an officer and director of Curriculum, swore a Statement of Affairs dated March 28, 2018 in which she swore that Curriculum had assets totaling $1,903,563.87 and liabilities totaling $5,605,253.28, resulting in a deficiency of $3,701,689.41. The single largest liability shown on the Statement of Affairs was Curriculum's liability to the Landlord, which was reflected as follows:

(i) Unsecured claim: $3,986,725.25; and
(ii) Preferred claim: $100,558.59.

[5] On March 29, 2018, pursuant to the Assignment, Curriculum became bankrupt. RSM Canada Inc. was appointed as Trustee.

[6] On April 20, 2018, the Landlord filed a Proof of Claim with the Trustee claiming:

(i) A preferred claim for three months' accelerated rent in the amount of $100,558.59 under s. 136(1)(f) of the BIA, which reads as follows:

> **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;

and;

(iii) An unsecured claim in the amount of $4,028,11.23 for the unexpired portion of the term of the Lease under s. 136(3) of the BIA, which reads as follows:

> **s. 136(3)** A creditor whose rights are restricted by this section is entitled to rank as an unsecured creditor for any balance of claim due him.

[7] On April 23, 2018, the Trustee issued a Notice of Disclaimer of the Lease pursuant to s. 30(1)(k) of the *BIA*, effective that date.

[8] On September 19, 2018, pursuant to s. 135(3) of the *BIA*, the Trustee disallowed part of the Landlord's preferred claim for $100,558.59, on the basis that the Trustee had realized only $24,571 from the assets on the leased premises (i.e. the office equipment). The Trustee therefore admitted the Landlord's preferred claim for $24,571 under s. 136(1)(f) of the *BIA*, in addition to the occupation rent that the Trustee paid to the Landlord.

[9] The Trustee disallowed the entirety of the Landlord's claim for the unexpired portion of the term of the Lease in the amount of $4,028,111.23. The Trustee reasoned then, and now argues on appeal, that s. 146 of the *BIA* and ss. 38 and 39 of the *Commercial Tenancies Act*, R.S.O. 1990, c. L.7 (the "*CTA*") operate to deem the disclaimer of a lease in Ontario by a trustee in bankruptcy as a consensual surrender of the lease by the tenant to the landlord, and consequently no claim for damages can be founded on the cessation of obligations under the lease.

[10] Following the Disclaimer, the Landlord successfully mitigated its damages for the unexpired portion of the term of the Lease by obtaining another tenant. The Landlord has therefore amended its claim for the unexpired portion of the term to seek recovery of the tenant inducements provided to Curriculum under the terms of the Lease. These inducements were leasehold improvements provided by the Landlord under the Lease, costing $45,280 and free rent for a six-month period, worth a total of $175,225.28. The Landlord also seeks the balance of its claim for accelerated rent.

[11] The Landlord appeals the Notice of Disallowance. It argues that there is no legal principle under which the Landlord should be disentitled from filing a proof of claim for its damages for the unexpired term of the Lease. It argues that these are contractual damages, and should be treated equally with any contractual damages potentially suffered by any of Curriculum's other creditors.

[12] For reasons that follow, I disagree. There is long-established legal precedent that bars the claims made by the Landlord. The appeal is therefore dismissed.

Analysis

[13] The Landlord's appeal requires the court to consider whether it remains the law in Ontario that the disclaimer of a lease by a trustee in bankruptcy prevents a landlord from claiming unsecured damages.

[14] Pursuant to s. 136(3) of the *BIA*, a creditor whose rights are restricted by s. 136 is entitled to rank as an unsecured creditor for the balance of any claim due to him. Pursuant to s. 146 of the *BIA*, subject to priority for arrears of rent and accelerated rent, the rights of lessors are to be determined according to the law of the province in which the leased premises are situated. In Ontario, unlike in other provinces like Alberta, the statute that governs a landlord's rights on the bankruptcy of a tenant (the *CTA*) is silent as to whether a landlord can pursue an unsecured claim for its damages over and above its preferred claim (ss. 38 and 39 of the *CTA*; *Landlord's Rights on Bankruptcy Act*, R.S.A. 2000, c. L-5, s. 4).

[15] The issue of whether there is a damage remedy for landlords in Ontario beyond s. 38 of the *CTA* and s. 136 of the *BIA* was most recently considered by a Registrar in *Linens 'N Things Canada Corp.* (Re) (2009), 53 C.B.R (5th) 232 (Ont. S.C.). Relying on *Re Mussens Ltd.*, [1933] O.W.N. 459, 14 C.B.R. 479 (Ont. H.C.J.), the Registrar concluded that the law in Ontario is as the Trustee advocates on this appeal: that after a disclaimer there is no right in Ontario for a landlord to claim damages on the unexpired portion of the lease.

[16] In *Linens 'N Things*, the Landlord of the bankrupt *Linens 'N Things* appealed the bankruptcy trustee's disallowance of amounts it claimed under the lease, including the costs of building the structure expressly for the *Linens 'N Things*, tenant allowance and leasing commission. The Landlord went "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 relied on the Supreme Court of Canada's decision in *Highway Properties Ltd. v. Kelly, Douglas & Co.*, [1971] S.C.R. 562 for the proposition that a lease of real property is both a lease and a contract. Based on this, it argued that it should have recourse not only to its rights as a landlord, but to contractual damages for breach of the lease contract: *Linens 'N Things* at paras. 12-13.

[17] The Registrar distinguished *Highway Properties* on one very important fact: that case did not involve any insolvency. In the context of an insolvency, s.146 of the *BIA* and ss. 38 and 39 of the *CTA* apply. The Registrar stated that through these enactments "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... In other words, it is at an end, and no claim for damages can possibly be founded from such a cessation of obligations under a lease": *Linens 'N Things* at paras. 16-18.

[18] In coming to this conclusion, the Registrar relied on *Re Mussens Ltd.* In this 1933 case, Rose C.J.H.C. dismissed a landlord's claim for damages for breach of covenant to pay future rent in its tenant's bankruptcy proceedings. His Honour interpreted the predecessor to s. 39 of the *CTA* as giving the bankrupt tenant a statutory right to breach the lease without liability:

> [T]he statute means I think that whether the lessor is or is not willing the liquidator may surrender possession or disclaim the lease, and that if he does ... the tenant in liquidation 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.

[19] Based on this decision, the Registrar in *Linens 'N Things* stated that "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": para. 21.

[20] The Landlord submits that the decision in *Linens 'N Things* is flawed as the Registrar failed to consider the Supreme Court's decision in *Crystalline Investments v. Domgroup Ltd.*, 2004 SCC 3, [2004] 1 S.C.R. 60. It argues as follows. In finding against the landlord in *Linen 'N Things*, the Registrar relied heavily on *Mussens*. *Mussens* was adopted and applied in *Cummer-Yonge Investments Ltd. v. Fagot et al.*, [1965] 2 O.R. 152 (H.C.J.), aff'd [1965] 2 O.R. 157n (C.A.). *Cummer-Yonge* was overruled by the Supreme Court in *Crystalline Investments*. It follows then that *Mussens* was also overturned such that the rights of landlords survive the issuance of a disclaimer.

[21] I disagree.

[22] In *Cummer-Yonge*, a landlord sought unpaid past and future rents from the guarantors of a lease after the trustee of the bankrupt tenant had disclaimed it. The guarantee clause in the lease stated that the defendants guaranteed "the due performance by the Lessee of all its covenants in this lease..." The plaintiff landlord argued that a disclaimer did not have the legal effect of a surrender, such that the guarantor's liability survived the bankrupt tenant's disclaimer (p. 155):

> It was his submission that while a surrender operates to determine a lease and to preclude any subsequent accrual of rent, the trustee's disclaimer divested only himself of the rights and obligations under the lease, and had the effect in law of revesting these rights and obligations in the bankrupt tenant, the person from whom they originally came. <u>While conceding that these obligations would be unenforceable against the tenant because of the provisions of the Bankruptcy Act,</u> counsel argued that since the bankrupt's theoretical liability continued, the liability of the guarantors continued as well. [Emphasis added.]

[23] To reject this suggested distinction between a surrender and a disclaimer, the defendants cited *Mussens* (p. 155):

> In answer to this suggested distinction between a surrender and a disclaimer, counsel for the defendants relied upon the case of *Re Mussens Ltd., Petrie Ltd.'s Claim*, [1933] O.W.N. 459, 14 C.B.R. 479, a decision of Rose, C.J.H.C. Although this case involved a liquidator under the Dominion Winding-Up Act, it turned on

an interpretation of s. 38 of the Landlord and Tenant Act, which applies equally to a trustee in bankruptcy. There, the liquidator purported "to surrender possession or disclaim" the lease, and the lessor alleged that, while the liquidator was no longer liable for rent under the lease, the tenant in liquidation was in breach of its covenant to pay rent and was liable in damages for this breach. In rejecting this contention, the learned Chief Justice stated (at pp. 460-1):

> By his letter of June 21st, 1932, confirming an earlier letter, the liquidator exercised his right "to surrender possession or disclaim" the lease, and when he had exercised that right the obligation of the tenant, the insolvent company, to pay rent was at an end. It did not require a statute to confer upon the liquidator power to surrender possession or disclaim the lease with the consent of the lessor; the statute means that, whether the lessor is or is not willing, the liquidator may surrender possession or disclaim the lease, and that, if he does so surrender possession or disclaim the lease, the tenant in liquidation 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.

[24] The Registrar noted that Rose C.J.H.C. did not distinguish between a surrender and a disclaimer in *Mussens*, and "the clear inference is that, in the opinion of the learned Chief Justice, the legal effect of each is the same": p. 156.

[25] After considering the defendants' submissions on *Mussens*, the Registrar made his conclusions on a different basis (p. 156):

> Apart entirely from this decision, however, I am not persuaded that a disclaimer of a lease by a trustee in bankruptcy has the consequence contended for by counsel for the plaintiff in this action. Assuming, for purposes of argument, that his submission that the sole effect of the trustee's disclaimer is simply to divest him of his entire interest in the lease is correct, it nevertheless does not follow in law that that interest thereupon reverts to the bankrupt tenant. As indicated previously, whatever interest the tenant had in the lease prior to bankruptcy was, by the operation of s. 41(5) of the Bankruptcy Act, vested in the trustee upon the filing of the assignment. In my view, when the trustee subsequently disclaimed that interest, all the rights and obligations which he inherited from the bankrupt were wholly at an end.

[26] The Registrar supported this analysis by examining the *BIA*, finding that "an examination of the Act yields no authority for [the plaintiff landlord's position]: p. 157. Ultimately, the Registrar found that upon the bankruptcy of the tenant, all of its rights and obligations passed to the trustee, such that there were no covenants in the lease which the tenant was required to

perform, and the guarantee of the "due performance by the Lessee of all its covenants in this lease" therefore became inoperative.

[27] *Cummer-Yonge*, therefore, stood for the proposition that the disclaimer of a lease in bankruptcy extinguishes the lease obligations of any guarantor. *Mussens* was referenced to the extent of the suggested distinction between a surrender and a disclaimer as advanced by the plaintiff. Apart from *Mussens* and accepting a difference for the purposes of argument, the Court remained unconvinced of the plaintiff landlord's position, relying on the *BIA*. Furthermore, the proposition that a bankruptcy trustee's disclaimer ended the obligations of the bankrupt tenant was not at issue in *Cummer-Yonge*. It was not disputed by the parties or considered by the Registrar.

[28] *Crystalline* overturned *Cummer-Yonge*. The case considered the effect of a bankruptcy trustee's disclaimer of a lease from the perspective of an assignor of a lease, not a guarantor. The plaintiff landlords had leased premises to the defendant, who had assigned the leases to a wholly owned subsidiary which it subsequently sold, and which subsequently became insolvent. Under the leases, the landlords' consent was not required for the assignments. The insolvent assignee's trustee repudiated the leases under s. 65.2 of the *BIA* as part of a court-approved proposal. The landlords received payments equivalent to six months' rent under the leases pursuant to s. 65.2(3) of the *BIA*.

[29] The question before the Supreme Court was whether the insolvent assignee's repudiation of the lease ended the obligations of the assignor. The Supreme Court held that s. 65.2 should be read narrowly. It held that the plain purposes of the section were to free the insolvent from its obligations under a commercial lease, to compensate the landlord, and to allow the insolvent to resume viable operations as best it could. Nothing in s. 65.2, or any part of the Act, protects third parties from the consequences of an insolvent's repudiation of a commercial lease.

[30] The Court noted that this result is consistent with the concept of assignments in general. When a lease is assigned, the original tenant remains liable should the assignee not pay the rent. The bankruptcy of the assignee destroys the original tenant's right to require the assignee to discharge the obligations of the lease, and impairs the original tenant's right of indemnity against the assignee if the original tenant must discharge the obligations itself, but the assignee's bankruptcy has no effect on the original tenant's liability towards the lessor, which continues unaffected.

[31] The Court dismissed the suggestion that the original tenant's right of indemnity against the insolvent assignee would frustrate the scheme of the *BIA*. The Court reasoned that the original tenant's claim would be dealt with according to the scheme of the Act, joining other unsecured creditors.

[32] A unanimous Supreme Court therefore held that the disclaimer of the lease alone did not affect the obligations of the assignor.

[33] Having decided the issue before it (the post-disclaimer obligations of an assignor), the Court went on to provide guidance on the post-disclaimer liability of a guarantor.

[34] The Court questioned the correctness of the decision in *Cummer-Yonge* (para. 39):

> *Cummer-Yonge* has created uncertainty in leasing and bankruptcy. Not only have drafters of leases attempted to circumvent the holding in *Cummer-Yonge* by playing upon the primary and secondary obligation distinction, but courts have also performed what has been called "tortuous distinctions" in order to reimpose liability on guarantors. See J. W. Lem and S. T. Proniuk, "Goodbye *'Cummer-Yonge*': A Review of Modern Developments in the Law Relating to the Liability of Guarantors of Bankrupt Tenants" (1993), 1 D.R.P.L. 419, at p. 436.

[35] The Court further noted that the English case *Stacey v. Hill*, [1901] 1 Q.B. 660, which had come to the same conclusion as and was applied in *Cummer-Yonge*, had been overruled by the House of Lords in *Hindcastle Ltd. v. Barbara Attenborough Associates Ltd.*, [1996] 1 All E.R. 737 (H.L.). In overruling it, Lord Nicholls stated that treating the guarantor and the assignor of a lease differently in the case of the current tenant's insolvency "would make no sort of legal or commercial sense": p. 754.

[36] Ultimately, the Court in *Crystalline* held that, like *Stacey v. Hill*, *Cummer-Yonge* should be overruled. It concluded that "Post-disclaimer, assignors and guarantors ought to be treated the same with respect to liability. The disclaimer alone should not relieve either from their contractual obligations": para. 42.

[37] The Court stated, therefore, that there should be no distinction in the post-disclaimer liability of assignors and guarantors. Consistent with its holding on the liability of assignors, and contrary to the holding in *Cummer-Yonge*, the Court held that a disclaimer alone should not relieve a guarantor from its obligations. The comments of the Court were *obiter dicta* but, in my view, carry significant weight with respect to the issue of whether a guarantor's assurances survive a tenant's bankruptcy. They are not relevant, however, to the issue presented by this appeal.

[38] Neither the *ratio decidendi* nor the *obiter dicta* of *Crystalline* address whether a landlord can claim unsecured damages in the bankruptcy proceedings of its tenant upon the disclaimer of a lease by the trustee in bankruptcy. The principle in *Mussens* remains the law on this issue in Ontario as correctly applied in *Linen 'N Things*.

Conclusion

[39] The Appeal is therefore dismissed.

V.R. Chiappetta J.

Date: February 15, 2019